

Francesca's Holdings CORP  
Form 10-Q  
December 07, 2011

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended October 29, 2011

OR

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

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-35239

FRANCESCA'S HOLDINGS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

20-8874704  
(I.R.S. Employer  
Identification No.)

3480 W. 12th Street, Houston, Texas  
(Address of principal executive offices)

77008  
(Zip Code)

(713) 864-1358  
(Registrant's telephone number, including area code)

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

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

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

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒ (Do not check if a smaller reporting company)

Smaller reporting company ☐

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

The registrant had 43,538,592 shares of its common stock outstanding as of November 30, 2011.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

Francesca's Holdings Corporation  
Unaudited Consolidated Balance Sheets  
(In thousands)

	October 29, 2011	January 29, 2011	October 30, 2010
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 14,982	\$ 12,516	\$ 17,763
Accounts receivable	3,571	4,054	4,037
Inventories	16,675	11,959	13,292
Deferred income taxes	1,784	1,321	1,130
Prepaid expenses and other current assets	2,912	1,871	1,755
Total current assets	39,924	31,721	37,977
Property and equipment, net	29,973	21,300	16,802
Deferred income taxes	—	2,704	2,208
Other assets, net	2,698	3,399	881
<b>TOTAL ASSETS</b>	<b>\$ 72,595</b>	<b>\$ 59,124</b>	<b>\$ 57,868</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>			
Current liabilities:			
Accounts payable	\$ 8,713	\$ 6,146	\$ 4,657
Accrued liabilities	5,931	6,410	7,381
Current portion of long-term debt	—	5,938	—
Total current liabilities	14,644	18,494	12,038
Deferred and accrued rents	14,839	8,223	7,908
Deferred income taxes	455	—	—
Long-term debt	35,000	87,875	—
Total liabilities	64,938	114,592	19,946
Commitments and contingencies			
Stockholders' equity (deficit):			
Common stock - \$.01 par value, 80.0 million shares authorized; 43.5 million shares issued and outstanding at October 29, 2011; 40.5 million shares issued and outstanding at January 29, 2011; 40.4 million shares issued and outstanding at October 30, 2010.	435	405	404
Additional paid-in capital	76,179	27,232	24,951
Retained earnings (accumulated deficit)	(68,957 )	(83,105 )	12,567
Total stockholders' equity (deficit)	7,657	(55,468 )	37,922

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Total liabilities and stockholders' equity (deficit)	\$	72,595	\$	59,124	\$	57,868
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The accompanying notes are an integral part of these Unaudited Consolidated Financial Statements.

Francesca's Holdings Corporation  
Unaudited Consolidated Statements of Operations  
(In thousands, except per share data)

	Thirteen Weeks Ended		Thirty Nine Weeks Ended	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010
Net sales	\$ 50,020	\$ 35,073	\$ 142,506	\$ 95,293
Cost of goods sold and occupancy costs	24,187	16,924	68,048	45,717
Gross profit	25,833	18,149	74,458	49,576
Selling, general and administrative expenses	17,789	9,748	45,388	28,845
Income from operations	8,044	8,401	29,070	20,731
Interest expense	(473 )	—	(4,529 )	—
Loss on early extinguishment of debt	—	—	(1,591 )	—
Other income	198	79	248	103
Income before income tax expense	7,769	8,480	23,198	20,834
Income tax expense	3,025	3,365	9,050	8,267
Net income	\$ 4,744	\$ 5,115	\$ 14,148	\$ 12,567
Basic earnings per common share	\$ 0.11	\$ 0.13	\$ 0.34	\$ 0.32
Diluted earnings per common share	\$ 0.11	\$ 0.13	\$ 0.33	\$ 0.31
Weighted average shares outstanding:				
Basic shares	43,538	40,406	41,601	39,030
Diluted shares	44,533	40,675	42,421	40,625

The accompanying notes are an integral part of these Unaudited Consolidated Financial Statements.

Francesca's Holdings Corporation  
Unaudited Consolidated Statement of Changes in Stockholders' Equity (Deficit)  
(In thousands)

	Common Stock Shares Outstanding	Par Value	Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
Balance, January 29, 2011	40,457	\$ 405	\$ 27,232	\$ (83,105 )	\$ (55,468 )
Net income	—	—	—	14,148	14,148
Issuance of stock in initial public offering, net of costs	2,941	29	44,089	—	44,118
Stock-based compensation	—	—	3,907	—	3,907
Stock options exercised and related tax benefit	140	1	951	—	952
Balance, October 29, 2011	43,538	\$ 435	\$ 76,179	\$ (68,957 )	\$ 7,657

The accompanying notes are an integral part of these Unaudited Consolidated Financial Statements.

Francesca's Holdings Corporation  
Unaudited Consolidated Statements of Cash Flows  
(In thousands)

	October 29, 2011	October 30, 2010
<b>Cash Flows From Operating Activities:</b>		
Net income	\$ 14,148	\$ 12,567
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation expense	3,509	1,707
Stock-based compensation expense	3,907	1,706
Excess tax benefit from stock-based compensation	(449 )	(535 )
Loss on sale of assets	20	22
Amortization of debt issue costs	462	—
Loss on early extinguishment of debt	1,591	—
Deferred income taxes	2,696	(1,997 )
<b>Changes in assets and liabilities:</b>		
Accounts receivable	931	(3,539 )
Inventories	(4,716 )	(6,914 )
Prepaid expenses and other assets	(926 )	(896 )
Accounts payable	2,567	1,954
Accrued liabilities	(479 )	4,601
Deferred and accrued rents	6,616	5,684
Net cash provided by operating activities	29,877	14,360
<b>Cash Flows Used by Investing Activities:</b>		
Purchase of property and equipment	(12,236 )	(11,037 )
Other	35	—
Net cash used by investing activities	(12,201 )	(11,037 )
<b>Cash Flows Used by Financing Activities:</b>		
Proceeds from issuance of stock in initial public offering, net of costs	44,118	—
Proceeds from borrowings under the new revolving credit facility	41,000	—
Repayments of borrowings under the prior senior secured credit facility	(93,813 )	—
Repayments of borrowings under the new revolving credit facility	(6,000 )	—
Payment of debt issue costs	(1,468 )	—
Proceeds from the exercise of stock options	504	138
Excess tax benefit from stock-based compensation	449	535
Net cash (used by) provided by financing activities	(15,210 )	673
Net increase in cash and cash equivalents	2,466	3,996
Cash and cash equivalents, beginning of year	12,516	13,767
Cash and cash equivalents, end of period	\$ 14,982	\$ 17,763
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Cash paid for income taxes	\$ 6,300	\$ 6,837
Interest paid	\$ 5,027	\$ —

The accompanying notes are an integral part of these Unaudited Consolidated Financial Statements.





Francesca's Holdings Corporation  
Notes to Unaudited Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Nature of Business

Francesca's Holdings Corporation (the "Company") is a holding company incorporated in 2007 under the laws of the State of Delaware. The Company's business operations are conducted through its indirectly wholly-owned subsidiary Francesca's Collections, Inc. ("Francesca's Collections"), a corporation formed and existing under the laws of the State of Texas. Francesca's Collections is wholly-owned by Francesca's LLC (the "Parent"), a limited liability company formed and existing under the laws of the State of Delaware. Parent is a wholly-owned subsidiary of the Company.

The Company operates a national chain of retail locations designed and merchandised to feel like independently owned, upscale boutiques and provide its customers with an inviting, intimate and fun shopping experience. The Company offers a diverse and uniquely balanced mix of apparel, jewelry, accessories and gifts at attractive prices. At October 29, 2011, the Company operated 283 boutiques, which are located in 41 states throughout the United States, and its e-commerce website.

In February 2010, two affiliates of CCMP Capital Advisors, LLC ("CCMP"), acquired approximately 84% of the Company (the "CCMP Acquisition"). The Company incurred \$0.2 million of transaction costs in connection with the CCMP Acquisition included in selling, general and administrative expenses in the unaudited consolidated statement of operations for the thirty nine weeks ended October 30, 2010.

