Vera Bradley, Inc.
Form 10-Q
December 12, 2018
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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 November 3, 2018
OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From to
Commission File Number: 001-34918

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

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

(877) 708-8372
(Registrant's telephone number, including area code)
None
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨
		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 Exchange Act). Yes ¨ No x

The registrant had 34,666,924 shares of its common stock outstanding as of December 5, 2018.

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FORWARD-LOOKING STATEMENTS

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

- possible inability to successfully implement our long-term strategic plan, including our Vision 20/20 initiatives;
- possible continued declines in our comparable sales;
- possible inability to maintain and enhance our brand;
- possible failure of our multi-channel distribution model;
- possible adverse changes in general economic conditions and their impact on consumer confidence and consumer spending;
- possible inability to predict and respond in a timely manner to changes in consumer demand;
- possible inability to successfully open new stores and/or operate current stores as planned;
- possible loss of key management or design associates or inability to attract and retain the talent required for our business;
- possible ramifications from the payment card incident disclosed in October 2016;
- possible data security or privacy breaches or disruptions in our computer systems or website; and
- possible new or increased tariffs on our products that could lead to increased product costs and lower profit margins.

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

For a discussion of risks and uncertainties that could cause actual results to differ materially from those contained in our forward-looking statements, please refer to "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the fiscal year ended February 3, 2018.

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

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	November 3, 2018	February 3, 2018
Assets		
Current assets:		
Cash and cash equivalents	$ 62,314	$ 68,751
Short-term investments	46,026	54,150
Accounts receivable, net	23,514	15,566
Inventories	96,275	87,838
Income taxes receivable	5,314	4,391
Prepaid expenses and other current assets	10,620	11,327
Total current assets	244,063	242,023
Property, plant, and equipment, net	79,936	86,463
Long-term investments	23,247	15,515
Deferred income taxes	4,687	5,385
Other assets	1,076	1,283
Total assets	$ 353,009	$ 350,669
Liabilities and Shareholders’ Equity		
Current liabilities:		
Accounts payable	$ 14,651	$ 13,503
Accrued employment costs	9,587	13,616
Other accrued liabilities	13,733	12,343
Income taxes payable	1,292	812
Total current liabilities	39,263	40,274
Long-term liabilities	23,864	25,112
Total liabilities	63,127	65,386
Commitments and contingencies		
Shareholders’ equity:		
Preferred stock; 5,000 shares authorized, no shares issued or outstanding	—	—
Common stock, without par value; 200,000 shares authorized, 41,282 and 41,102 shares issued and 34,856 and 35,459 shares outstanding, respectively	—	—
Additional paid-in-capital	94,342	91,192
Retained earnings	283,375	270,783
Accumulated other comprehensive loss	(143)	(114)
Treasury stock	(87,692)	(76,578)
Total shareholders’ equity	289,882	285,283
Total liabilities and shareholders’ equity	$ 353,009	$ 350,669

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

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

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 3, 2018	October 28, 2017	November 3, 2018	October 28, 2017
Net revenues	$97,688	$114,095	$297,904	$322,648
Cost of sales	40,536	50,266	126,396	142,826
Gross profit	57,152	63,829	171,508	179,822
Selling, general, and administrative expenses	51,866	63,511	156,341	181,029
Other income	57	144	280	574
Operating income (loss)	5,343	462	15,447	(633)
Interest income, net	(175)	(122)	(677)	(257)
Income (loss) before income taxes	5,518	584	16,124	(376)
Income tax expense	1,292	225	3,986	1,121
Net income (loss)	$4,226	$359	$12,138	$(1,497)
Basic weighted-average shares outstanding	35,219	35,885	35,431	36,081
Diluted weighted-average shares outstanding	35,496	35,959	35,654	36,081
Basic net income (loss) per share	$0.12	$0.01	$0.34	$(0.04)
Diluted net income (loss) per share	$0.12	$0.01	$0.34	$(0.04)

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

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

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	November 3, 2018	October 28, 2017	November 3, 2018	October 28, 2017
Net income (loss)	$ 4,226	$ 359	$ 12,138	$ (1,497)
Unrealized (loss) gain on available-for-sale debt investments	(43)	(22)	(31)	12
Cumulative translation adjustment	9	7	2	(10)
Comprehensive income (loss), net of tax	$ 4,192	$ 344	$ 12,109	$ (1,495)

