

Perfumania Holdings, Inc.  
Form 10-Q  
June 15, 2010  
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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 May 1, 2010

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: 0-19714

**PERFUMANIA HOLDINGS, INC.**

(Exact name of Registrant as specified in its charter)

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**Florida**  
(State or other jurisdiction of  
incorporation or organization)

**65-0977964**  
(I.R.S. Employer  
Identification No.)

**35 Sawgrass Drive, Suite 2**

**Bellport, NY**  
(Address of principal executive offices)

**11713**  
(Zip Code)

**Registrant's telephone number, including area code: (631) 866-4100**

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark 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 (Check one):

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 number of shares outstanding of the registrant's common stock, as of the latest practicable date: At June 11, 2010 there were 8,966,417 outstanding shares of its common stock, \$0.01 par value.

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**PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES**

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(in thousands, except share amounts)

|   | May 1, 2010<br>(unaudited) | January 30, 2010  |
|---|----------------------------|-------------------|
| <b>ASSETS:</b>  |                            |                   |
| Current assets  |                            |                   |
| Cash  | \$ 1,343                   | \$ 1,951          |
| Accounts receivable, net of allowances of \$385 and \$335, as of May 1, 2010 and January 30, 2010, respectively             | 25,216                     | 25,382            |
| Inventories   | 215,908                    | 216,038           |
| Prepaid expenses and other current assets   | 8,386                      | 11,902            |
| <b>Total current assets</b>   | <b>250,853</b>             | <b>255,273</b>    |
| Property and equipment, net   | 34,459                     | 35,882            |
| Other assets, net   | 14,712                     | 15,430            |
| <b>Total assets</b>   | <b>\$ 300,024</b>          | <b>\$ 306,585</b> |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY:</b>   |                            |                   |
| Current liabilities:  |                            |                   |
| Revolving credit facility   | \$ 47,466                  | \$ 40,012         |
| Accounts payable  | 35,607                     | 35,017            |
| Accounts payable-affiliate  | 24,690                     | 35,277            |
| Accrued expenses and other liabilities  | 20,145                     | 18,068            |
| Current portion of notes payable - affiliate  | 640                        | 640               |
| Current portion of obligations under capital leases   | 969                        | 1,147             |
| <b>Total current liabilities</b>  | <b>129,517</b>             | <b>130,161</b>    |
| Notes payable - affiliate   | 95,579                     | 95,739            |
| Long-term portion of obligations under capital leases   | 1,960                      | 2,034             |
| Other long term liabilities   | 16,261                     | 14,560            |
| <b>Total liabilities</b>  | <b>243,317</b>             | <b>242,494</b>    |
| Commitments and contingencies (see Note 9)  |                            |                   |
| Shareholders equity:  |                            |                   |
| Preferred stock, \$.10 par value, 1,000,000 shares authorized, as of May 1, 2010 and January 30, 2010, none issued          |                            |                   |
| Common stock, \$.01 par value, 20,000,000 shares authorized; 9,864,666 shares issued as of May 1, 2010 and January 30, 2010 | 99                         | 99                |
| Additional paid-in capital  | 125,052                    | 125,045           |

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|  |                   |                   |
|--|-------------------|-------------------|
| Accumulated deficit  | (59,867)          | (52,476)          |
| Treasury stock, at cost, 898,249 shares as of May 1, 2010 and January 30, 2010 | (8,577)           | (8,577)           |
| <b>Total shareholders' equity</b>  | <b>56,707</b>     | <b>64,091</b>     |
| <b>Total liabilities and shareholders' equity</b>                              | <b>\$ 300,024</b> | <b>\$ 306,585</b> |

See accompanying notes to condensed consolidated financial statements.

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**PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

(in thousands, except share and per share amounts)

|   | Thirteen Weeks<br>Ended<br>May 1, 2010 | Thirteen Weeks<br>Ended<br>May 2, 2009 |
|---|--|--|
| Net sales   | \$ 102,809                             | \$ 96,660                              |
| Cost of goods sold                                    | 65,225                                 | 60,826                                 |
| <b>Gross profit</b>                                   | <b>37,584</b>                          | <b>35,834</b>                          |
| Operating expenses:                                   |  |  |
| Selling, general and administrative expenses          | 39,351                                 | 38,709                                 |
| Depreciation and amortization                         | 2,192                                  | 2,490                                  |
| <b>Total operating expenses</b>                       | <b>41,543</b>                          | <b>41,199</b>                          |
| Loss from operations                                  | (3,959)                                | (5,365)                                |
| Interest expense                                      | (3,432)                                | (4,501)                                |
| Loss before income tax expense                        | (7,391)                                | (9,866)                                |
| Income tax expense                                    |  |  |
| Net loss  | \$ (7,391)                             | \$ (9,866)                             |
| Net loss per common share:                            |  |  |
| Basic and diluted                                     | \$ (0.82)                              | \$ (1.10)                              |
| Weighted average number of common shares outstanding: |  |  |
| Basic and diluted                                     | 8,966,417                              | 8,966,417                              |

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(in thousands)**

|  | <b>Thirteen Weeks<br/>Ended<br/>May 1, 2010</b> | <b>Thirteen Weeks<br/>Ended<br/>May 2, 2009</b> |
|--|---|---|
| <b>Cash flows from operating activities:</b>   |   |   |
| Net loss   | \$ (7,391)                                      | \$ (9,866)                                      |
| <b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b> |   |   |
| Amortization of deferred financing costs   | 526   |   |
| Depreciation and amortization  | 2,192   | 2,490   |
| Provision (recovery) for losses on accounts receivable   | 2   | (114)   |
| Share based compensation   | 7   |   |
| <b>Change in operating assets and liabilities:</b>   |   |   |
| Trade receivables  | 164   | 2,448   |
| Inventories  | 130   | 26,611  |
| Prepaid expenses and other assets  | 3,518   | (1,898)   |
| Accounts payable-non affiliates  | 590   | 1,146   |
| Accounts payable-affiliates  | (10,587)  | (1,021)   |
| Accrued expenses and other liabilities and long-term interest                                    | 3,817   | 3,467   |
| <b>Net cash (used in) provided by operating activities</b>                                       | <b>(7,032)</b>                                  | <b>23,263</b>                                   |
| <b>Cash flows from investing activities:</b>   |   |   |
| Additions to property and equipment  | (579)   | (2,086)   |
| Other investing activities   |   | (1,500)   |
| <b>Net cash used in investing activities</b>   | <b>(579)</b>                                    | <b>(3,586)</b>                                  |
| <b>Cash flows from financing activities:</b>   |   |   |
| Net borrowings and (repayments) under bank line of credit  | 7,454   | (21,553)  |
| Payments on affiliated notes payable   | (160)   | (160)   |
| Principal payments under capital lease obligations   | (252)   | (459)   |
| Payments of long-term debt and other   | (39)  | (39)  |
| <b>Net cash provided by (used in) financing activities</b>                                       | <b>7,003</b>                                    | <b>(22,211)</b>                                 |
| Decrease in cash   | (608)   | (2,534)   |
| Cash at beginning of period  | 1,951   | 4,202   |
| Cash at end of period  | \$ 1,343  | \$ 1,668  |
| <b>Supplemental Information:</b>   |   |   |
| <b>Cash paid during the period for:</b>  |   |   |
| Interest   | \$ 825  | \$ 2,571  |

Income taxes

See accompanying notes to condensed consolidated financial statements.

