

TILLY'S, INC.  
Form 10-K  
March 30, 2018

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended February 3, 2018

OR

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

Commission File Number: 001-35535

TILLY'S, INC.

(Exact name of registrant as specified in its charter)

Delaware	45-2164791
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
10 Whatney, Irvine, CA	92618
(Address of principal executive offices)	(Zip Code)
(949) 609-5599	
(Registrant's telephone number, including area code)	

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Class A Common Stock, \$0.001 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a nonaccelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "small reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act:

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Large accelerated filer:

Accelerated filer:

Nonaccelerated filer:  (Do not check if a smaller reporting company)

Smaller reporting company:

Emerging growth company:

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

As of July 29, 2017, the aggregate market value of voting stock held by non-affiliates of the registrant as of the last business day of the registrant's most recently completed second fiscal quarter, at July 29, 2017, was \$131,459,893 based on the closing sale price of \$10.12 per share at July 28, 2017.

As of March 28, 2018, the registrant had 15,106,824 shares of Class A common stock, par value \$0.001 per share, outstanding, and 14,028,497 shares of Class B common stock, par value \$0.001 per share, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the registrant's Annual Meeting of Stockholders to be held June 12, 2018 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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### Forward-Looking Statements

This annual report contains forward-looking statements that are subject to risks and uncertainties. All statements other than statements of historical or current fact included in this annual report are forward-looking statements.

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

- our ability to successfully open new stores and profitably operate our existing stores;
- our ability to attract customers to our e-commerce website;
- our ability to efficiently utilize our e-commerce fulfillment center;
- effectively adapting to new challenges associated with our expansion into new geographic markets;
- our ability to establish, maintain and enhance a strong brand image;
- generating adequate cash from our existing stores to support our growth;
- identifying and responding to new and changing customer fashion preferences and fashion-related trends;
- competing effectively in an environment of intense competition both in stores and online;
- containing the increase in the cost of mailing catalogs, paper and printing;
- the success of the malls, power centers, neighborhood and lifestyle centers, outlet centers and street-front locations in which our stores are located;
- our ability to attract customers in the various retail venues and geographies in which our stores are located;
- our ability to adapt to downward trends in traffic for our stores and changes in our customers' purchasing patterns;
- adapting to declines in consumer confidence and decreases in consumer spending;
- our ability to adapt to significant changes in sales due to the seasonality of our business;
- our ability to compete in social media marketing platforms;
- price reductions or inventory shortages resulting from failure to purchase the appropriate amount of inventory in advance of the season in which it will be sold;
- natural disasters, unusually adverse weather conditions, boycotts and unanticipated events;
- changes in the competitive environment in our industry and the markets we serve, including increased competition from other retailers;
- our dependence on third-party vendors to provide us with sufficient quantities of merchandise at acceptable prices;
- increases in costs of energy, transportation or utility costs and in the costs of labor and employment;
- our ability to balance proprietary branded merchandise with the third-party branded merchandise we sell;
- most of our merchandise is made in foreign countries, making price and availability of our merchandise susceptible to international trade conditions;
- failure of our vendors and their manufacturing sources to use acceptable labor or other practices;
- our dependence upon key executive management or our inability to hire or retain the talent required for our business;
- our ability to effectively adapt to our rapid expansion in recent years and our planned expansion;
- failure of our information technology systems to support our current and growing business, before and after our planned upgrades;
- disruptions in our supply chain and distribution center;
- our indebtedness and lease obligations, including restrictions on our operations contained therein;
- our reliance upon independent third-party transportation providers for certain of our product shipments;
- our ability to increase comparable store sales or sales per square foot, which may cause our operations and stock price to be volatile;

disruptions to our information systems in the ordinary course or as a result of systems upgrades;

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- our inability to protect our trademarks or other intellectual property rights;
- acts of war, terrorism or civil unrest;
- the impact of governmental laws and regulations and the outcomes of legal proceedings;
- our ability to secure the personal financial information of our customers and comply with the security standards for the credit card industry;
- our failure to maintain adequate internal controls over our financial and management systems; and
- continuing costs incurred as a result of being a public company.

We derive many of our forward-looking statements from our operating budgets and forecasts, which are based upon 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.

See “Risk Factors” for a more complete discussion of the risks and uncertainties mentioned above and for discussion of other risks and uncertainties. All forward-looking statements attributable to us are expressly qualified in their entirety by these cautionary statements as well as others made in this annual report and hereafter in our other SEC filings and public communications. You should evaluate all forward-looking statements made by us in the context of these risks and uncertainties.