On July 27, 2011, the Company completed an initial public offering of 11,500,000 shares of common stock at a price to the public of \$17 per share, of which 2,941,176 shares were sold by the Company and 8,558,824 shares were sold by the selling stockholders (including 616,109 by members of the Company's management). Upon completion of the offering, the Company received net proceeds of approximately \$44.1 million, after deducting the underwriting discount of \$3.5 million and related fees and expenses of \$2.4 million. On July 27, 2011, net proceeds from the offering, together with \$41.0 million of indebtedness under a new revolving credit facility and \$6.9 million of cash on hand, were used to repay the \$92.0 million (including accrued interest of \$0.6 million) outstanding under the senior secured credit facility. The senior secured credit facility was then terminated. See Note 5 for more information.

Basis of Presentation

The accompanying (a) consolidated balance sheet as of January 29, 2011, which was derived from the audited financial statements as of that date included in the Company's Registration Statement on Form S-1, as amended (Registration No. 333-173581), and filed with the Securities and Exchange Commission ("SEC") and (b) unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") for interim financial statements and are in the form prescribed by the SEC. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These unaudited financial statements should be read in conjunction with the audited financial statements and notes thereto of the Company included in its Registration Statement. In the opinion of management, these unaudited financial statements include all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation. Due to seasonal variations in the retail industry, interim results are not necessarily indicative of results that may be expected for any other interim period or for a full year.

Principles of Consolidation

The accompanying unaudited consolidated financial statements include the accounts of the Company and all its subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

Fiscal Year

The Company maintains its accounts on a 52- or 53-week year ending on the Saturday closest to January 31st. The fiscal quarters ended October 29, 2011 and October 30, 2010 refer to the thirteen-week periods ended as of those dates. The year-to-date periods ended October 29, 2011 and October 30, 2010 refer to the thirty-nine week periods ended as of those dates.

## Management Estimates and Assumption

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, net of estimated sales return, and expenses during the reporting periods. Actual results could differ from those estimates.

## 2. Earnings Per Share

Basic earnings per common share amounts are calculated using the weighted-average number of common shares outstanding for the period. Diluted earnings per common share amounts are calculated using the weighted-average number of common shares outstanding for the period and include the dilutive impact of stock options and restricted stock grants using the treasury stock method.

The following table summarizes the potential dilution that could occur if options to acquire common stock were exercised or if the restricted stock grants have fully vested and reconciles the weighted-average common shares outstanding used in the computation of basic and diluted earnings per share:

	Thirteen Weeks Ended		Thirty Nine Weeks Ended	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010
(In thousands, except per share data)				
<b>Numerator:</b>				
Net income	\$4,744	\$5,115	\$14,148	\$12,567
<b>Denominator:</b>				
Weighted-average common shares outstanding - basic	43,538	40,406	41,601	39,030
Options and other dilutive securities	995	269	820	1,595
Weighted-average common shares outstanding - diluted	44,533	40,675	42,421	40,625
<b>Per common share:</b>				
Basic earnings per common share	\$0.11	\$0.13	\$0.34	\$0.32
Diluted earnings per common share	\$0.11	\$0.13	\$0.33	\$0.31

Stock options to purchase common stock in the amount of 0.9 million in each of the thirteen and thirty nine weeks ended October 29, 2011; and 1.5 million and 1.9 million in the thirteen and thirty nine weeks ended October 30, 2010, respectively, were not included in the computation of diluted earnings per share due to its anti-dilutive effect.

## 3. Fair value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The carrying amount reflected in the consolidated balance sheets of financial assets and liabilities, which includes cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, approximated their fair values. The carrying amount of these financial assets and liabilities approximates fair value because of their short maturities. The carrying amount of the Company's debt approximates its fair value at October 29, 2011 and January 29, 2011 due to proximity of the debt issue date and the balance sheet date and the variable component of the interest on debt.

## 4. Income Taxes

The provision for income taxes is based on the current estimate of the annual effective tax rate. The effective income tax rates for the thirteen weeks ended October 29, 2011 and October 30, 2010 were 38.9% and 39.7%, respectively. The effective income tax rates for the thirty nine weeks ended October 29, 2011 and October 30, 2010 were 39.0% and 39.7%, respectively. The difference between our effective tax rate and statutory rate primarily relates to state taxes.

During the thirteen weeks ended April 30, 2011, the Company elected bonus depreciation for certain fixed asset additions in fiscal year 2010 based on clarification from the IRS in Rev Proc. 2011-26 issued on March 29, 2011. The election resulted in a reduction of approximately \$0.6 million of deferred tax assets and income tax payable.

5. Credit Facility

New Revolving Credit Facility

On July 27, 2011, Francesca's Collections, Inc. (the "Borrower") entered into an Amended and Restated Credit Agreement (the "new revolving credit facility") with Royal Bank of Canada, as Administrative Agent, and KeyBank National Association, as Syndication Agent, which provided \$65.0 million of revolving credit facility (including borrowing capacity available for letters of credit). The new revolving credit facility is scheduled to terminate on July 27, 2016. As described in Note 1, on July 27, 2011, net proceeds from the Company's initial public offering, together with \$41.0 million of indebtedness under the new revolving credit facility and \$6.9 million of cash on hand, were used to repay the \$92.0 million (including accrued interest of \$0.6 million) outstanding under the prior senior secured credit facility. The prior senior secured credit facility was then terminated. In addition, in connection with the new revolving credit facility, the Company recorded \$1.5 million of debt issue costs that will be amortized over the term of the new revolving credit facility. At October 29, 2011, \$30.0 million was available under the new revolving credit facility for future borrowings.

All obligations under the new revolving credit facility are unconditionally guaranteed by, subject to certain exceptions, Parent and each of Borrower's existing and future direct and indirect wholly owned domestic subsidiaries. All obligations under the new revolving credit facility, and the guarantees of those obligations (as well as cash management obligations and any interest rate hedging or other swap agreements), are secured by substantially all of the Borrower's assets as well as the assets of each subsidiary guarantor.

The borrowings under the new revolving credit facility bear interest at a rate equal to an applicable margin plus, at the Company's option, either (a) in the case of base rate borrowings, a rate equal to the highest of (i) the prime rate of Royal Bank of Canada, (ii) the federal funds rate plus 1/2 of 1% and (iii) the LIBOR for an interest period of one month plus 1.00%; or (b) in the case of LIBOR borrowings, a rate equal to the higher of (1) 1.50% and (2) the LIBOR for the interest period relevant to such borrowing. The applicable margin for borrowings under the new revolving credit facility will range from 1.25% to 2.25% with respect to base rate borrowings and from 2.25% to 3.25% with respect to LIBOR borrowings, in each case based upon the achievement of specified levels of the ratio of consolidated total debt to consolidated EBITDA. Additionally, the Borrower will be required to pay a fee to the lenders under the new revolving credit facility on the unused amount at a rate ranging from 0.25% to 0.45%, based on the achievement of specified levels of the ratio of consolidated total debt to consolidated EBITDA. The Borrower is also required to pay customary letter of credit fees. During the thirteen weeks ended October 29, 2011, the average interest rate for the LIBOR borrowings was 3.9%.

The new revolving credit facility requires the Borrower to maintain a maximum consolidated total lease adjusted leverage ratio and a minimum consolidated interest coverage ratio, in each case, on the last day of any fiscal quarter and includes a maximum capital expenditure in any fiscal year. The Borrower's ability to pay dividends to Holdings is subject to restrictions including a maximum secured leverage ratio. If the Borrower's debt under the new revolving credit facility exceeds that ratio, it is restricted from paying dividends. At October 29, 2011, this ratio was within the required limit, thus, the Borrower was allowed to pay dividends.

The Borrower is in compliance with the debt covenants of its new revolving credit facility as of October 29, 2011.

Senior Secured Credit Facility

On November 17, 2010, the Borrower entered into a senior secured credit facility (the "prior senior secured credit facility") with a syndicate of financial institutions, which provided financing of up to \$100.0 million consisting of a \$95.0 million term loan facility and a \$5.0 million revolving credit facility each with a maturity date of November 17,

2013. As described in Note 1, on July 27, 2011, net proceeds from the Company's initial public offering, together with \$41.0 million of indebtedness under a new revolving credit facility and \$6.9 million of cash on hand, were used to repay the \$92.0 million (including accrued interest of \$0.6 million) outstanding under the prior senior secured credit facility. The prior senior secured credit facility was then terminated. In connection with the repayment, the Company wrote-off the unamortized debt issuance costs of \$1.6 million associated with the prior senior secured credit facility and included as loss on early extinguishment of debt in the accompanying unaudited consolidated statements of operations for the thirty nine weeks ended October 29, 2011.