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

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

	Thirty-Nine Weeks Ended	
	November 3, 2018	October 28, 2017
Cash flows from operating activities		
Net income (loss)	$12,138	$ (1,497)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation of property, plant, and equipment	12,402	14,992
Impairment charges	—	5,852
Provision for doubtful accounts	154	138
Stock-based compensation	3,697	2,522
Deferred income taxes	540	7
Cash gain on investments	32	154
Other non-cash charges, net	266	38
Changes in assets and liabilities:		
Accounts receivable	(7,442)	(4,205)
Inventories	(8,688)	2,162
Prepaid expenses and other assets	1,074	670
Accounts payable	1,313	(11,085)
Income taxes	(443)	84
Accrued and other liabilities	(3,440)	(2,341)
Net cash provided by operating activities	11,603	7,491
Cash flows from investing activities		
Purchases of property, plant, and equipment	(6,605)	(8,923)
Purchases of investments	(55,144)	(44,412)
Proceeds from maturities and sales of investments	55,209	37,600
Net cash used in investing activities	(6,540)	(15,735)
Cash flows from financing activities		
Tax withholdings for equity compensation	(547)	(610)
Repurchase of common stock	(10,795)	(6,126)
Payments of debt-issuance costs	(160)	(113)
Net cash used in financing activities	(11,502)	(6,849)
Effect of exchange rate changes on cash and cash equivalents	2	(10)
Net decrease in cash and cash equivalents	(6,437)	(15,103)
Cash and cash equivalents, beginning of period	68,751	86,375
Cash and cash equivalents, end of period	$62,314	$ 71,272
Supplemental disclosure of cash flow information		
Cash paid for income taxes, net	$3,921	$ 852
Supplemental disclosure of non-cash activity		
Non-cash operating, investing, and financing activities		
Repurchase of common stock		
Expenditures incurred but not yet paid as of November 3, 2018 and October 28, 2017	$319	$ 138
Expenditures incurred but not yet paid as of February 3, 2018 and January 28, 2017	$—	$ —
Purchases of property, plant, and equipment		

Expenditures incurred but not yet paid as of November 3, 2018 and October 28, 2017	$455	$ 1,779
Expenditures incurred but not yet paid as of February 3, 2018 and January 28, 2017	$1,183	$ 2,204

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

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

1. Description of the Company and Basis of Presentation

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

Vera Bradley is a leading designer of women's handbags, luggage and travel items, fashion and home accessories, and unique gifts. Founded in 1982 by friends Barbara Bradley Baekgaard and Patricia R. Miller, the brand's innovative designs, iconic patterns, and brilliant colors continue to inspire and connect women.

Vera Bradley offers a unique, multi-channel sales model, as well as a focus on service and a high level of customer engagement. The Company sells its products through two reportable segments: Direct and Indirect. The Direct business consists of sales of Vera Bradley products through the Company's full-line and factory outlet stores in the United States; verabradley.com; the Company's online outlet site; and the Company's annual outlet sale in Fort Wayne, Indiana. As of November 3, 2018, the Company operated 102 full-line stores and 57 factory outlet stores. The Indirect business consists of sales of Vera Bradley products to approximately 2,300 specialty retail locations, substantially all of which are located in the United States, as well as department stores, national accounts, third-party e-commerce sites, third-party inventory liquidators, and royalties recognized through licensing agreements.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been condensed or omitted as permitted by such rules and regulations. These interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2018, filed with the SEC.

The interim financial statements reflect all adjustments that are, in the opinion of management, necessary to present fairly the results for the interim periods presented. All such adjustments are of a normal, recurring nature. The results of operations for the thirteen and thirty-nine weeks ended November 3, 2018, are not necessarily indicative of the results to be expected for the full fiscal year.

Principles of Consolidation

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

Fiscal Periods

The Company's fiscal year ends on the Saturday closest to January 31. References to the fiscal quarters ended November 3, 2018 and October 28, 2017, refer to the thirteen-week periods ended on those dates.

Revenue Recognition and Accounts Receivable

Vera Bradley product sales to Direct and Indirect customers, including amounts billed to customers for shipping fees, as well as royalties from the Company's licensing arrangements, are included in net revenues. Costs related to shipping of product are classified in cost of sales in the Condensed Consolidated Statements of Operations. The Company has elected to treat shipping and handling activities that occur after the customer has obtained control of a good as an activity to fulfill the promise to transfer the product rather than as an additional promised service. Net revenues exclude sales taxes collected from customers and remitted to governmental authorities from the transaction price.

Revenue from the sale of the Company's products is recognized when control of the promised goods or services is transferred to customers, in the amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. Revenue is recognized using the five-step model identified in Accounting Standards Codification ("ASC") Topic 606. These steps are: (i) identify the contract with the customer; (ii) identify the performance obligations; (iii) determine the transaction price; (iv) allocate the transaction price to each performance obligation; and (v) recognize revenue as the performance obligations are satisfied.

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Vera Bradley, Inc.
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(unaudited)

The Company collects payment at the point of sale for full-line and factory outlet store transactions and upon shipment for e-commerce transactions. The Company generally collects payment in arrears in accordance with established payment terms for each customer within the Indirect segment.