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**PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1 OPERATIONS AND BASIS OF PRESENTATION**

The Company is an independent, national, vertically integrated wholesale distributor and specialty retailer of perfumes and fragrances that does business through four primary operating subsidiaries, Perfumania, Inc. ( "Perfumania" ), Quality King Fragrance, Inc. ( "QFG" ), Scents of Worth, Inc. ( "SOW" ), and Five Star Fragrance Company, Inc. ( "Five Star" ). We operate in two industry segments, wholesale distribution and specialty retail sales of designer fragrance and related products.

Our wholesale business, which is conducted through QFG, distributes designer fragrances to mass market retailers, drug and other chain stores, retail wholesale clubs, traditional wholesalers, and other distributors throughout the United States. For reporting purposes, the wholesale business also includes the Company's manufacturing division, operated by Five Star, which owns and licenses designer and other fragrance brands that are sold principally through the Company's wholesale business, SOW's consignment business and Perfumania's retail stores, paying royalties to the licensors based on a percentage of sales. All manufacturing operations are outsourced to third party manufacturers. Five Star's sales and results of operations are not significant to the Company's results on a consolidated basis.

Our retail business is conducted through three subsidiaries:

Perfumania, a specialty retailer of fragrances and related products,

SOW, which sells fragrances in retail stores on a consignment basis, and

perfumania.com, Inc., an Internet retailer of fragrances and other specialty items.

As of May 1, 2010, Perfumania operated a chain of 367 retail stores specializing in the sale of fragrances and related products at discounted prices up to 75% below the manufacturers' suggested retail prices. Perfumania.com offers a selection of our more popular products for sale over the Internet and serves as an alternative shopping experience to the Perfumania retail stores. SOW is the largest national designer fragrance consignment program, with contractual relationships to sell products on a consignment basis in approximately 2,500 stores, including more than 1,300 Kmart locations nationwide. Its other retail customers include Burlington Coat Factory, SYMS, Loehmann's, Daffy's, Duane Reade and K & G.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and note disclosures normally included in annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America ( "US GAAP" ), have been condensed or omitted pursuant to those rules and regulations. The financial information presented herein, which is not necessarily indicative of results to be expected for the current fiscal year, reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the interim unaudited condensed consolidated financial statements. These condensed consolidated financial statements should be read in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 30, 2010.

**OTHER MATTERS LIQUIDITY ENHANCEMENT AND COST REDUCTION**

The Company was greatly impacted by the recessionary pressures that began in the latter half of fiscal 2008 and continued into fiscal 2009, including a significant decline in consumer spending. As consumer spending and confidence could remain depressed, the Company has focused on carefully managing those factors within its control, most importantly spending, including reducing its fiscal 2009 and planned fiscal 2010 capital budget, and improved inventory productivity to maximize inventory turns for



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both wholesale and retail operations. The Company will also continue its efforts to improve its retail operations and in-store experience to maximize retail revenues, reduce its cost base and minimize discretionary spending, optimize inventory levels and improve working capital and operating cash flows throughout fiscal 2010.

In May 2009, the Company completed an amendment of its Senior Credit Facility, (see Note 5). The Company currently anticipates that cash flows from operations and the projected borrowing availability under the Senior Credit Facility will be sufficient to fund its liquidity requirements for at least the next twelve months. Nevertheless, there can be no certainty that availability under the Senior Credit Facility will be sufficient to fund the Company's liquidity needs. The sufficiency and availability of the Company's projected sources of liquidity may be adversely affected by a variety of factors, including, without limitation, the level of the Company's operating cash flows, which will be impacted by retailer and consumer acceptance of the Company's products, general economic conditions and the level of consumer spending; the Company's ability to comply with financial covenants (as amended) and other covenants included in its Senior Credit Facility.

If the Company does not have a sufficient borrowing base at any given time, borrowing availability under the Senior Credit Facility may not be sufficient to support liquidity needs. Insufficient borrowing availability under the Senior Credit Facility would have a material adverse effect on the Company's financial condition and results of operations. If the Company were unable to comply with the requirements in the the Senior Credit Facility, it would be unable to borrow under such agreement and any amounts outstanding would become immediately due and payable, which would have a material adverse effect on the Company's financial condition, results of operations and liquidity.

**NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS**

In June 2009, the Financial Accounting Standards Board ( FASB ) issued rules which modify how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The FASB clarified that the determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. An ongoing reassessment is required of whether a company is the primary beneficiary of a variable interest entity. Additional disclosures are also required about a company's involvement in variable interest entities and any significant changes in risk exposure due to that involvement. These rules were effective for fiscal years beginning after November 15, 2009. The adoption of this guidance did not have a material effect on the Company's consolidated results of operations, financial position or cash flows.

**Table of Contents****NOTE 3 INTANGIBLES**

The following table provides information related to intangible assets (in thousands), which are included in other assets, net on the accompanying condensed consolidated balance sheets as of May 1, 2010 and January 30, 2010:

|                                | Useful Life<br>(years) | May 1, 2010      |                             |                      | January 30, 2010 |                             |                      | Net<br>Book<br>Value |           |
|--------------------------------|------------------------|------------------|-----------------------------|----------------------|------------------|-----------------------------|----------------------|----------------------|-----------|
|                                |                        | Original<br>Cost | Accumulated<br>Amortization | Impairment<br>Charge | Original<br>Cost | Accumulated<br>Amortization | Impairment<br>Charge |                      |           |
| Tradenames                     | 7-20                   | \$ 10,559        | \$ 6,865                    | \$                   | \$ 3,694         | \$ 10,559                   | \$ 6,770             | \$                   | \$ 3,789  |
| Favorable leases               | 1-7                    | 1,350            | 389                         |                      | 961              | 1,350                       | 316                  |                      | 1,034     |
| Tradenames<br>(non-amortizing) | N/A                    | 8,500            |                             |                      | 8,500            | 8,500                       |                      |                      | 8,500     |
|                                |                        | \$ 20,409        | \$ 7,254                    | \$                   | \$ 13,155        | \$ 20,409                   | \$ 7,086             | \$                   | \$ 13,323 |

In accordance with accounting standards, intangible assets with indefinite lives are not amortized, but rather tested for impairment at least annually. Owned tradenames that have been determined to have indefinite lives are not subject to amortization but are reviewed at least annually for potential impairment. The fair values are estimated and compared to their carrying values.