All obligations under the prior senior secured credit facility were unconditionally guaranteed by, subject to certain exceptions, Parent and each of the Borrower's existing and future direct and indirect wholly-owned domestic subsidiaries. All obligations under the prior senior secured credit facility, and the guarantees of those obligations (as well as cash management obligations and any interest hedging or other swap agreements), were secured by substantially all of the Borrower's assets as well as those of the subsidiary guarantor. The borrowings under the prior senior secured credit facility bore interest at a rate equal to an applicable margin plus the base rate or LIBOR rate, at the Borrower's option. The loans were LIBOR-based and had an interest rate of 7.75% from the time of issuance through its termination on July 27, 2011. The Company was in compliance with the debt covenants of the prior senior secured credit facility during the period it was outstanding.

## 6. Stock-based Compensation

At October 29, 2011, the Company has three equity plans (collectively “Stock Plans”) under which stock options, phantom shares, restricted stock or other stock-based awards may be granted to employees, directors or consultants of the Company. The stock-based compensation cost is measured at the grant date fair value and is recognized as an expense on a straight-line basis over the employee’s requisite service period (generally the vesting period of the equity grant). The Company estimates forfeitures for option grants that are not expected to vest. The stock-based compensation cost recognized in the thirteen and thirty nine weeks ended October 29, 2011 totaled \$2.9 million and \$3.9 million, respectively, while \$0.3 million and \$1.7 million were recorded in the thirteen and thirty nine weeks ended October 30, 2010, respectively.

On August 18, 2011, the vesting period for the options to purchase 545,333 shares of common stock granted on March 26, 2010 to our Chief Executive Officer (“CEO”) accelerated due to the performance targets achieved by CCMP and certain of their affiliates as disclosed in the Company’s Registration Statement on Form S-1, as amended (Registration No. 333-173581), and filed with the SEC. The Company recognized compensation expense in the amount of \$2.3 million during the thirteen and thirty nine weeks ended October 29, 2011 as a result of the accelerated vesting of these options.

On July 14, 2011, the 2011 Equity Incentive Plan (the “2011 Plan”) was approved by the stockholders and became immediately effective. Under the 2011 Plan, awards may be in the form of nonqualified stock options, stock appreciation rights, stock bonuses, restricted stock, performance stock and other stock-based awards which can be granted to any officers, directors, employees and consultants of the Company. A total of 3,175,365 shares of common stock are authorized for issuance under the 2011 Plan. Awards granted under the 2011 Plan generally vest over three to five years and have a ten-year contractual life.

## Stock Options

The following table presents stock options granted, exercised, expired and aggregate intrinsic value under the existing Stock Plans for the thirty nine weeks ended October 29, 2011.

	Number of Shares	Weighted Average Exercise Price (Per share data)	Weighted Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value (In thousands)
Outstanding as of January 29, 2011	2,443,088	\$ 5.23	9	
Options granted	872,099	\$ 17.42	10	
Options exercised	(140,075 )	\$ 3.60	8	
Options forfeited or expired	—	—	—	
Outstanding as of October 29, 2011	3,175,112	\$ 8.65	9	\$ 55,136
Exercisable at October 29, 2011	1,364,006	\$ 4.51	8	\$ 29,589

During the thirty nine weeks ended October 29, 2011, 872,099 stock options were granted at an average grant date fair value of \$9.65. For stock option exercises during the thirty nine weeks ended October 29, 2011, cash received, intrinsic value and excess tax benefit totaled \$0.5 million, \$1.7 million and \$0.4 million, respectively.



The fair value of stock options was estimated on the date of grant using the Black Scholes option pricing model using the following weighted average assumptions:

	Thirty Nine Weeks Ended October 29, 2011	
Expected volatility (1)	55.9	%
Risk-free interest rate (2)	2.0	%
Expected term (in years) (3)	6.5	
Expected dividend yield	—	

(1) The expected volatility incorporates historical and implied volatility of similar entities whose share prices are publicly available. The Company determined that the use of historical volatility for similar entities represents a more accurate calculation of option fair value than actual Company stock experience because of the limited duration the Company's stock has been publicly traded.

- (2) The risk-free interest rate was determined based on the rate of Treasury instruments with maturities similar to those of the expected term of the award being valued.
- (3) Represents the period of time options are expected to be outstanding. The weighted-average expected option term was determined using the “simplified method” as allowed by Staff Accounting Bulletin 114, Topic 14. The expected term used to value a share option grant under the simplified method is the midpoint between the vesting date and the contractual term of the share option. This method was used due to the lack of sufficient historical data to provide basis upon which to estimate the expected term.

The following table summarizes information regarding non-vested outstanding options as of October 29, 2011.

	Options	Weighted Average Fair Value at Grant Date
Non-vested as of January 29, 2011	1,757,748	\$ 4.27
Granted	872,099	\$ 9.65
Vested	(818,741 )	\$ 4.03
Cancelled	—	—
Non-vested as of October 29, 2011	1,811,106	\$ 6.97

As of October 29, 2011 there was approximately \$11.8 million of unrecognized compensation cost related to non-vested stock options that is expected to be recognized over a weighted-average period of 4.1 years. The total fair value of options vested during the thirty nine weeks ended October 29, 2011 was \$3.3 million.

#### Restricted Stock Awards

On August 5, 2011, the Company granted 9,600 restricted stock awards, with an aggregate fair value of \$0.2 million, to certain employees under the 2011 Plan. These restricted stock awards vest in three equal annual installments on each anniversary from the grant date subject to continuous employment of the grantee. The Company determined the fair value of the award based on the closing price of the Company’s stock on the grant date.

#### 7. Commitment and Contingencies

##### Operating Leases

The Company leases boutique space and office space under operating leases expiring in various years through the fiscal year ending 2022. Certain of the leases provide that the Company may cancel the lease, with penalties as defined in the lease, if the Company’s boutique sales at that location fall below an established level. Certain leases provide for additional rent payments to be made when sales exceed a base amount. Certain operating leases provide for renewal options for periods from three to five years at their fair rental value at the time of renewal.

In fiscal 2010, the Company determined that its policy of recording straight-line rent expense had historically been inconsistently applied. The Company corrected the deferred rent expense account, resulting in a non-cash \$0.7 million cumulative adjustment to record additional rent expense during the thirty nine weeks ended October 30, 2010 included in the cost of goods sold and occupancy cost. The adjustment did not impact historical cash flows and will not impact future net cash flows or the timing of the payments under the related leases. Prior years’ financial statements were not restated as the impact of this issue was immaterial to previously reported results for any individual prior year.

Minimum future rental payments under non-cancellable operating leases as of October 29, 2011, are approximately as follows:

Fiscal year	Amount (In thousands)
Remainder of 2011	\$ 4,332
2012	18,715
2013	17,539
2014	16,180
2015	15,261
Thereafter	70,014
	\$ 142,041

## 8. Segment Reporting

The Company determines its operating segments on the same basis used internally to evaluate performance. The Company's reporting segments are the operation of boutiques and the e-commerce website, which have been aggregated into one reportable financial segment. The Company aggregates its operating segments because (i) the merchandise offered at boutique locations and through the e-commerce business is largely the same, (ii) management believes that the majority of its e-commerce customers are also customers of boutique locations and (iii) the merchandise margin of both segments is similar. All of the Company's identifiable assets are located in the United States.

The following is sales information regarding the Company's major merchandise categories:

	Thirteen Weeks Ended		Thirty Nine Weeks Ended	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010
	(In thousands)			
Apparel	\$ 27,698	\$ 19,073	\$ 78,507	\$ 53,133
Jewelry	9,802	6,938	28,039	19,154
Accessories	7,653	5,207	21,444	12,823
Gift	5,032	3,794	14,891	10,040
Shipping	73	61	155	143
	50,258	35,073	143,036	95,293
Allowance for returns	(238 )	—	(530 )	—
Net sales	\$ 50,020	\$ 35,073	\$ 142,506	\$ 95,293

## 9. Subsequent Events

Subsequent to October 29, 2011, the Borrower made principal payments in the aggregate amount of \$10.0 million on the new revolving credit facility, bringing the outstanding principal balance to \$25.0 million.