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

## PART I

### Item 1. Business

Tillys is a leading destination specialty retailer of casual apparel, footwear and accessories for young men, young women, boys and girls. We believe we bring together an unparalleled selection of iconic global, emerging and proprietary brands rooted in an active and outdoor lifestyle. Our stores and website are designed to be a seamless extension of our teen and young adult consumers' lifestyles in a stimulating environment. Tillys is headquartered in Irvine, California and we operated 219 stores in 32 states as of February 3, 2018. Our stores are located in malls, lifestyle centers, 'power' centers, community centers, outlet centers and street-front locations. Customers may also shop online, where we feature the same assortment of products as is carried in our brick-and-mortar stores, supplemented by additional online-only styles. We believe our success across a variety of real estate venues and geographies in the United States demonstrates Tillys' portability. Our goal is to serve as a destination for the most relevant merchandise and brands important to our customers.

The Tillys concept began in 1982 when our co-founders, Hezy Shaked and Tilly Levine, opened their first store in Orange County, California. Tilly's, Inc., a Delaware corporation, conducted an initial public offering on May 2, 2012, becoming the publicly-traded entity that operates the Tillys business through its wholly-owned subsidiary, World of Jeans & Tops, a California corporation.

Our fiscal year ends on the Saturday closest to January 31. For example, "fiscal 2017" refers to the fiscal year ended February 3, 2018, "fiscal 2016" refers to the fiscal year ended January 28, 2017; and "fiscal 2015" refers to the fiscal year ended January 30, 2016.

As used in this annual report on Form 10-K, except where the context otherwise requires or where otherwise indicated, the terms "the Company", "World of Jeans and Tops", "WOJT", "we", "our", "us", and "Tillys" refer to World of Jeans & Tops before our initial public offering, and to Tilly's, Inc. and its subsidiary after our initial public offering.

#### Our Strengths

We believe that the following competitive strengths contribute to our success and distinguish us from our competitors: Destination retailer with a broad and differentiated assortment. We believe the combined depth and breadth of apparel, footwear and accessories offered at our stores exceeds the selection offered at many other specialty retailers. We offer an extensive selection of over 400 third-party lifestyle brands over the course of a given year, which are complemented by our proprietary brands. Our merchandise includes a wide assortment of brands, styles, colors, sizes and price points to ensure we have what our customers want every time they visit our stores. We offer a balanced mix of merchandise across the apparel, footwear and accessories categories serving young men, young women, boys and girls. We believe that by combining proven and emerging fashion trends and core style products with a vibrant blend of carefully selected music and visuals, we provide an in-store experience that is authentic, fun, and engaging for our core customers. We believe that our differentiated in-store environment, evolving selection of relevant brands, and broader and deeper assortment positions us as a retail destination that appeals to a larger demographic than many other specialty retailers and encourages customers to visit our stores more frequently and spend more on each trip. Dynamic merchandise model. We believe our extensive selection of third-party and proprietary merchandise allows us to identify and offer several trends simultaneously, offer a greater range of price points, and manage our inventories more dynamically. By closely monitoring trends and shipping product to our stores multiple times per week, we are able to adjust our merchandise mix based on store size and location. We also keep our merchandise mix relevant by introducing emerging brands not available at many other retailers. Our merchandising capabilities enable us to adjust our merchandise mix with a frequency that promotes a current look to our stores and website and encourages frequent visits.

Flexible real estate strategy across real estate venues and geographies. Our stores have proven to be successful in different real estate venues and geographies. We operate stores in malls, power centers, neighborhood and lifestyle centers, outlet centers and street-front locations across 85 markets in 32 states. We believe our success operating in these different retail venues and geographies demonstrates the portability of the Tillys brand.

Multi-pronged marketing approach. We utilize a multi-pronged marketing strategy to connect with our customers and drive traffic to our stores and online platforms. We distribute catalogs, newspapers and postcards to potential and

existing customers from our proprietary database to familiarize them with the Tillys brand, our products, and to drive traffic to our stores and website. We offer an integrated digital platform between our online and mobile applications for our customers to shop how and when they like and to drive further connection with them. We partner and collaborate with our vendors on exclusive, compelling in-store events and contests to build credibility with our target customers, actively involve them in our brands, and enhance the connection between Tillys and our customers' active lifestyle. We use social media to communicate directly with our customers while also encouraging customers to interact with one another and provide



feedback on our events and products. We have a customer loyalty program to further engage with our customers, build customer loyalty, reward our most loyal customers, and gain customer insights. All of these programs are complemented by digital and email marketing, as well as print advertising, to build customer awareness and loyalty, highlight key merchandise offerings, drive traffic to our stores and online platforms, and promote the Tillys brand. Also, through our “We Care Program”, we support and participate in various academic, art, and athletic programs at local schools and other organizations in communities surrounding our stores.