Trademarks, including tradenames and owned licenses having finite lives, are amortized over their respective lives to their estimated residual values and are also reviewed for impairment in accordance with accounting standards. The recoverability of the carrying values of all long-lived assets with finite lives is re-evaluated when changes in circumstances indicate the assets' value may be impaired. Impairment testing is based on a review of forecasted operating cash flows and the profitability of the related brand. There were no triggering events during the thirteen weeks ended May 1, 2010 that would indicate potential impairment and the requirement to review the carrying value of intangible assets.

Amortization expense associated with intangible assets subject to amortization is included in depreciation and amortization on the accompanying condensed consolidated statements of operations. For both the thirteen weeks ended May 1, 2010 and May 2, 2009, amortization expense for intangible assets subject to amortization was \$0.2 million. The weighted average amortization periods for the remaining tradenames with finite lives and for favorable lease agreements are 16.9 years and 5.4 years, respectively. For the remainder of fiscal 2010, we expect amortization expense to be \$0.5 million. As of May 1, 2010, future amortization expense associated with intangible assets subject to amortization for each of the five succeeding fiscal years is as follows (in thousands):

| Fiscal Year | Amortization<br>Expense |
|-------------|-------------------------|
| 2011        | \$ 623                  |
| 2012        | 500                     |
| 2013        | 476                     |
| 2014        | 476                     |
| 2015        | 476                     |

**NOTE 4 ACCOUNTING FOR SHARE-BASED PAYMENTS**

The Company has two stock option plans which provide for equity-based awards to its employees and directors (collectively, the Plans). Under the Plans, the Company has reserved 1,165,000 shares of common stock, of which 192,000 options are outstanding. All stock options have an exercise price that is equal to the fair value of the Company's stock on the date the options were granted. The term of the stock option awards is ten years from the date of grant.

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The following is a summary of the stock option activity during the thirteen weeks ended May 1, 2010:

|  | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value |
|--|------------------|---------------------------------|---|---------------------------|
| Outstanding and exercisable as of January 30, 2010 | 191,814          | \$ 9.92                         | 6.83  | \$                        |
| Granted  |                  |                                 |   |                           |
| Exercised  |                  |                                 |   |                           |
| Forfeited  |                  |                                 |   |                           |
| Outstanding as of May 1, 2010                      | 191,814          | \$ 9.92                         | 6.58  | \$ 292,000                |
| Exercisable as of May 1, 2010                      | 168,484          | \$ 10.63                        | 6.60  | \$ 205,000                |

The aggregate intrinsic value in the table above is the value before applicable income taxes which would have been received by the optionees based on the Company's closing stock price as of the last business day of the respective period had all options been exercised on that date.

During the thirteen week period ended May 1, 2010, the Company recognized share based compensation expense of \$7,000 in the condensed consolidated financial statements. No share based compensation expense was recorded in the thirteen week period ended May 2, 2009.

**NOTE 5 REVOLVING CREDIT FACILITY, NOTES PAYABLE TO AFFILIATES AND SUBORDINATED CONVERTIBLE NOTE PAYABLE TO AFFILIATE**

The revolving credit facility, notes payable to affiliates and subordinated convertible note payable to affiliate consist of the following:

|  | May 1, 2010    | January 30, 2010 |
|--|----------------|------------------|
|  | (in thousands) |                  |
| Revolving credit facility interest payable monthly, secured by a pledge of substantially all of the Company's assets | \$ 47,466      | \$ 40,012        |
| Subordinated convertible note payable-affiliate  | 5,000          | 5,000            |
| Subordinated non-convertible notes payable-affiliates  | 91,219         | 91,379           |
|  | 143,685        | 136,391          |
| Less current portion   | (48,106)       | (40,652)         |
| Total long-term debt   | \$ 95,579      | \$ 95,739        |

The Company has a \$250 million revolving credit facility with a syndicate of banks for which General Electric Capital Corporation ( GECC ) serves as Agent, Collateral Agent and Lender, GE Capital Markets, Inc. serves as Joint Lead Arranger and Book Runner and Wells Fargo Capital Finance serves as Joint Lead Arranger (the Senior Credit Facility ). The Senior Credit Facility is used for the Company's general corporate purposes and those of its subsidiaries, including working capital. The Company and certain of its subsidiaries are co-borrowers under the Senior Credit Facility, and the Company's other subsidiaries have guaranteed all of their obligations thereunder.



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The Senior Credit Facility is scheduled to expire on August 11, 2011, when all amounts will be due and payable in full. The Senior Credit Facility does not require amortization of principal and may be paid before maturity in whole or in part at the Company's option without penalty or premium; provided that, if the Company permanently reduces the revolving commitment in connection with a prepayment after August 11, 2009 and on or before August 11, 2010, it must pay a prepayment fee equal to 0.5% of the prepayment.

Revolving loans under the Senior Credit Facility may be drawn, repaid and reborrowed up to the amount available under a borrowing base calculated with reference to a specified percentage of the borrowers' eligible accounts and a specified percentage of the borrowers' eligible inventory from time to time. GECC has the right to impose reserves in its reasonable credit judgment, whether or not there is an Event of Default, which would effectively reduce the borrowing base and thereby the amount that the borrowers may borrow under the Senior Credit Facility. Under an amendment to the Senior Credit Facility executed as of May 26, 2009 (Waiver and Amendment No. 1), reserves against borrowing availability increasing from \$9 million to \$15 million at August 4, 2009 and thereafter will automatically apply, in addition to any reserves that may be imposed from time to time in GECC's reasonable credit judgment. The Senior Credit Facility also includes a sub-limit of \$25 million for letters of credit and a sub-limit of \$12.5 million for swing line loans (that is, same-day loans from the lead or agent bank).