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

### FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements concerning our business, operations and financial performance and condition as well as our plans, objectives and expectations for our business operations and financial performance and condition, which are subject to risks and uncertainties. All statements other than statements of historical fact included in this report are forward-looking statements. These statements may include words such as “aim”, “anticipate”, “assume”, “believe”, “can have”, “could”, “due”, “estimate”, “expect”, “goal”, “intend”, “likely”, “may”, “objective”, “plan”, “potential”, “should”, “target”, “will”, “would” and other words and terms of similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events or trends. For example, all statements we make relating to our estimated and projected earnings, sales, costs, expenditures, cash flows, growth rates, market share and financial results, our plans and objectives for future operations, growth or initiatives, strategies or the expected outcome or impact of pending or threatened litigation are forward-looking statements.

These forward-looking statements are based on current expectations, estimates, forecasts and projections about our business and the industry in which we operate and our management's beliefs and assumptions. These statements are not guarantees of future performance or development and involve known and unknown risks, uncertainties and other factors that are in many cases beyond our control. All of our forward-looking statements are subject to risks and uncertainties that may cause our actual results to differ materially from our expectations. Factors that may cause such differences include, but are not limited to, the risks described under “Risk Factors,” in our Registration Statement on Form S-1, as amended (Registration No. 333-173581), including:

• our ability to identify and respond to new and changing fashion trends, customer preferences and other related factors;

- our ability to maintain a broad and shallow merchandise assortment;
- failure to execute successfully our growth strategy;
- disruptions to our information systems in the ordinary course or as a result of systems upgrades;
- changes in consumer spending and general economic conditions;
- significant increases in the cost of raw materials and other inputs used in the production of our merchandise;

• changes in the competitive environment in our industry and the markets we serve, including increased competition from other retailers;

• failure of our new boutiques or existing boutiques to achieve sales and operating levels consistent with our expectations;

- the success of the malls and shopping centers in which our boutiques are located;
- our dependence on a strong brand image;
- failure of our e-commerce business to grow consistent with our growth strategy;

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- our dependence upon key senior management or our inability to hire or retain additional personnel;
    - disruptions in our supply chain and distribution facility;
    - our indebtedness and lease obligations;
  - our reliance upon independent third-party transportation providers for all of our merchandise shipments;
  - hurricanes, natural disasters, unusually adverse weather conditions, boycotts and unanticipated events;
    - the seasonality of our business;
- significant increases in costs of fuel, or other energy, transportation or utilities costs and in the costs of labor and employment;
- the impact of governmental laws and regulations and the outcomes of legal proceedings;
  - restrictions imposed by our indebtedness on our current and future operations;
    - our failure to maintain effective internal controls;
  - our inability to protect our trademarks or other intellectual property rights; and
    - increased costs as a result of being a public company.

The above is not a complete list of factors or events that could cause actual results to differ from our expectations, and it is not possible for us to predict all of them. For a discussion of these risks and other risks and uncertainties that could cause actual results to differ materially from those contained in our forward-looking statements, please refer to “Risk Factors” beginning on page 12 of the final prospectus, dated July 21, 2011 and filed with the SEC on July 25, 2011 (the “July 21, 2011 Prospectus”), constituting part of our Registration Statement on Form S-1, as amended (Registration No. 333-173581), and filed with the SEC, which became effective on July 21, 2011. We derive many of our forward-looking statements from our own operating budgets and forecasts, which are based upon many detailed assumptions. While we believe that our assumptions are reasonable, we caution that it is very difficult to predict the impact of known factors, and it is impossible for us to anticipate all factors that could affect our actual results. All written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by the cautionary statements contained in this report as well as other cautionary statements that are made from time to time in our other SEC filings and public communications. You should evaluate all forward-looking statements made in this report in the context of these risks and uncertainties.

Potential investors and other readers are urged to consider these factors carefully in evaluating the forward-looking statements and are cautioned not to place undue reliance on the forward-looking statements. These forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update or revise any forward-looking statements publicly whether as a result of new information, future developments or otherwise.

### Overview

francesca’s collections® is one of the fastest growing specialty retailers in the United States. Our retail locations are designed and merchandised to feel like independently owned, upscale boutiques and provide our customers with an inviting, intimate and fun shopping experience. We believe we offer compelling value with a diverse and uniquely balanced mix of high-quality, trend-right apparel, jewelry, accessories and gifts at attractive prices. We tailor our assortment to appeal to our core 18-35 year-old, fashion conscious, female customer, although we find that women of all ages are attracted to our eclectic and sophisticated merchandise selection and boutique setting. We carry a broad selection but limited quantities of individual styles and introduce new merchandise to our boutiques five days a week in order to create a sense of scarcity and newness, which helps drive customer shopping frequency and loyalty.

We continue to experience growth in net sales. Our net sales increased 42.6% to \$50.0 million in the thirteen weeks ended October 29, 2011 from \$35.1 million in the thirteen weeks ended October 30, 2010. Our income from operations decreased by 4.2% to \$8.0 million from \$8.4 million over the same period principally due to the recognition of \$2.3 million non-cash stock-based compensation associated with the accelerated vesting of certain options in connection with the Company’s initial public offering. Net income in the third fiscal quarter was \$4.7 million, or \$0.11 per diluted share, compared to net income of \$5.1 million, or \$0.13 per diluted share, in the comparable prior year period. For the year-to-date period, net sales increased 49.5% to \$142.5 million in the thirty nine weeks ended October 29, 2011 from \$95.3 million in the thirty nine weeks ended October 30, 2010. Income from operations increased 40.2% to \$29.1 million from \$20.7 million over the same period. Net income totaled \$14.1 million, or \$0.33 per diluted share, in the thirty nine weeks ended October 29, 2011 while it was \$12.6 million, or \$0.31 per diluted share, in the comparable prior year period.

As of the end of our third fiscal quarter, we have completed our planned boutique openings in fiscal 2011 and increased our boutique count to 283 boutiques in 41 states from 207 boutiques in 38 states as of January 29, 2011. Since October 30, 2010, we experienced new boutique unit growth of 37.4% and boutique square footage growth of 35.5%. We expect to continue our strong growth in the near future. We plan to open 75 boutiques in fiscal year 2012.

### Results of Operations

This Quarterly Report on Form 10-Q for the thirteen and thirty nine weeks ended October 29, 2011, represents an update to the more detailed and comprehensive disclosures included in the July 21, 2011 Prospectus. Accordingly, you should read the following discussion in conjunction with the information included in the July 21, 2011 Prospectus as well as the unaudited financial statements included elsewhere in this Quarterly Report on Form 10-Q.

In addition, some of the statements and assumptions in this Quarterly Report on Form 10-Q are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, each as amended, including, in particular, statements about our plans, strategies and prospects. See “Forward-Looking Statements.”

The following data represents the amounts shown in our unaudited consolidated statements of operations, both in dollars and as a percentage of net sales, and operating data for the thirteen and thirty nine weeks October 29, 2011 and October 30, 2010.



Thirteen Weeks Ended      Thirty Nine Weeks Ended  
October 29,      October 30,      October 29,      October 30,  
2011      2010      2011      2010

(In thousands except percentages and number of boutiques  
as

provided below)

Net sales	\$ 50,020	\$ 35,073	\$ 142,506	\$ 95,293
Cost of goods sold and occupancy costs	24,187	16,924	68,048	45,717
Gross profit	25,833	18,149	74,458	49,576
Selling, general and administrative expenses	17,789	9,748	45,388	28,845
Income from operations	8,044	8,401	29,070	20,731
Interest expense	(473 )	—	(4,529 )	—
Loss on early extinguishment of debt	—	—	(1,591 )	—
Other income	198	79	248	103
Income before income tax expense	7,769	8,480	23,198	20,834
Income tax expense	3,025	3,365	9,050	8,267
Net income	\$ 4,744	\$ 5,115	\$ 14,148	\$ 12,567