Historical experience provides the Company the ability to reasonably estimate the amount of product sales that customers will return. Product returns are often resalable through multiple channels. Additionally, the Company reserves for customer allowances for certain Indirect retailers based upon various contract terms and other potential product credits granted to Indirect retailers.

The Company establishes an allowance for doubtful accounts based on historical experience and customer-specific identification and believes that collections of receivables, net of the allowance for doubtful accounts, are reasonably assured. The allowance for doubtful accounts was approximately $0.3 million and $0.9 million as of November 3, 2018 and February 3, 2018, respectively.

The Company sells gift cards with no expiration dates to customers and does not charge administrative fees on unused gift cards. Gift cards issued by the Company are recorded as a liability until they are redeemed, at which point revenue is recognized. In addition, the Company recognizes revenue on estimated unredeemed gift cards based upon the historical patterns of gift card redemption. During the thirteen and thirty-nine weeks ended November 3, 2018, the Company recorded an immaterial amount of revenue related to gift card breakage. Gift card breakage is included in net revenues in the Condensed Consolidated Statements of Operations, as well as Direct segment net revenues for the current-year period. The Company did not recognize gift card breakage revenue within net revenues in the comparable prior-year period as ASC Topic 606 was adopted using the modified retrospective transition approach with an immaterial adjustment to fiscal 2019 beginning retained earnings. Refer to Note 2 herein for additional information regarding the Company’s net revenues and its policies.

Operating Leases and Tenant-Improvement Allowances

The Company has leases that contain rent holidays and predetermined, fixed escalations of minimum rentals. For each of these leases, the Company recognizes the related rent expense on a straight-line basis commencing on the date of initial possession of the leased property. The Company records the difference between the recognized rent expense and the amount payable under the lease as a deferred rent liability. As of November 3, 2018 and February 3, 2018, deferred rent liability was $12.9 million and is included within long-term liabilities on the Condensed Consolidated Balance Sheets.

The Company receives tenant-improvement allowances from some of the landlords of its leased properties. These allowances generally are in the form of cash received by the Company from its landlords as part of the negotiated lease terms. The Company records each tenant-improvement allowance as a deferred credit and amortizes the allowance on a straight-line basis as a reduction to rent expense over the term of the lease, commencing on the possession date. As of November 3, 2018 and February 3, 2018, the deferred lease credit liability was $13.5 million and $14.6 million, respectively. Of these amounts, $2.6 million and $2.4 million is included within other accrued liabilities as of November 3, 2018 and February 3, 2018, respectively; $10.9 million and $12.2 million is included within long-term liabilities as of November 3, 2018 and February 3, 2018, respectively.

Recently Issued Accounting Pronouncements

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers. This guidance requires companies to recognize revenue in a manner that depicts the transfer of promised goods or services to customers in amounts that reflect the consideration to which a company expects to be entitled in exchange for those goods or services. The standard also requires enhanced disclosures about the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The standard allows for either a full retrospective or a modified retrospective transition method. In August 2015, the FASB issued ASU 2015-14 to defer the effective date of ASU 2014-09 for all entities by one year to annual periods beginning after December 15, 2017, including interim periods within that reporting period, which for the Company was February 4, 2018 (the beginning of the Company’s fiscal 2019).

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The Company adopted this standard in the first quarter of fiscal 2019 using the modified retrospective method with a $0.5 million cumulative adjustment to beginning retained earnings. As a result of this adoption method, the prior-year period presented in the Company's Condensed Consolidated Financial Statements was not recast.

The Company no longer adjusts revenue for shipments not yet received at each reporting period as it recognizes revenue as control is passed to the customer. It was determined that control is passed to the customer upon shipment, consistent with when legal title is passed. This accelerates the recognition of revenue at each reporting period compared to the Company's historical practice.

Revenue for unredeemed gift cards is estimated and recognized based on the historical patterns of gift card redemption. Historically, the Company recognized revenue for gift card breakage when the likelihood of the customer exercising their remaining rights became remote. The new revenue standard results in accelerated recognition of gift card breakage revenue at each reporting period compared to the Company's historical practice.

Revenue associated with contractually guaranteed minimum royalties in sales-based royalty arrangements is recognized straight-line over the remaining license period once determined that the minimum sales level will not be achieved. Historically, the Company recognized any excess of the guaranteed minimum royalty over the actual royalties earned at the end of the license period.

Certain liabilities for estimated product returns have been re-classified to other accrued liabilities from a contra-asset within accounts receivable, net, as of the adoption date.

Refer to Note 2 herein for additional information regarding the adoption of ASC 606.