As a result of the covenant defaults described below, which were waived by Waiver and Amendment No. 1, effective January 23, 2009, GECC elected to impose the Default Rate of interest on outstanding borrowings, which is 2% higher than the interest rate otherwise applicable. The Company was also required to pay fees equal to 0.375% of the unused amount of the Senior Credit Facility and the outstanding amount of letters of credit under that facility. Under Waiver and Amendment No. 1, the imposition of the Default Rate of interest was suspended and interest under the Senior Credit Facility for periods after May 26, 2009 will be, at the Company's election unless an event of default exists, either (i) the highest of (A) The Wall Street Journal prime rate, (B) the federal funds rate plus .50% or (C) the sum of 3-month LIBOR plus 1.00%, (the Index Rate), in each case plus 3.50% or (ii) the applicable LIBOR rate (but not less than 2.00%) plus 4.50%. The Company is also now required to pay fees equal to 1.00% of the unused amount of the Senior Credit Facility and 4.50% of the outstanding amount of any letters of credit under that facility.

All obligations of the Company under the Senior Credit Facility and under any interest rate protection or other hedging arrangements entered into in connection with the Senior Credit Facility are secured by a first priority perfected security interest in all existing and after-acquired personal property and owned real property owned by the Company and its subsidiaries, which are co-borrowers or guarantors, including, without limitation, 100% (or, in the case of excluded foreign subsidiaries, 66%) of the outstanding equity interests in their subsidiaries.

The Senior Credit Facility limits the Company's and its subsidiaries' ability to, among other things: incur additional indebtedness; incur liens or guarantee obligations; pay dividends and make other distributions; make investments and enter into joint ventures; dispose of assets; and engage in transactions with affiliates, except for certain existing arrangements under which the Company leases space and obtains certain business services from affiliated companies and other arrangements in the ordinary course of business. The Senior Credit Facility also provides that advances to suppliers by the Company and its subsidiaries may not exceed \$8 million with respect to all suppliers or \$3 million with respect to any one supplier (together with its affiliates).

Under the Senior Credit Facility, the Company and its subsidiaries have been required to maintain certain financial ratios, as specified in the agreement. The Company was not in compliance with certain of these ratios as of November 1, 2008 and January 31, 2009. In order to better align the provisions of the Senior Credit Facility with the Company's current business situation, Waiver and Amendment No. 1 waived the covenant defaults and certain other defaults under the facility, provided for no testing of the minimum fixed charge coverage ratio, the inventory turnover ratio or the maximum leverage ratio covenants for the fiscal quarter ended May 2, 2009, deleted the inventory turnover ratio covenant and the maximum leverage ratio covenant thereafter, and suspended the minimum fixed charge coverage ratio covenant until the fiscal quarter ending January 30, 2010. The Company was in compliance with the minimum fixed charge coverage ratio covenant under the Senior Credit Facility as of May 1, 2010.

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The Senior Credit Facility also includes other customary events of default that, if not waived, would permit the lenders to accelerate the indebtedness and terminate the credit facility. Any future defaults that are not waived could result in our having to refinance the Senior Credit Facility and obtain an alternative source of financing. Due to the current weakness in the credit markets, there is no assurance that such financing would be obtained, or if such refinancing is obtained, that the terms of a new facility would be on terms comparable to the current Senior Credit Facility. If the Company were unable to obtain such financing, its operations and financial condition would be materially adversely affected and it would be forced to seek an alternative source of liquidity, such as by selling additional securities, to continue operations, or to limit its operations.

On August 11, 2008, six estate planning trusts established by Glenn, Stephen and Arlene Nussdorf (the Nussdorf Trusts ) loaned an aggregate of approximately \$55 million to the Company on an unsecured basis. At the same time, we issued an unsecured subordinated promissory note in the principal amount of \$35 million to Quality King Distributors, Inc. ( Quality King ). All of the subordinated promissory notes issued to the Nussdorf Trusts and Quality King are subordinated to the Senior Credit Facility and, pursuant to amendments as of May 26, 2009, no payments of principal or interest may be made before the maturity of the Senior Credit Facility on August 11, 2011. The maturity date of the subordinated promissory notes payable to the Nussdorf Trusts is February 8, 2012 and that of the note payable to Quality King is June 30, 2012. The Nussdorf Trusts notes bear interest at a rate equal to 2% over the rate in effect from time to time on the revolving loans under the Senior Credit Facility, and the Quality King note bears interest at a rate equal to 1% over the rate in effect from time to time on the revolving loans under the Senior Credit Facility. Quality King and the Nussdorf Trusts have acknowledged that the Company's nonpayment, because of the subordination provisions, of amounts otherwise due under these notes will not constitute a default under the notes.

On December 9, 2004, E Com issued a Subordinated Convertible Note (the Convertible Note ) to Glenn and Stephen Nussdorf in exchange for a \$5 million subordinated secured demand loan made in March 2004. The Convertible Note was originally secured by E Com's assets, but, in connection with the August 11, 2008 financing transactions, Glenn and Stephen Nussdorf released and terminated their security interest. The Convertible Note was originally payable in January 2007; however it was modified in January 2006 to extend the due date to January 2009. The Convertible Note is subordinate to all bank related indebtedness and, pursuant to a May 26, 2009 amendment, no payments of principal or interest may be made before the maturity of the Senior Credit Facility on August 11, 2011. As a result, the Convertible Note is currently in default, resulting in an increase of 2% in the nominal interest rate, which is the prime rate plus 1%. The Convertible Note allows Glenn and Stephen Nussdorf to convert any or all of the principal and accrued interest due on the Convertible Note into shares of the Company's common stock. The conversion price was originally \$11.25, which equaled the closing market price of E Com's common stock on December 9, 2004, and was reduced to \$7.00 by the May 26, 2009 amendment.

Interest expense on the Nussdorf Trust Notes, the Quality King Note and the Convertible Note was approximately \$1.8 million and \$1.6 million for the thirteen weeks ended May 1, 2010 and May 2, 2009, respectively, and is included in interest expense on the accompanying condensed consolidated statements of operations. No payments have been made on the Nussdorf Trust Notes or the Quality King Note. Accrued interest payable due at May 1, 2010 and January 30, 2010, respectively on the Nussdorf Trust Notes, the Quality King Note and the Convertible Note was approximately \$12.7 million and \$10.9 million and is included in other long-term liabilities on the accompanying condensed consolidated balance sheets as of May 1, 2010 and January 30, 2010, respectively.



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**NOTE 6 ACCOUNTING FOR INCOME TAXES**

The Company conducts business throughout the United States and Puerto Rico and as a result, files income tax returns in the U.S. federal jurisdiction and various state jurisdictions and Puerto Rico. In the normal course of business the Company is subject to examinations in these jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state, local or Puerto Rico income tax examinations for fiscal years prior to 2004. State and foreign income tax returns are generally subject to examination for a period of three to five years after filing of the respective return. The state impact of any federal changes remains subject to examination by various states for a period of up to one year after formal notification to the states. The Company is not currently under examination in any state or foreign jurisdictions.