#### Percentage of Sales:

Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of goods sold and occupancy costs	48.4	%	48.3	%	47.8	%	48.0	%
Gross profit	51.6	%	51.7	%	52.2	%	52.0	%
Selling, general and administrative expenses	35.6	%	27.7	%	31.8	%	30.2	%
Income from operations	16.0	%	24.0	%	20.4	%	21.8	%
Interest expense	(0.9 )	)%	—		(3.2 )	)%	—	
Loss on early extinguishment of debt	—		—		(1.1 )	)%	—	
Other income	0.4	%	0.2	%	0.2	%	0.1	%
Income before income tax expense	15.5	%	24.2	%	16.3	%	21.9	%
Income tax expense	6.0	%	9.6	%	6.4	%	8.7	%
Net income	9.5	%	14.6	%	9.9	%	13.2	%

#### Operating data:

Comparable boutique sales growth for period (1)	6.5	%	21.1	%	8.4	%	15.5	%
Number of boutiques open at end of period	283		206		283		206	
Net sales per average square foot for period (not in thousands)(2)	\$ 126		\$ 122		\$ 391		\$ 365	
Average square feet (in thousands)(3)	397		289		365		261	
Total gross square feet at end of period (in thousands)	399		294		399		294	

(1) A boutique is included in comparable boutique sales on the first day of the fifteenth full month following the boutique's opening. When a boutique that is included in comparable boutique sales is relocated, we continue to consider sales from that boutique to be comparable boutique sales. If a boutique is closed for thirty days or longer for a remodel or as a result of weather damage, fire or the like, we no longer consider sales from that boutique to be comparable boutique sales. E-commerce sales are excluded from comparable boutique sales.

(2) Net sales per average square foot are calculated by dividing net sales for the period by the average square feet during the period (see footnote 3 below).

(3) Because of our rapid growth, for purposes of providing sales per square foot measure we use average square feet during the period as opposed to total gross square feet at the end of the period. For individual quarterly periods, average square feet is calculated as (a) the sum of total gross square feet at the beginning and end of the period,

divided by (b) two. For periods consisting of more than one fiscal quarter, average square feet is calculated as (a) the sum of the average square feet for each individual fiscal quarter within that period, divided by (b) the number of periods. There may be variations in the way in which some of our competitors and other retailers calculate sales per square foot or similarly titled measures. As a result, average square feet and net sales per average square foot for period may not be comparable to similar data made available by other retailers.

The following table summarizes the number of boutiques open at the beginning and end of the periods indicated.

	Thirteen Weeks Ended		Thirty Nine Weeks Ended	
	October 29, 2011	October 30, 2010	October 29, 2011	October 30, 2010
Number of boutiques open at beginning of period	279	197	207	147
Boutiques added	4	9	76	60
Boutiques closed	—	—	—	(1)
Number of boutiques open at the end of period	283	206	283	206

We determine our operating segments on the same basis that we use internally to evaluate performance. Our reporting segments are our boutiques and e-commerce business, which have been aggregated into one reportable financial segment. We aggregate our operating segments because (i) the merchandise offered at our boutique locations and through our e-commerce business is largely the same, (ii) we believe that the majority of our e-commerce customers are also customers of our boutique locations and (iii) the merchandise margin of both segments is similar.

#### Thirteen Weeks Ended October 29, 2011 Compared to Thirteen Weeks Ended October 30, 2010

##### Net Sales

Net sales increased 42.6% to \$50.0 million in the thirteen weeks ended October 29, 2011 from \$35.1 million in the thirteen weeks ended October 30, 2010. This increase resulted primarily from a 30.7% increase in transaction count, which in turn was primarily attributable to the increase in the number of boutiques in operation, and an increase in average unit retail price. Comparable boutique sales increased 6.5%, or \$2.0 million, while non-comparable boutique sales increased \$12.9 million in the thirteen weeks ended October 29, 2011 as compared to the thirteen weeks ended October 30, 2010. There were 185 comparable boutiques and 98 non-comparable boutiques open at October 29, 2011 compared to 123 and 83, respectively, at October 29, 2010.

	Thirteen Weeks Ended		
	October 29, 2011	October 30, 2010	Change
	(In thousands)		
Apparel	\$ 27,698	\$ 19,073	\$ 8,625
Jewelry	9,802	6,938	2,864
Accessories	7,653	5,207	2,446
Gift	5,032	3,794	1,238
Shipping	73	61	12
	50,258	35,073	15,185
Allowance for returns	(238 )	—	(238 )
Net sales	\$ 50,020	\$ 35,073	\$ 14,947

The preceding table presents sales by merchandise category. As shown in the table, sales increased in all of our merchandise categories.

##### Cost of Goods Sold and Occupancy Costs

Cost of goods sold and occupancy costs increased 42.9% to \$24.2 million in the thirteen weeks ended October 29, 2011 from \$16.9 million in the thirteen weeks ended October 30, 2010. Cost of merchandise and freight expenses increased by \$4.2 million, primarily driven by the increased sales volume. Occupancy costs increased by \$2.8 million principally due to the increase in the number of boutiques in operation during the thirteen weeks ended October 29, 2011 compared to the same period of the prior year. Allowance for shrinkage increased by \$0.3 million, primarily due to increased sales. As a percentage of net sales, cost of goods sold and occupancy costs increased to 48.4% in the thirteen weeks ended October 29, 2011 from 48.3% in the thirteen weeks ended October 30, 2010 principally caused by an increase in occupancy costs and depreciation expense of mall-based boutiques partially offset by improved merchandise margin as a result of a shift in sales mix to the higher margin merchandise categories.

## Gross Profit

Gross profit increased 42.3% to \$25.8 million in the thirteen weeks ended October 29, 2011 from \$18.1 million in the thirteen weeks ended October 30, 2010. Gross margin decreased 10 basis points to 51.6% for the thirteen weeks ended October 29, 2011 from 51.7% for the thirteen weeks ended October 30, 2010. This decrease was primarily attributable to an increase in occupancy costs and depreciation expense of mall-based boutiques partially offset by improved merchandise margin as a result of a shift in sales mix to the higher margin merchandise categories.

## Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 82.5% to \$17.8 million in the thirteen weeks ended October 29, 2011 from \$9.7 million in the thirteen weeks ended October 30, 2010. Of the total increase, \$2.6 million was attributable to the increase in selling expenses, principally caused by the increase in the number of boutiques in operation in the thirteen weeks ended October 29, 2011 compared to the same period of the prior year. Specifically, payroll and related expenses increased by \$2.3 million, credit card merchant fees increased by \$0.1 million and boutique and office supplies expense increased by \$0.1 million. General and administrative expenses increased by \$5.5 million primarily due to a \$2.6 million increase in stock-based compensation, which included a \$2.3 million charge associated with the accelerated vesting of certain options in connection with the Company's initial public offering. General and administrative expenses were further increased by additional costs related to adding corporate office and distribution employees to support the larger boutique base and increased net sales as well as additional costs incurred to meet the ongoing requirements for a public company. Payroll and related expenses increased by \$1.1 million; software and computer services expense increased by \$0.7 million, a part of which is related to the new merchandising system conversion; professional fees increased by \$0.5 million; and freight expense increased by \$0.2 million. As a percentage of net sales, selling, general and administrative expense was 35.6% in the thirteen weeks ended October 29, 2011 and was 27.7% in the thirteen weeks ended October 30, 2010.

## Income from Operations

Income from operations decreased by 4.2%, to \$8.0 million, or 16.0% of net sales, in the thirteen weeks ended October 29, 2011 from \$8.4 million, or 24.0% of net sales, in the thirteen weeks ended October 30, 2010. This decrease was principally due to an increase of \$8.0 million in selling, general and administrative expenses, including the aforementioned stock-based compensation expense, partially offset by a \$7.7 million increase in gross profit.

## Interest Expense

Interest expense was \$0.5 million in the thirteen weeks ended October 29, 2011. The company had no borrowings during the thirteen weeks ended October 30, 2010.

## Provision for Income Taxes

The decrease in provision for income taxes of \$0.3 million in the thirteen weeks ended October 29, 2011 compared to the thirteen weeks ended October 30, 2010 was due primarily to the decrease in pre-tax income. The effective tax rate of 38.9% in the thirteen weeks ended October 29, 2011 was comparable to the effective tax rate of 39.7% in the thirteen weeks ended October 30, 2010.

## Net Income

Net income decreased 7.3% to \$4.7 million in the thirteen weeks ended October 29, 2011 from \$5.1 million in the thirteen weeks ended October 30, 2010. This decrease was primarily due to increases in selling, general and

administrative expenses of \$8.0 million and interest expense of \$0.5 million and was partially offset by an increase in gross profit of \$7.7 million and a decrease in provision for income taxes of \$0.3 million.