Systems and distribution/fulfillment infrastructure to support growth. We have previously made investments in distribution, fulfillment and allocation infrastructure that we believe are adequate to support continued growth for several years. Our distribution center allows us to quickly sort and process merchandise and deliver it to our stores in a floor-ready format for immediate display. We also have a dedicated e-commerce fulfillment center to support our future online growth potential. Our systems enable us to respond to changing fashion trends, manage inventory in real time, and provide a customized selection of merchandise at each location. We believe our distribution and fulfillment infrastructure can support significant growth in our stores and e-commerce platform with minimal incremental capital investment.

Experienced management team. Our senior management team, led by Hezy Shaked and Edmond Thomas, has extensive experience across a wide range of disciplines in the specialty retail and direct-to-consumer industries, including store operations, merchandising, distribution, real estate, and finance. Mr. Shaked, our Co-Founder, Executive Chairman of the Board of Directors, and Chief Strategy Officer, plays an important role in developing our long-term growth initiatives and cultivating our unique culture. Mr. Thomas, our President and Chief Executive Officer, rejoined Tillys in October 2015 with over 30 years of retail experience. He previously served as our President and Co-Chief Executive Officer from September 2005 to October 2007.

#### Growth Strategy

We are pursuing several strategies to drive long-term sales and profitability, including:

**Drive Comparable Store Sales.** We seek to maximize our comparable store sales by consistently offering new, on-trend and relevant merchandise, including exclusive and proprietary branded merchandise, across a broad assortment of categories, increasing our brand awareness through our multi-pronged marketing approach, providing an authentic store and online experience for our core customers, and maintaining a high level of customer service. We believe the combination of these factors, together with the operating strategies described below, will improve our comparable store sales results over time.

**Increase Our Operating Margins.** We believe we have the opportunity to drive operating margin expansion through scale efficiencies and continued process improvements. We believe comparable store sales increases will permit us to take advantage of largely fixed occupancy costs, favorable buying costs from larger volume purchases, leverage of our costs for store management and corporate overhead, as well as the fixed portion of shipping and handling costs over higher sales volumes. In addition, we expect to improve operating margins and support growth by leveraging previous investments in infrastructure, including our dedicated fulfillment center for e-commerce, upgraded e-commerce platform, ongoing investments to upgrade our point-of-sale, merchandise allocation and merchandise planning systems. We also will continue to use established business processes to identify and execute initiatives focused on lowering our unit costs and improving operational efficiency throughout our organization.

**Continue Growing E-Commerce.** We believe our e-commerce platform is an extension of our brand and retail stores, providing our customers a seamless shopping experience. Our e-commerce platform allows us to provide our customers with extensions of the same assortment offered in our brick-and-mortar stores, reach new customers, and build our brand in markets where we currently do not have stores. For example, we generate e-commerce sales in all 50 states although we have physical stores in only 32 states. Our target customer regularly shops online and via mobile devices in addition to visiting stores, giving us a continued opportunity to grow our e-commerce platform over time. In fiscal 2017, we commenced implementation of a new platform for our e-commerce website. In fiscal 2018, we plan to upgrade our mobile application to provide an enhanced customer experience. Key factors we expect to drive growth include continuing our catalog, online and mobile application marketing efforts, enhancing the efficiency and responsiveness of our digital capabilities, and supplementing the assortment available in our brick-and-mortar stores with additional online-only styles. We also expect to expand marketing efforts and build

brand awareness in the communities surrounding our existing stores to drive growth in both brick-and-mortar and e-commerce sales.

**Improve Inventory Management.** We believe we can improve our operating results through improved micro-merchandising based on specific store characteristics. We regularly update individual store profiles for every store to highlight the differences in brand performance, gender penetrations, and customer interests that exist within our fleet of stores. By adapting allocation strategies to capitalize on these individual store differences, we believe we can improve sales results in our existing store base.