The Company continues to provide a full valuation allowance against all deferred tax assets due to the uncertainty as to when business conditions will improve sufficiently to enable it to utilize its deferred tax assets. As a result, the Company did not record a federal or state tax benefit on its operating loss for the thirteen weeks ended May 1, 2010.

During the thirteen weeks ended May 1, 2010, there were no changes to the liability for income tax associated with uncertain tax positions. The Company accrues interest related to unrecognized tax benefits as well as any related penalties in operating expenses in its condensed consolidated statements of operations, which is consistent with the recognition of these items in prior reporting periods. The accrual for interest and penalties related to uncertain tax positions as of May 1, 2010 and January 30, 2010 was not significant.

The Company does not anticipate any material adjustments relating to unrecognized tax benefits within the next twelve months; however the ultimate outcome of tax matters is uncertain and unforeseen results can occur.

**NOTE 7 BASIC AND DILUTED INCOME (LOSS) PER COMMON SHARE**

Basic income (loss) per common share has been computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period.

Diluted net income per common share includes, in periods in which they are dilutive, the effect of those common stock equivalents where the average market price of the common stock exceeds the exercise prices for the respective periods. All common stock equivalents, which include outstanding stock options, the subordinated convertible note payable to affiliate and warrants outstanding were not included in diluted net loss for any period presented because the results would be anti-dilutive.

**NOTE 8 FAIR VALUE MEASUREMENTS**

The Company applies authoritative accounting guidance regarding fair value and disclosures as it applies to financial and non-financial assets and liabilities. The guidance defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability on the measurement date. The three levels are defined as follows:

Level 1: Observable inputs such as quoted prices in active markets (the fair value hierarchy gives the highest priority to Level 1 inputs);

Level 2: Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

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Level 3: Unobservable inputs in which there is little or no market data and require the reporting entity to develop its own assumptions

As of May 1, 2010, the Company had no material financial assets or liabilities measured on a recurring basis that required adjustments or write-downs and the carrying values of current assets and liabilities approximate their fair value. The Company measures certain assets at fair value on a non-recurring basis, specifically long-lived assets evaluated for impairment. No such impairments were recorded during the thirteen weeks ended May 1, 2010.

**NOTE 9 CONTINGENCIES**

The Company is involved in various legal proceedings in the ordinary course of business. Management cannot presently predict the outcome of these matters, although management believes, based in part on the advice of counsel, that the ultimate resolution of these matters will not have a materially adverse effect on the Company's consolidated financial position, results of operations or cash flows.

**NOTE 10 RELATED PARTY TRANSACTIONS**

Glenn and Stephen Nussdorf and their sister, Arlene Nussdorf, owned an aggregate 6,649,476 shares or approximately 74% of the total number of shares of the Company's common stock as of May 1, 2010, excluding shares issuable upon conversion of certain Warrants or the Convertible Note discussed in Note 5, and not assuming the exercise of any outstanding options held by the Company's officers and directors. Stephen Nussdorf has served as the Chairman of the Company's Board of Directors since February 2004.

The Nussdorfs are officers and principals of Quality King, which distributes pharmaceuticals and health and beauty care products. The Company's President and Chief Executive Officer, Michael W. Katz ( Mr. Katz ), is also an executive of Quality King.

Effective August 1, 2008, the 2003 Stockholder Agreement between our predecessor company, Model Reorg, Inc. and Mr. Katz was amended and restated (the Agreement ) and the Company's subsidiary, Model Reorg Acquisition LLC, issued a \$1.9 million promissory note payable to Mr. Katz. The note, which bears interest at 4% and is payable in equal monthly installments of \$53,333 commencing September 1, 2008 and terminating August 1, 2011, liquidated Model Reorg's preexisting obligation to Mr. Katz under the Agreement, which had provided for stock ownership and an earnings participation in Model Reorg. Under the Agreement, Mr. Katz is bound by certain non-compete, non-solicitation and confidentiality covenants. The note payable is included in current and long term notes payable - affiliate as of May 1, 2010 and January 30, 2010, in the aggregate amount of \$0.9 million and \$1.0 million, respectively.

**Transactions With Affiliated Companies**

Glenn Nussdorf beneficially owns approximately 10.1% of the outstanding common stock of Parlux Fragrances, Inc. ( Parlux ), a manufacturer and distributor of prestige fragrances and beauty products. Perfumania has historically purchased merchandise from Parlux. Starting in fiscal 2009, the Company purchased merchandise from Quality King. Purchases of merchandise from these related companies aggregated approximately \$10.4 million and \$0.2 million for the thirteen weeks ended May 1, 2010 and May 2, 2009, respectively. The amounts due to these related companies at May 1, 2010 and January 30, 2010 were approximately \$24.7 million and \$35.3 million, respectively. These amounts are non-interest bearing and are included in accounts payable-affiliate in the accompanying condensed consolidated balance sheet. Purchases from related parties are generally payable in 90 days, however, due to the seasonality of the Company's business, these terms are generally extended. Related party accounts have historically been brought closer to terms at the end of the holiday season. During the rest of the year, the Company has relied upon these extended terms to provide a portion of its liquidity.

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Quality King occupies a leased 560,000 square foot facility in Bellport, NY. Model Reorg began occupying approximately half of this facility in December 2007 under a sublease that terminates on September 30, 2027, and this is now the location of the Company's principal offices. The monthly current sublease payments of approximately \$203,000 increase by 3% annually.

The Company and Quality King are parties to a Services Agreement providing for the Company's participation in certain third party arrangements, at the Company's respective share of Quality King's cost, including allocated overhead, plus a 2% administrative fee, and the provision of legal services. The Company also shares with Quality King the economic benefit of the bulk rate contract that the Company has with UPS to ship Quality King's merchandise and related items. The Services Agreement will terminate on thirty days' written notice from either party. During both the thirteen weeks ended May 1, 2010 and May 2, 2009, the expenses charged under these arrangements to the Company and Model Reorg were \$0.7 million.

**NOTE 11 SEGMENT INFORMATION**

The Company operates in two industry segments, wholesale distribution and specialty retail sales of designer fragrance and related products. Management reviews segment information by segment and on a consolidated basis each month. Retail sales include sales through Perfumania retail stores, the Scents of Worth consignment business and the Company's internet site, perfumania.com. Transactions between Five Star and unrelated customers are included in our wholesale segment information. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in the Annual Report on Form 10-K for the fiscal year ended January 30, 2010. The Company's chief operating decision maker who is its Chief Executive Officer, assesses segment performance by reference to gross profit. Each of the segments has its own assets, liabilities, revenues and cost of goods sold. While each segment has certain unallocated operating expenses, these expenses are not reviewed by the chief operating decision maker on a segment basis but rather on a consolidated basis. Financial information for these segments is summarized in the following table.