Thirty Nine Weeks Ended October 29, 2011 Compared to Thirty Nine Weeks Ended October 30, 2010

#### Net Sales

Net sales increased 49.5% to \$142.5 million in the thirty nine weeks ended October 30, 2011 from \$95.3 million in the thirty nine weeks ended October 30, 2010. This increase resulted primarily from a 42.5% increase in transaction count, which in turn was primarily attributable to the increase in the number of boutiques in operation, and an increase in the average unit retail price. Comparable boutique sales increased 8.4%, or \$6.7 million, while non-comparable boutique sales increased \$40.5 million in the thirty nine weeks ended October 29, 2011 as compared to the same period of the prior year. There were 185 comparable boutiques and 98 non-comparable boutiques open at October 29, 2011 compared to 123 and 83, respectively, at October 30, 2010.

	Thirty Nine Weeks Ended		
	October 29, 2011	October 30, 2010	Change
	(In thousands)		
Apparel	\$ 78,507	\$ 53,133	\$ 25,374
Jewelry	28,039	19,154	8,885
Accessories	21,444	12,823	8,621
Gift	14,891	10,040	4,851
Shipping	155	143	12
	143,036	95,293	47,743
Allowance for returns	(530 )	—	(530 )
Net sales	\$ 142,506	\$ 95,293	\$ 47,213

The preceding table presents sales by merchandise category. As shown in the table, sales increased in all of our merchandise categories.

#### Cost of Goods Sold and Occupancy Costs

Cost of goods sold and occupancy costs increased 48.8% to \$68.0 million in the thirty nine weeks ended October 29, 2011 from \$45.7 million in the thirty nine weeks ended October 30, 2010. Cost of merchandise and freight expenses increased by \$13.8 million primarily driven by the increased sales volume. Occupancy costs increased by \$7.7 million principally due to the increase in the number of boutiques in operation during the thirty nine weeks ended October 29, 2011 compared to the same period of the prior year. Allowance for shrinkage increased by \$1.0 million primarily due to increased sales. As a percentage of net sales, cost of goods sold and occupancy costs decreased to 47.8% in the thirty nine weeks ended October 29, 2011 from 48.0% in the thirty nine weeks ended October 30, 2010. This decrease was principally caused by improved merchandise margin as a result of a shift in sales mix to the higher margin merchandise categories partially offset by an increase in occupancy costs and depreciation expense of mall-based boutiques.

#### Gross Profit

Gross profit increased 50.2% to \$74.5 million in the thirty nine weeks ended October 29, 2011 from \$49.6 million in the thirty nine weeks ended October 30, 2010. Gross margin increased 20 basis points to 52.2% for the thirty nine weeks ended October 29, 2011 from 52.0% for the thirty nine weeks ended October 30, 2010 principally due to improved merchandise margin as a result of a shift in sales mix to the higher margin merchandise categories partially offset by an increase in occupancy costs and depreciation expense of mall-based boutiques.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 57.4% to \$45.4 million in the thirty nine weeks ended October 29, 2011 from \$28.8 million in the thirty nine weeks ended October 30, 2010. Of the total increase, \$8.3 million was attributable to the increase in selling expenses, principally caused by the increase in the number of boutiques in operation in the thirty nine weeks ended October 29, 2011 compared to the same period of the prior year. Specifically, payroll and related expenses increased by \$7.0 million, credit card merchant fees increased by \$0.7 million and boutique and office supplies expense increased by \$0.4 million. General and administrative expenses increased by \$8.2 million primarily due to additional costs related to adding corporate office and distribution employees to support the larger boutique base and increased net sales as well as additional costs incurred to meet the ongoing requirements for a public company. Specifically, payroll and related expenses increased by \$3.8 million, which includes a \$2.3 million increase in stock-based compensation associated with the accelerated vesting of certain options in connection

with the Company's initial public offering; professional fees increased by \$1.3 million; software and computer services expense increased by \$1.5 million, a part of which is related to the new merchandise system conversion; freight expenses increased by \$0.4 million; and travel expense increased by \$0.4 million. As a percentage of net sales, selling, general and administrative expenses increased to 31.8% in the thirty nine weeks ended October 29, 2011 from 30.2% in the thirty nine weeks ended October 30, 2010.

#### Income from Operations

Income from operations increased 40.2% to \$29.1 million, or 20.4% of net sales, in the thirty nine weeks ended October 29, 2011 from \$20.7 million, or 21.8% of net sales, in the thirty nine weeks ended October 30, 2010. This increase was principally due to an increase of \$24.9 million in gross profit partially offset by an increase of \$16.5 million in selling, general and administrative expenses.



### Interest Expense

Interest expense was \$4.5 million in the thirty nine weeks ended October 29, 2011. The company made no borrowings during the thirty nine weeks ended October 30, 2010.

### Loss on early extinguishment of debt

Loss on early extinguishment of debt was \$1.6 million in the thirty nine weeks ended October 29, 2011 due to the write-off of debt issue costs related to early repayment of our prior senior secured credit facility.

### Provision for Income Taxes

The increase in provision for income taxes of \$0.8 million in the thirty nine weeks ended October 29, 2011 compared to the thirty nine weeks ended October 30, 2010 was primarily due to an increase in pre-tax income. The effective tax rate of 39.0% in the thirty nine weeks ended October 29, 2011 was comparable to the effective tax rate of 39.7% in the thirty nine weeks ended October 30, 2010.

### Net Income

Net income increased 12.6% to \$14.1 million in the thirty nine weeks ended October 29, 2011 from \$12.6 million in the thirty nine weeks ended October 30, 2010. This increase was primarily due to a \$24.9 million increase in gross profit, but was partially offset by increases in selling, general and administrative expenses of \$16.5 million, interest expense of \$4.5 million, loss on early extinguishment of debt of \$1.6 million and provision for income taxes of \$0.8 million.

### Liquidity and Capital Resources

Our primary sources of liquidity are cash flows from operations and borrowings under our new revolving credit facility. Our primary cash needs are for capital expenditures in connection with opening new boutiques and remodeling existing boutiques, investing in improved technology and distribution facility enhancements, funding normal working capital requirements and payments of interest and principal under our new revolving credit facility. We also occasionally use cash or our credit facility to issue letters of credit to support merchandise imports or for other corporate purposes. The most significant components of our working capital are cash and cash equivalents, merchandise inventories, accounts payable and other current liabilities. Our working capital position benefits from the fact that we generally collect cash from sales to customers the day of or, in the case of credit or debit card transactions, within several days of the related sales and we typically have up to 30 days to pay our vendors.

While we believe we have sufficient liquidity and capital resources to meet our current operating requirements and expansion plans, we may elect to pursue additional expansion opportunities within the next year which could require additional debt or equity financing. If we are unable to secure additional financing at favorable terms, or if such financing is unavailable due to credit-market conditions, in order to pursue such additional expansion opportunities, our ability to pursue such opportunities could be materially adversely affected.

We were in compliance with all covenants under our (i) prior senior credit facility at the time it was fully paid off on July 27, 2011 and (ii) new revolving credit facility as of October 29, 2011. At October 29, 2011, we had \$15.0 million of cash and cash equivalents and \$30.0 million in borrowing availability under our new revolving credit facility. There were no letters of credit outstanding at the end of October 29, 2011.

For the longer term, we expect that our cash flow from operations along with borrowings under our new revolving credit facility and tenant allowances for new boutiques will be sufficient to fund capital expenditures and our working capital requirements.

#### Cash Flow

A summary of our operating, investing and financing activities are shown in the following table:

Thirty Nine Weeks Ended  
October 29,              October 30,  
2011                      2010

(In thousands)

Provided by operating activities	\$ 29,877	\$ 14,360
Used for investing activities	(12,201 )	(11,037 )
Provided by (used by) financing activities	(15,210 )	673
Net increase in cash and cash equivalents	\$ 2,466	\$ 3,996

## Operating Activities

Operating activities consist primarily of net income adjusted for non-cash items, including depreciation and amortization, deferred taxes, the effect of working capital changes and tenant allowances received from landlords.