**Develop Omni-Channel Capabilities.** We have a direct-to-consumer program that allows online orders to be fulfilled and shipped directly to our customers from our brick-and-mortar stores when inventory is otherwise unavailable in our e-commerce fulfillment center. In addition, during fiscal 2017, we invested in additional omni-channel capabilities allowing for online orders to be picked up in stores at our customers' discretion, allowing us to satisfy an order from existing inventories within our stores as well as shipping product from our e-commerce fulfillment center to our stores. We believe these omni-channel capabilities will drive additional traffic to our stores and increase sales opportunities with customers who come to the store to pick up their online orders.

**Reinvest in Existing Stores.** We believe that re-investing in our existing stores is strategically important to enhance customer loyalty, elevate the customer experience and, in turn, drive additional comparable store sales. We have remodeled or refreshed many of our stores in recent years, and intend to continue to do so in the future to keep the physical representation of the Tillys brand updated and compelling for our customers.

**Real Estate Opportunities.** With 219 total stores at the end of fiscal 2017, we believe there are numerous attractive opportunities for Tillys to continue to open new stores in the future. During fiscal 2018, we plan to open up to 15 new stores. Additionally, we expect to open three RSQ-branded pop-up stores to improve the brand awareness of both Tillys and our proprietary RSQ brand. With regard to existing stores, we have an aggregate of approximately 120 lease decisions to make over the course of fiscal 2018 and 2019 covering a range of stores across all markets. These lease decisions include lease extension options, lease kick-out options, and lease expirations that require negotiated renewals. In each case, our real estate decisions will be driven by the overarching goal of improving our profitability. As a result, we may likely close stores from time to time if acceptable levels of profitability cannot be obtained through occupancy negotiations with landlords.

#### Merchandising, Purchasing, and Planning and Allocation

##### Merchandising

We seek to be viewed by our customers as the destination for the apparel, footwear and accessories that best represent their active, connected lifestyle. We believe we offer an unparalleled selection of relevant brands, styles, colors, sizes and price points to ensure we have what our customers want every time they visit our stores. Our extensive selection of third-party and proprietary merchandise allows us to identify and address trends more quickly, offer a greater range of price points and manage our inventories more dynamically. We offer a balanced mix of merchandise for young men, young women, boys and girls across the apparel, footwear and accessories categories. We believe this category mix contributes to our broad demographic appeal. Our apparel merchandise includes branded, fashion and core styles for tops, outerwear, bottoms, and dresses. Accessories merchandise includes backpacks, hats, sunglasses, headphones, handbags, watches, jewelry and more. We focus on our merchandise presentation and vary the visual displays in our stores and windows throughout the month, presenting new looks and fashion combinations to our customers.

Our ability to maintain an image consistent with our customers' lifestyle is important to our branded vendors and provides us better access to a wide assortment of products and styles. Our third-party branded merchandise includes a selection of over 400 globally recognized, lifestyle, and emerging brands over the course of a year. In each of the last three fiscal years, over 100 of these brands each generated net sales in excess of \$0.5 million for us. We strive to keep our merchandise mix current by continuously introducing emerging brands and styles not available at many other specialty retailers in order to identify and respond to the evolving desires of our customers. Our third-party brands represented approximately 74%, 72% and 72% of our total net sales in fiscal 2017, 2016 and 2015, respectively. No single third-party brand exceeded 7% of our total net sales in the last three years.

Selected third-party brands include, in alphabetical order:

- AYC
- Adidas
- Billabong
- Brixton
- Converse
- Diamond Supply
- Dickies
- Ethika
- Jansport
- Levi's
- LRG
- Neff
- Nike SB
- Nixon
- O'Neill
- Primitive
- Roxy
- RVCA
- Salty Crew
- Santa Cruz
- Spy
- Stance
- The North Face
- Vans

- G-Shock
- Hurley
- HUF
- RayBan
- Riot Society
- Rip Curl
- Volcom
- ...and many more

We supplement our third-party merchandise assortment with our own proprietary brands across many of our product categories. We utilize our own branded merchandise to expand our price point range, identify and respond to changing fashion trends quickly, fill merchandise gaps and provide a deeper selection of styles and colors for proven fashion items. Our proprietary brands represented approximately 26%, 28% and 28% of our total net sales in fiscal 2017, 2016 and 2015, respectively.

Examples of our proprietary branded merchandise include:

Brand Category

Denim, apparel and fragrance brand for young men, young women and kids

Apparel and accessories brand for young women and girls

Apparel and accessories brand for young men and boys

Fragrance brand for young men

Apparel and fragrance brand for young women