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|                      | Thirteen Weeks<br>Ended<br>May<br>1, 2010 | Thirteen Weeks<br>Ended<br>May 2, 2009<br>(in thousands) |
|----------------------|---|--|
| <b>Net sales:</b>    |   |  |
| Retail               | \$ 65,914                                 | \$ 63,120  |
| Wholesale            | 36,895                                    | 33,540   |
|                      | \$ 102,809                                | \$ 96,660  |
| <b>Gross profit:</b> |   |  |
| Retail               | \$ 28,188                                 | \$ 28,808  |
| Wholesale            | 9,396                                     | 7,026  |
|                      | \$ 37,584                                 | \$ 35,834  |
|                      | <b>May 1, 2010</b>                        | <b>January 30, 2010</b>                                  |
| <b>Total assets:</b> |   |  |
| Wholesale            | \$ 313,809                                | \$ 304,935   |
| Retail               | 237,913                                   | 230,935  |
|                      | \$ 551,722                                | \$ 535,870   |
| Eliminations (a)     | (251,698)                                 | (229,285)  |
| Consolidated assets  | \$ 300,024                                | \$ 306,585   |

(a) Adjustment to eliminate intercompany receivables and investment in subsidiaries

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**  
**Comparison of the Thirteen Weeks Ended May 1, 2010 with the Thirteen Weeks Ended May 2, 2009.**

**Net Sales**

|                        | Thirteen Weeks<br>Ended<br>May<br>1, 2010 | Percentage<br>of<br>Net Sales | Thirteen Weeks<br>Ended<br>May 2, 2009 | Percentage<br>of<br>Net Sales |
|------------------------|---|-------------------------------|--|-------------------------------|
|                        | (\$ in thousands)                         |                               |  |                               |
| Retail                 | \$ 65,914                                 | 64.1%                         | \$ 63,120                              | 65.3%                         |
| Wholesale              | 36,895                                    | 35.9%                         | 33,540                                 | 34.7%                         |
| <b>Total net sales</b> | <b>\$ 102,809</b>                         | <b>100.0%</b>                 | <b>\$ 96,660</b>                       | <b>100.0%</b>                 |

Net sales increased 6.4% from \$96.7 million in the thirteen weeks ended May 2, 2009 to \$102.8 million in the thirteen weeks ended May 1, 2010. The increase in sales was due to increases in both retail and wholesale sales as discussed below.

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Perfumania's retail sales increased from \$46.7 million for the thirteen weeks ended May 2, 2009 to \$52.0 million in the thirteen weeks ended May 1, 2010. Perfumania's comparable store sales increased by 7.4% during the thirteen weeks ended May 1, 2010. Comparable store sales measure sales from stores that have been open for one year or more. We exclude stores that are closed for renovation from comparable store sales from the month during which renovation commences until the first full month after reopening. The average retail price per unit sold during the thirteen weeks ended May 1, 2010 decreased 7% from the prior year's comparable period while the total number of units sold increased by 19%. We attribute the

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decrease in the average retail price per unit sold and the increase in the number of units sold to various store level pricing promotions. The average number of stores operated was 367 in the thirteen week period ended May 1, 2010, versus 359 in the prior year's comparable period, which contributed to the increase in retail sales.

SOW's consignment sales decreased approximately \$2.5 million for the thirteen weeks ended May 1, 2010 as compared to the thirteen weeks ended May 2, 2009.

The increase in wholesale sales of \$3.4 million is the result of an increase in product selection and the increase in financial resources becoming available to our wholesale customers as a result of improving economic conditions, which enables them to purchase more.

**Gross Profit**

|                           | <b>Thirteen Weeks<br/>Ended<br/>May<br/>1, 2010</b> | <b>Thirteen Weeks<br/>Ended<br/>May 2, 2009</b> |
|---------------------------|---|---|
|                           | (in thousands)                                      |   |
| Retail                    | \$ 28,188   | \$ 28,808                                       |
| Wholesale                 | 9,396   | 7,026   |
| <b>Total gross profit</b> | <b>\$ 37,584</b>                                    | <b>\$ 35,834</b>                                |

**Gross Profit Percentages**

|                                      | <b>Thirteen Weeks<br/>Ended<br/>May 1, 2010</b> | <b>Thirteen Weeks<br/>Ended<br/>May 2, 2009</b> |
|--------------------------------------|---|---|
| Retail                               | 42.8%   | 45.6%   |
| Wholesale                            | 25.5%   | 21.0%   |
| <b>Total gross profit percentage</b> | <b>36.6%</b>                                    | <b>37.1%</b>                                    |

Gross profit increased 4.9% from \$35.8 million in the thirteen weeks ended May 2, 2009 (37.1% of total net sales) to \$37.6 million in the thirteen weeks ended May 1, 2010 (36.6% of total net sales). The increase in gross profit was due to the increase in wholesale sales volume as discussed above offset by a decrease in retail gross profit due to the decrease in SOW's consignment sales and gross profit.

Perfumania's retail gross profit for the thirteen weeks ended May 1, 2010 increased by 5.6% to \$23.3 million compared with the same period in 2009.

Selling, general and administrative expenses include payroll and related benefits for our distribution centers, sales, store operations, field management, purchasing and other corporate office and administrative personnel; rent, common area maintenance, real estate taxes and utilities for our stores, distribution centers and corporate office; advertising, consignment fees, sales promotion, insurance, supplies, freight out, and other administrative expenses. Selling, general and administrative expenses increased by \$0.7 million from \$38.7 million in thirteen weeks ended May 2, 2009 to \$39.4 million in the thirteen weeks ended May 1, 2010. Included in selling, general and administrative expenses are expenses in connection with the Service Agreement with Quality King, which were \$0.7 million for both the thirteen weeks ended May 1, 2010 and May 2, 2009.

Perfumania's selling, general and administrative expenses for the thirteen weeks ended May 1, 2010, increased by 0.8% to \$27.5 million compared to \$27.2 million in the same period of 2009. The increase was largely attributable to the higher store occupancy expenses incurred in the current period.



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Depreciation and amortization was approximately \$2.2 million in the thirteen weeks ended May 1, 2010, compared to \$2.5 million for the thirteen week period ended May 2, 2009.

Interest expense was approximately \$3.4 million for the thirteen weeks ended May 1, 2010 compared with approximately \$4.5 million for the thirteen weeks ended May 2, 2009. The interest rates on total variable interest debt decreased by approximately 0.2% during the thirteen weeks ended May 1, 2010 as compared to the thirteen weeks ended May 2, 2009.