Recently Issued Accounting Pronouncements Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, Leases, which increases transparency and comparability among organizations by requiring lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by leases and disclosing key information about leasing arrangements. This guidance is effective for interim and annual periods beginning on or after December 15, 2018. In July 2018, the FASB issued ASU 2018-11 for targeted improvements, including the option of allowing entities to initially apply the new leases standard at the adoption date (February 3, 2019 for the Company) and recognize a cumulative-effect adjustment to the opening balance of retained earnings. The Company plans to adopt the standard using this adoption method and is on track to adopt the standard on February 3, 2019. In addition, the Company anticipates electing certain practical expedients and transition reliefs, including the short-term lease recognition exemption, which excludes leases with a term of 12 months or less from recognition on the balance sheet, recognizing lease components and nonlease components together as a single lease component, and the transition relief package which, among other things, includes not reassessing the lease classification or whether a contract is or contains a lease.

The Company has operating leases at all of its retail stores; therefore, the adoption of this standard will result in a material increase of assets and liabilities on the Company's Consolidated Balance Sheets. The Company is continuing to evaluate the impact on its consolidated results of operations and cash flows.

In August 2018, the FASB issued ASU 2018-13, Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurements. The amendments in this update remove, modify, and add certain disclosure requirements to ASC 820, Fair Value Measurement. This guidance is effective for interim and annual periods beginning on or after December 15, 2019 (fiscal 2021). Early adoption is permitted, and certain amendments are to be adopted prospectively for only the most recent annual or interim period presented in the initial year of adoption or retrospectively. The Company is currently evaluating the impact of the guidance on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, Customers Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract, which aligns the requirements for capitalizing or expensing implementation costs in hosting arrangements (regardless of whether they convey a license to the hosted software) with capitalizing or expensing implementation costs incurred to develop or obtain internal-use software. This guidance is effective for interim and annual periods beginning on or after December 15, 2019 (fiscal 2021). Early adoption is permitted, and the amendments can be adopted either retrospectively or prospectively. The Company is currently evaluating the impact of the guidance on its consolidated financial statements.

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Vera Bradley, Inc.
Notes to the Condensed Consolidated Financial Statements
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2. Revenue from Contracts with Customers

The Company adopted ASC Topic 606 beginning in the first quarter of fiscal 2019 using the modified retrospective adoption method. Accordingly, disclosures herein required by the standard were excluded for the prior-year period.

The following tables illustrate the financial statement line items that were impacted as a result of the adoption of ASC 606 as of and for the thirteen and thirty-nine weeks ended November 3, 2018. These adjustments are a result of adjusting for shipments not yet received by customers, gift card breakage revenue, and the re-classification of certain liabilities for estimated product returns, which are further described in Note 1 herein (schedules in thousands).

	November 3, 2018		
	As Reported	Adjustments	Balances Under Prior U.S. GAAP
Condensed Consolidated Balance Sheet			
Accounts receivable, net	$23,514	$ (2,739)	$20,775
Inventories	96,275	951	97,226
Income taxes receivable	5,314	328	5,642
Total current assets	244,063	(1,460)	242,603
Deferred income taxes	4,687	118	4,805
Total assets	353,009	(1,342)	351,667
Other accrued liabilities	13,733	11	13,744
Total current liabilities	39,263	11	39,274
Total liabilities	63,127	11	63,138
Retained earnings	283,375	(1,353)	282,022
Total shareholders’ equity	289,882	(1,353)	288,529
Total liabilities and shareholders’ equity	353,009	(1,342)	351,667

	Thirteen Weeks Ended November 3, 2018		
	As Reported	Adjustments	Amounts Under Prior U.S. GAAP
Condensed Consolidated Statement of Operations			
Net revenues	$97,688	$ 1,027	$98,715
Cost of sales	40,536	392	40,928
Gross profit	57,152	635	57,787
Operating income	5,343	635	5,978
Income before income taxes	5,518	635	6,153
Income tax expense	1,292	155	1,447
Net income	4,226	480	4,706

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(unaudited)

	Thirty-Nine Weeks Ended November 3, 2018		
	As Reported	Adjustments	Amounts Under Prior U.S. GAAP
Condensed Consolidated Statement of Operations			
Net revenues	$297,904	$ (1,887)	$296,017
Cost of sales	126,396	(700)	125,696
Gross profit (loss)	171,508	(1,187)	170,321
Operating income (loss)	15,447	(1,187)	14,260
Income (loss) before income taxes	16,124	(1,187)	14,937
Income tax expense (benefit)	3,986	(288)	3,698
Net income (loss)	12,138	(899)	11,239

	Thirty-Nine Weeks Ended November 3, 2018		
	As Reported	Adjustments	Amounts Under Prior U.S. GAAP
Condensed Consolidated Statement of Cash Flows			
Cash flows from operating activities			
Net income (loss)	$12,138	$ (899)	$11,239
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Deferred income taxes	540	40	580
Changes in assets and liabilities:			
Accounts receivable	(7,442)	2,079	(5,363)
Inventories	(8,688)	(700)	