Thirty Nine Weeks Ended  
October 29,              October 30,  
2011                      2010

(In thousands)

Net income	\$ 14,148	\$ 12,567
Adjustments to reconcile net income to net cash provided by Operating activities:		
Depreciation and amortization	3,509	1,707
Stock-based compensation expense	3,907	1,706
Excess tax benefit from stock-based compensation	(449 )	(535 )
Loss on sale of assets	20	22
Amortization of debt issuance costs	462	—
Loss on early extinguishment of debt	1,591	—
Deferred income taxes	2,696	(1,997 )
Changes in assets and liabilities:		
Accounts receivable	931	(3,539 )
Inventories	(4,716 )	(6,914 )
Prepaid expenses and other assets	(926 )	(896 )
Accounts payable	2,567	1,954
Accrued liabilities	(479 )	4,601
Deferred and accrued rents	6,616	5,684
Net cash provided by operating activities	\$ 29,877	\$ 14,360

Net cash provided by operating activities increased \$15.6 million, to \$30.0 million in the thirty nine weeks ended October 29, 2011 from \$14.4 million in the thirty nine weeks ended October 30, 2010 primarily due to a \$10.8 million increase in non-cash expenses, including depreciation, deferred income taxes, loss on early extinguishment of debt and stock-based compensation as well as higher net income in the thirty nine weeks ended October 29, 2011 compared to the same period of the prior year. Net working capital decreased \$0.7 million for the period ended October 29, 2011 as compared the same period ended October 30, 2010 due to increases in accounts payable and accrued liabilities in connection with the increase in the number of boutiques in operation as well as decrease in accounts receivable principally due to collection of tenant allowances. These changes were partially offset by increases in: merchandise inventory, in connection with both new as well as existing boutiques; prepaid assets, as a result of higher prepaid rent and prepaid insurance as well as a decrease in income tax payable due to lower income tax expense.

## Investing Activities

Investing activities consist primarily of capital expenditures for new boutiques, improvements to existing boutiques, as well as investment in information technology and our distribution facility.

	Thirty Nine Weeks Ended	
	October 29, 2011	October 30, 2010
	(In thousands)	
Capital expenditures for:		
New boutiques	\$ 10,488	\$ 9,195
Existing boutiques	582	522
Technology	875	1,066
Corporate and distribution	291	254
Proceeds from sale of property and equipment	(35 )	—
Net cash used in investing activities	12,201	\$ 11,037

Our capital expenditures for the thirty nine weeks ended October 29, 2011 were \$12.2 million, with new boutiques accounting for the majority of spending at \$10.5 million. Spending for new boutiques includes amounts associated with boutiques that will open subsequent to October 29, 2011. The company opened 76 boutiques in the thirty nine weeks ended October 29, 2011 compared to 60 new boutiques in the thirty nine weeks ended October 29, 2010. Our capital expenditures for the new boutiques opened during the thirty nine weeks ended October 29, 2011 totaled \$13.6 million, of which \$10.5 million were incurred in the thirty nine weeks ended October 29, 2011. The remaining \$3.1 million of capital expenditures were incurred and paid in fiscal year 2010. The average cost of the leasehold improvements and furniture and fixtures for new boutiques opened in the thirty nine weeks ended October 29, 2011 was approximately \$180,000 per boutique while tenant allowances averaged approximately \$81,000 per boutique. The average collection period for tenant allowances is six months after boutique opening. As a result, we fund the cost of new boutiques with cash flow from operations, tenant allowances from our landlords and borrowings under the new revolving credit facility. We expect that our cash flow from operations along with borrowings under the new revolving credit facility and tenant allowances for new boutiques will be sufficient to fund our capital expenditures for the rest of fiscal year 2011.

Management anticipates that capital expenditures for the remainder of 2011 will be approximately \$3.9 million, including approximately \$3.8 million in connection with boutiques we plan to open in early fiscal year 2012. In connection with these capital expenditures, we anticipate receiving similar amounts of tenant allowances in fiscal year 2012. The remaining \$0.1 million capital expenditures are expected to be used for investment in information technology.

### Financing Activities

Financing activities consist principally of borrowings and payments under our prior senior secured credit facility and new revolving credit facility as well as proceeds from the initial public offering of our common shares. We also paid fees and expenses in connection with our credit facilities.

	Thirty Nine Weeks Ended	
	October 29, 2011	October 30, 2010
	(In thousands)	
Proceeds from issuance of stock in initial public offering, net of costs	\$ 44,118	\$ —
Proceeds from borrowings under the new revolving credit facility	41,000	—
Repayments of borrowings under the prior senior secured credit facility	(93,813 )	—
Repayments of borrowings under the new revolving credit facility	(6,000 )	—
Payment of debt issue costs	(1,468 )	—

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Proceeds from the exercise of stock options	504	138
Excess tax benefit from stock-based compensation	449	535
Net cash (used by) provided by financing activities	\$ (15,210 )	\$ 673

Net cash used by financing activities was \$15.2 million during the thirty nine weeks ended October 29, 2011. On July 27, 2011, we completed our initial public offering which resulted in net proceeds to us of \$44.1 million, after deducting underwriting discount of \$3.5 million and related fees and expenses of \$2.4 million. The net proceeds from the offering, together with \$41.0 million of indebtedness under a new revolving credit facility and \$6.3 million of cash on hand, were used to repay the \$91.4 million principal balance outstanding under our prior senior secured credit facility. Prior to the repayment, we also made the required quarterly principal payment totaling \$2.4 million under our prior senior secured credit facility. In connection with the new revolving credit facility, we paid \$1.5 million of debt issue costs to be amortized over the term of the facility. We also made principal payments totaling \$6.0 million on the new revolving credit facility. Finally, we received cash proceeds of \$0.5 million and recorded excess tax benefit of \$0.4 million related to stock option exercises in the thirty nine weeks ended October 29, 2011.

## New Revolving Credit Facility

On July 27, 2011, the Borrower entered into the new revolving credit facility with Royal Bank of Canada, as Administrative Agent, KeyBank National Association, as Syndication Agent, and certain other lenders which provided \$65.0 million of revolving credit facility (including borrowing capacity available for letters of credit). The new revolving credit facility is scheduled to terminate on July 27, 2016. On July 27, 2011, proceeds of the initial borrowing, in an amount of \$41.0 million were used, together with \$44.1 million net proceeds from the Company's initial public offering and \$6.9 million of cash on hand, to repay the \$92.0 million (including \$0.6 million of accrued interest) outstanding as of that date under our prior senior secured credit facility. In connection with the new revolving credit facility, we recorded \$1.5 million of debt issue costs that will be amortized over the term of the new revolving credit facility. At October 29, 2011, \$30.0 million was available under the new revolving credit facility for future borrowings.

All obligations under the new revolving credit facility are unconditionally guaranteed by, subject to certain exceptions, Parent and each of Borrower's existing and future direct and indirect wholly owned domestic subsidiaries. All obligations under the new revolving credit facility, and the guarantees of those obligations (as well as cash management obligations and any interest rate hedging or other swap agreements), are secured by substantially all of Borrower's assets as well as the assets of each subsidiary guarantor.

The borrowings under the new revolving credit facility bear interest at a rate equal to an applicable margin plus, at the our option, either (a) in the case of base rate borrowings, a rate equal the highest of (i) the prime rate of Royal Bank of Canada, (ii) the federal funds rate plus 1/2 of 1% and (iii) the LIBOR for an interest period of one month plus 1.00%; or (b) in the case of LIBOR borrowings, a rate equal to the higher of (1) 1.50% and (2) the LIBOR for the interest period relevant to such borrowing. The applicable margin for borrowings under the new revolving credit facility will range from 1.25% to 2.25% with respect to base rate borrowings and from 2.25% to 3.25% with respect to LIBOR borrowings, in each case based upon the achievement of specified levels of the ratio of consolidated total debt to consolidated EBITDA. Additionally, the Borrower will be required to pay a fee to the lenders under the new revolving credit facility on the unused amount at a rate ranging from 0.25% to 0.45%, based on the achievement of specified levels of the ratio of consolidated total debt to consolidated EBITDA. The Borrower is also required to pay customary letter of credit fees. During the thirteen weeks October 29, 2011, the average interest rate for the LIBOR borrowings was 3.9%.