Since the Company continues to record a full valuation allowance against all deferred tax assets, no income tax benefit was recorded during the thirteen week periods ended May 1, 2010 and May 2, 2009.

As a result of the foregoing, we realized a net loss of \$7.4 million in the thirteen weeks ended May 1, 2010, compared to a net loss of \$9.9 million in the thirteen weeks ended May 2, 2009.

**LIQUIDITY AND CAPITAL RESOURCES**

Our principal funding requirements are for inventory purchases, financing extended terms on accounts receivable, paying down accounts payable and debt, and to a lesser extent, opening new stores and renovation of existing stores. These capital requirements generally have been satisfied through borrowings under the respective revolving credit facilities and notes payable to affiliates, as described below. We believe that these resources will be adequate to meet our requirements in both the short and long term.

The Company has a \$250 million revolving credit facility with a syndicate of banks for which General Electric Capital Corporation ( GECC ) serves as Agent, Collateral Agent and Lender, GE Capital Markets, Inc. serves as Joint Lead Arranger and Book Runner and Wells Fargo Capital Finance serves as Joint Lead Arranger (the Senior Credit Facility ). The Senior Credit Facility is used for the Company s general corporate purposes and those of its subsidiaries, including working capital. The Company and certain of its subsidiaries are co-borrowers under the Senior Credit Facility, and the Company s other subsidiaries have guaranteed all of their obligations thereunder.

The Senior Credit Facility is scheduled to expire on August 11, 2011, when all amounts will be due and payable in full. The Senior Credit Facility does not require amortization of principal and may be paid before maturity in whole or in part at the Company s option without penalty or premium; provided that, if the Company permanently reduces the revolving commitment in connection with a prepayment after August 11, 2009 and on or before August 11, 2010, it must pay a prepayment fee equal to 0.5% of the prepayment.

Revolving loans under the Senior Credit Facility may be drawn, repaid and reborrowed up to the amount available under a borrowing base calculated with reference to a specified percentage of the borrowers eligible accounts and a specified percentage of the borrowers eligible inventory from time to time. GECC has the right to impose reserves in its reasonable credit judgment, whether or not there is an Event of Default, which would effectively reduce the borrowing base and thereby the amount that the borrowers may borrow under the Senior Credit Facility. Under an amendment to the Senior Credit Facility executed as of May 26, 2009 ( Waiver and Amendment No. 1 ), reserves against borrowing availability increasing from \$9 million to \$15 million at August 4, 2009 and thereafter will automatically apply, in addition to any reserves that may be imposed from time to time in GECC s reasonable credit judgment. The Senior Credit Facility also includes a sub-limit of \$25 million for letters of credit and a sub-limit of \$12.5 million for swing line loans (that is, same-day loans from the lead or agent bank).

As a result of the covenant defaults described below, which were waived by Waiver and Amendment No. 1, effective January 23, 2009, GECC elected to impose the Default Rate of interest on outstanding borrowings, which is 2% higher than the interest rate otherwise applicable. The Company was also required to pay fees equal to 0.375% of the unused amount of the Senior Credit Facility and the outstanding amount of letters of credit under that facility. Under Waiver and Amendment No. 1, the



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imposition of the Default Rate of interest was suspended and interest under the Senior Credit Facility for periods after May 26, 2009 will be, at the Company's election unless an event of default exists, either (i) the highest of (A) The Wall Street Journal prime rate, (B) the federal funds rate plus .50% or (C) the sum of 3-month LIBOR plus 1.00%, (the Index Rate), in each case plus 3.50% or (ii) the applicable LIBOR rate (but not less than 2.00%) plus 4.50%. The Company is also now required to pay fees equal to 1.00% of the unused amount of the Senior Credit Facility and 4.50% of the outstanding amount of any letters of credit under that facility.

All obligations of the Company under the Senior Credit Facility and under any interest rate protection or other hedging arrangements entered into in connection with the Senior Credit Facility are secured by a first priority perfected security interest in all existing and after-acquired personal property and owned real property owned by the Company and its subsidiaries, which are co-borrowers or guarantors, including, without limitation, 100% (or, in the case of excluded foreign subsidiaries, 66%) of the outstanding equity interests in their subsidiaries.

The Senior Credit Facility limits the Company's and its subsidiaries' ability to, among other things: incur additional indebtedness; incur liens or guarantee obligations; pay dividends and make other distributions; make investments and enter into joint ventures; dispose of assets; and engage in transactions with affiliates, except for certain existing arrangements under which the Company leases space and obtains certain business services from affiliated companies and other arrangements in the ordinary course of business. The Senior Credit Facility also provides that advances to suppliers by the Company and its subsidiaries may not exceed \$8 million with respect to all suppliers or \$3 million with respect to any one supplier (together with its affiliates).

Under the Senior Credit Facility, the Company and its subsidiaries have been required to maintain certain financial ratios, as specified in the agreement. The Company was not in compliance with certain of these ratios as of November 1, 2008 and January 31, 2009. In order to better align the provisions of the Senior Credit Facility with the Company's current business situation, Waiver and Amendment No. 1 waived the covenant defaults and certain other defaults under the facility, provided for no testing of the minimum fixed charge coverage ratio, the inventory turnover ratio or the maximum leverage ratio covenants for the fiscal quarter ended May 2, 2009, deleted the inventory turnover ratio covenant and the maximum leverage ratio covenant thereafter, and suspended the minimum fixed charge coverage ratio covenant until the fiscal quarter ending January 30, 2010. The Company was in compliance with the minimum fixed charge coverage ratio covenant under the Senior Credit Facility as of May 1, 2010.

The Senior Credit Facility also includes other customary events of default that, if not waived, would permit the lenders to accelerate the indebtedness and terminate the credit facility. Any future defaults that are not waived could result in our having to refinance the Senior Credit Facility and obtain an alternative source of financing. Due to the current weakness in the credit markets, there is no assurance that such financing would be obtained, or if such refinancing is obtained, that the terms of a new facility would be on terms comparable to the current Senior Credit Facility. If the Company were unable to obtain such financing, its operations and financial condition would be materially adversely affected and it would be forced to seek an alternative source of liquidity, such as by selling additional securities, to continue operations, or to limit its operations.

On August 11, 2008, six estate planning trusts established by Glenn, Stephen and Arlene Nussdorf (the Nussdorf Trusts) loaned an aggregate of approximately \$55 million to the Company on an unsecured basis. At the same time, we issued an unsecured subordinated promissory note in the principal amount of \$35 million to Quality King. All of the subordinated promissory notes issued to the Nussdorf Trusts and Quality King are subordinated to the Senior Credit Facility and, pursuant to amendments as of May 26, 2009, no payments of principal or interest may be made before the maturity of the Senior Credit Facility on August 11, 2011. The maturity date of the subordinated promissory notes payable to the Nussdorf Trusts is February 8, 2012 and that of the note payable to Quality King is June 30, 2012. The Nussdorf Trusts notes bear interest at a rate equal to 2% over the rate in effect from time to time on the revolving loans under the Senior Credit Facility, and the Quality King note bears interest at a rate equal to 1% over the rate in effect from time to time on the revolving loans under the Senior Credit Facility. Quality King and the Nussdorf Trusts have acknowledged that the Company's nonpayment, because of the subordination provisions, of amounts otherwise due under these notes will not constitute a default under the notes.

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On December 9, 2004, E Com issued a Subordinated Convertible Note (the Convertible Note ) to Glenn and Stephen Nussdorf in exchange for a \$5 million subordinated secured demand loan made in March 2004. The Convertible Note was originally secured by E Com s assets, but, in connection with the August 11, 2008 financing transactions, Glenn and Stephen Nussdorf released and terminated their security interest. The Convertible Note was originally payable in January 2007; however it was modified in January 2006 to extend the due date to January 2009. The Convertible Note is subordinate to all bank related indebtedness and, pursuant to a May 26, 2009 amendment, no payments of principal or interest may be made before the maturity of the Senior Credit Facility on August 11, 2011. As a result, the Convertible Note is currently in default, resulting in an increase of 2% in the nominal interest rate, which is the prime rate plus 1%. The Convertible Note allows Glenn and Stephen Nussdorf to convert any or all of the principal and accrued interest due on the Convertible Note into shares of the Company s common stock. The conversion price was originally \$11.25, which equaled the closing market price of E Com s common stock on December 9, 2004, and was reduced to \$7.00 by the May 26, 2009 amendment.

Accrued interest payable due at May 1, 2010 and January 30, 2010 on the Nussdorf Trust Notes, the Quality King Note and the Convertible Note was approximately \$12.7 million and \$10.9 million, respectively.

Net cash used in operating activities during the thirteen weeks ended May 1, 2010 was approximately \$7.0 million, compared with approximately \$23.3 million provided by operating activities during the thirteen weeks ended May 2, 2009. Accounts receivable decreased due to the timing of shipments to our wholesale customers. The decrease in accounts payable-affiliates is due to repayments of accounts payable from cash generated from operations. Inventory levels during the thirteen weeks ended May 2, 2009 decreased by approximately \$26.6 million due to a planned reduction in inventory purchases.

Our purchases from related parties are generally payable in 90 days; however due to the seasonality of our business these terms are generally extended. Related party accounts have historically been brought closer to terms at the end of the holiday season. During the rest of the year, the Company has relied upon these extended terms to provide a portion of its liquidity.

Net cash used in investing activities was approximately \$0.6 million in the thirteen weeks ended May 1, 2010 compared to \$3.6 million in the thirteen weeks ended May 2, 2009. The current period s investing activities primarily represented spending for renovation of existing stores and new stores that either opened or were under construction during the thirteen weeks ended May 1, 2010. During the thirteen weeks ended May 1, 2010, Perfumania opened one new store, relocated one existing store and closed four stores. We plan to open approximately two stores for the remainder of fiscal 2010 and plan to close approximately one store.

Net cash provided by financing activities during the thirteen weeks ended May 1, 2010 was approximately \$7.0 million, primarily from net borrowings under our credit facility, compared with approximately \$22.2 million used in financing activities from net repayments for the thirteen weeks ended May 2, 2009.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our consolidated financial statements have been prepared in accordance with US GAAP. Preparation of these statements requires management to make judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, management evaluates its estimates, including those related to bad debts, inventories, asset impairments, sales returns and allowances, and other contingent assets and liabilities. As such, some accounting policies have a significant impact on amounts reported in these financial statements. The judgments and estimates made

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can significantly affect results. Materially different amounts might be reported under different conditions or by using different assumptions. We consider an accounting policy to be critical if it is both important to the portrayal of our financial condition and results of operations, and requires significant judgment and estimates by management in its application. We have identified certain critical accounting policies that affect the significant estimates and judgments used in the preparation of its financial statements. There have been no significant changes to our critical accounting policies and estimates as discussed in our Annual Report on Form 10-K for the year ended January 30, 2010.

### **FORWARD LOOKING STATEMENTS**

Some of the statements in this quarterly report, including those that contain the words anticipate, believe, plan, estimate, expect, should, and other similar expressions, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements of those of our industry to be materially different from any future results, performance or achievements expressed or implied by those forward-looking statements. Among the factors that could cause actual results, performance or achievement to differ materially from those described or implied in the forward-looking statements are our ability to integrate and achieve synergies between acquired businesses, our ability to service our obligations, our ability to comply with the covenants in our Senior Credit Facility, general economic conditions including a decrease in discretionary spending by consumers, competition, the ability to raise additional capital to finance our expansion and other factors included in our filings with the SEC, including the Risk Factors included in our 2009 Annual Report on Form 10-K. Those Risk Factors contained in our 2009 Annual Report on Form 10-K are incorporated herein by this reference to them. Copies of our SEC filings are available from the SEC or may be obtained upon request from us.

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

#### **ITEM 4. CONTROLS AND PROCEDURES**

##### **Management's Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures, as defined in SEC Rule 13a-15(e), which our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated as of the end of the fiscal quarter covered by this report. Those controls and procedures are designed to ensure, among other things, that information we are required to disclose in the reports that we file with the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Based on our management's evaluation of our disclosure controls and procedures as of May 1, 2010, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective.

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

There were no changes in our internal control over financial reporting during the quarter ended May 1, 2010 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**

None.

**ITEM 1A. RISK FACTORS**

Not applicable.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND PROCEEDS THEREOF**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. REMOVED AND RESERVED**

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

The exhibits listed in the following Exhibit Index are filed herewith.

- 3.1 Amended and Restated Articles of Incorporation, as amended through August 8, 2008 (Incorporated by reference to Exhibit 3.1 to the Company's Form 10-K filed July 2, 2009).
- 3.2 Bylaws (Incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (No 33-46833)).
- 31.1 Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification by Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**PERFUMANIA HOLDINGS, INC.**

**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.

**PERFUMANIA HOLDINGS, INC.**

(Registrant)

Date: June 15, 2010

By: /S/ Michael W. Katz  
Michael W. Katz  
President and Chief Executive Officer

(Principal Executive Officer)

By: /S/ Donna Dellomo  
Donna Dellomo  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

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**Exhibit Index**

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 31.1               | Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
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