The new revolving credit facility contains customary affirmative and negative covenants, including limitations on the ability of Borrower and its subsidiaries, to (i) incur additional debt; (ii) create liens; (iii) make certain investments, loans and advances; (iv) sell assets; (v) pay dividends or make distributions or make other restricted payments; (vi) repay other indebtedness; (vii) engage in mergers or consolidations; (viii) change the business conducted by Borrower and its subsidiaries; (ix) engage in certain transactions with affiliates; (x) enter into agreements that restrict dividends from subsidiaries; and (xi) amend certain charter documents and material agreements governing subordinated and junior indebtedness.

In addition, the new revolving credit facility requires Borrower to comply with the following financial covenants:

• A maximum ratio of (i) lease-adjusted consolidated total debt (as defined in the credit agreement) to (ii) consolidated EBITDAR of 4.25 to 1.00.

- A minimum ratio of (i) consolidated EBITDA to (ii) interest expense of 4:00 to 1:00.

• Maximum capital expenditures of \$25.0 million per fiscal year, with any unused portion allowed to be carried over to the next two fiscal years subject to a 50.0% cap.

The new revolving credit facility also contains customary events of default, including: (i) failure to pay principal, interest, fees or other amounts under the new revolving credit facility when due taking into account any applicable grace period; (ii) any representation or warranty proving to have been incorrect in any material respect when made; (iii) failure to perform or observe covenants or other terms of the prior senior secured credit facility (as amended by the new revolving credit facility) subject to certain grace periods; (iv) a cross default with respect to other material indebtedness; (v) bankruptcy and insolvency events; (vi) unsatisfied material final judgments; (vii) a “change of control”; (viii) certain defaults under the Employee Retirement Income Security Act of 1974; (ix) the invalidity or impairment of any loan document or any security interest; and (x) the subordination provisions of any material subordinated debt or junior debt shall cease to be in full force.

We were in compliance with the covenants under our new revolving credit facility at October 29, 2011. The Borrower’s ability to declare and pay dividends to Holdings at October 29, 2011 is subject to restrictions. Those restrictions include a maximum secured leverage ratio of no more than 1.75 to 1.00. If the Borrower’s debt under the new revolving credit facility exceeds such ratio, it is restricted from paying dividends. At October 29, 2011, this ratio was within the required limit, thus, the Borrower was allowed to pay dividends.



Subsequent to October 29, 2011, the Borrower made principal payments in the aggregate amount of \$10.0 million on the new revolving credit facility, bringing the outstanding principal balance to \$25.0 million.

#### Senior Secured Credit Facility

On November 17, 2010, the Borrower entered into a senior secured credit facility with a syndicate of financial institutions, which provided financing of up to \$100.0 million consisting of a \$95.0 million term loan facility and a \$5.0 million revolving credit facility each with a maturity date of November 17, 2013. On July 27, 2011, net proceeds from the offering, together with \$41.0 million of indebtedness under a new revolving credit facility and \$6.9 million of cash on hand, were used to repay the \$92.0 million (including accrued interest of \$0.6 million) outstanding under the prior senior secured credit facility. The prior senior secured credit facility was then terminated. We wrote-off the unamortized debt issuance costs of \$1.6 million associated with the prior senior secured credit facility and reported a loss on early extinguishment of debt in such amount.

During the period amounts were outstanding under the prior senior secured credit facility, it accrued interest at the rate of 7.75%. We were in compliance with debt covenants of the prior senior secured credit facility.

#### Critical Accounting Policies

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, as well as the related disclosures of contingent assets and liabilities at the date of the financial statements. A summary of the company's significant accounting policies is included in Note 1 to the company's annual consolidated financial statements in the company's Registration Statement on Form S-1, as amended (File No. 333-173581), and filed with the SEC.

Certain of the company's accounting policies and estimates are considered critical, as these policies and estimates are the most important to the depiction of the company's consolidated financial statements and require significant, difficult, or complex judgments, often about the effect of matters that are inherently uncertain. Such policies are summarized in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section beginning on page 50 of the July 21, 2011 Prospectus, constituting part of our Registration Statement on Form S-1, as amended (Registration No. 333-173581). As of October 29, 2011, there were no significant changes to any of the critical accounting policies and estimates described in the Registration Statement.

#### Contractual Obligations

Except as set forth below, there have been no significant changes to our contractual obligations and commercial commitments as disclosed in the July 21, 2011 Prospectus, constituting part of our Registration Statement on Form S-1, as amended (Registration No. 333-173581), other than those which occur in the normal course of business.

On July 27, 2011, net proceeds from our initial public offering, together with \$41.0 million of initial borrowing under a new revolving credit facility and \$6.9 million of cash on hand, were used to repay the \$92.0 million (including accrued interest of \$0.6 million) outstanding under the prior senior secured credit facility. The prior senior secured credit facility was then terminated. At October 29, 2011, outstanding borrowings under the new revolving credit facility amounted to \$35.0 million which matures on July 27, 2016. Estimated interest payments also decreased due to a lower outstanding balance as well as a lower interest rate.

#### Off Balance Sheet Arrangements

We are not party to any off balance sheet arrangements.

#### Subsequent Events

Subsequent to October 29, 2011, the Borrower made principal payments in the aggregate amount of \$10.0 million on the new revolving credit facility, bringing the outstanding principal balance to \$25.0 million.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our principal exposure to market risk relates to changes in interest rates. Our new revolving credit facility carries floating interest rates that are tied to LIBOR, the federal funds rate and the prime rate, and therefore, our statements of operations and our cash flows will be exposed to changes in interest rates to the extent that we do not have effective hedging arrangements in place. We historically have not used interest rate swap agreements to hedge the variable cash flows associated with the interest on our credit facilities. At October 29, 2011, the interest rate on our borrowings under the new revolving credit facility was 3.75%. Based on a sensitivity analysis at October 29, 2011, assuming the loan balance would be outstanding for a full fiscal year, a 100 basis point increase in interest rates would increase our annual interest by approximately \$0.3 million. We do not use derivative financial instruments for speculative or trading purposes; however, this does not preclude our adoption of specific hedging strategies in the future.

### ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) that are designed to ensure that information required to be disclosed in our reports under the Exchange Act is processed, recorded, summarized and reported within the time periods specified in the SEC's rules and regulations and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

At the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision and with the participation of our disclosure committee and management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the company's disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the company's disclosure controls and procedures were effective as of October 29, 2011.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

We are subject to various legal proceedings and claims, including employment claims, wage and hour claims, intellectual property claims, contractual and commercial disputes and other matters that arise in the ordinary course of business. While the outcome of these and other claims cannot be predicted with certainty, we do not believe that the outcome of these matters will have a material adverse effect on our business, results of operations or financial condition.

### ITEM 1A. RISK FACTORS

There have been no material changes to our risk factors as previously disclosed beginning on page 12 of the July 21, 2011 Prospectus, which constitutes part of our Registration Statement on Form S-1, as amended (File No. 333-173581), and filed with the SEC.

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

None.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

None.

ITEM 4. RESERVED

ITEM 5. OTHER INFORMATION

As disclosed in our Registration Statement on Form S-1, as amended (Registration No. 333-173581), and filed with the SEC, we are in the process of upgrading several of our systems, including implementation of a fully integrated enterprise software platform from JDA. The first stage of the implementation of the JDA platform was completed on August 29, 2011 and we are now operating on the JDA merchandise system. Currently, we are in the process of designing our boutiques' point-of-sale system to be deployed chain-wide in 2012.

ITEM 6. EXHIBITS

Exhibit No.	Description
31.1	Certification of Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a)
31.2	Certification of Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a)
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Unaudited Consolidated Balance Sheets as of October 29, 2011, January 29, 2011 and October 30, 2010, (22) the Unaudited Consolidated Statements of Operations for the thirteen weeks and thirty nine weeks ended October 29, 2011 and October 30, 2010, (iii) Unaudited Consolidated Statements of Changes in Stockholders' Equity (Deficit) for the thirty nine weeks ended October 29, 2011, (iv) Unaudited Consolidated Statements of Cash Flows for the thirty nine weeks ended October 29, 2011 and (v) the Notes to the Unaudited Consolidated Financial Statements.

SIGNATURE

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

Francesca's Holdings Corporation  
(Registrant)

Date: December 7, 2011

/s/ Gene S. Morphis  
Gene Morphis  
Chief Financial Officer (duly authorized officer and  
Principal Financial and Accounting Officer)