Phillips 66
Form 10-Q
May 02, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended March 31, 2013

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: 001-35349

Phillips 66
(Exact name of registrant as specified in its charter)

Delaware	45-3779385
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3010 Briarpark Drive, Houston, Texas 77042
(Address of principal executive offices) (Zip Code)
281-293-6600
(Registrant's telephone number, including area code)

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 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 [X] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [ ]

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

The registrant had 619,232,443 shares of common stock, $.01 par value, outstanding as of March 31, 2013.

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PART I. FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS

Consolidated Statement of Income Phillips 66

	Millions of Dollars Three Months Ended March 31	
	2013	2012
Revenues and Other Income		
Sales and other operating revenues*	$41,263	45,783
Equity in earnings of affiliates	1,039	734
Net gain on dispositions	1	2
Other income	23	1
Total Revenues and Other Income	42,326	46,520
Costs and Expenses		
Purchased crude oil and products	35,264	40,328
Operating expenses	978	1,092
Selling, general and administrative expenses	332	349
Depreciation and amortization	245	216
Impairments	24	43
Taxes other than income taxes*	3,324	3,420
Accretion on discounted liabilities	6	5
Interest and debt expense	70	13
Foreign currency transaction (gains) losses	2	(15)
Total Costs and Expenses	40,245	45,451
Income before income taxes	2,081	1,069
Provision for income taxes	671	431
Net income	1,410	638
Less: net income attributable to noncontrolling interests	3	2
Net Income Attributable to Phillips 66	$1,407	636
Net Income Attributable to Phillips 66 Per Share of Common Stock (dollars)**		
Basic	$2.25	1.01
Diluted	2.23	1.00
Dividends Paid Per Share of Common Stock (dollars)	$0.3125	—
Average Common Shares Outstanding (in thousands)**		
Basic	625,030	627,628
Diluted	631,288	634,645
* Includes excise taxes on petroleum products sales:	$3,258	3,321

**See Note 10—Earnings Per Share.
See Notes to Consolidated Financial Statements.

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Consolidated Statement of Comprehensive Income Phillips 66

	Millions of Dollars Three Months Ended March 31	
	2013	2012
Net Income	$1,410	638
Other comprehensive income (loss)		
Defined benefit plans		
Actuarial gain/loss:		
Amortization to net income of net actuarial loss	26	2
Plans sponsored by equity affiliates	(13)	3
Income taxes on defined benefit plans	(3)	(2)
Defined benefit plans, net of tax	10	3
Foreign currency translation adjustments	(322)	54
Income taxes on foreign currency translation adjustments	4	(20)
Foreign currency translation adjustments, net of tax	(318)	34
Hedging activities by equity affiliates	—	1
Income taxes on hedging activities by equity affiliates	—	—
Hedging activities by equity affiliates, net of tax	—	1
Other Comprehensive Income (Loss), Net of Tax	(308)	38
Comprehensive Income	1,102	676
Less: comprehensive income attributable to noncontrolling interests	3	2
Comprehensive Income Attributable to Phillips 66	$1,099	674

See Notes to Consolidated Financial Statements.

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Consolidated Balance Sheet Phillips 66

	Millions of Dollars	
	March 31 2013	December 31 2012
Assets		
Cash and cash equivalents	$4,753	3,474
Accounts and notes receivable (net of allowance of $49 million in 2013 and $50 million in 2012)	8,388	8,593
Accounts and notes receivable—related parties	1,522	1,810
Inventories	5,811	3,430
Prepaid expenses and other current assets	696	655
Total Current Assets	21,170	17,962
Investments and long-term receivables	10,498	10,471
Net properties, plants and equipment	15,257	15,407
Goodwill	3,344	3,344
Intangibles	727	724
Other assets	155	165
Total Assets	$51,151	48,073
Liabilities		
Accounts payable	$11,920	9,731
Accounts payable—related parties	1,218	979
Short-term debt	13	13
Accrued income and other taxes	1,010	901
Employee benefit obligations	238	441
Other accruals	552	417
Total Current Liabilities	14,951	12,482
Long-term debt	6,958	6,961
Asset retirement obligations and accrued environmental costs	703	740
Deferred income taxes	5,507	5,444
Employee benefit obligations	1,339	1,325
Other liabilities and deferred credits	315	315
Total Liabilities	29,773	27,267
Equity		
Common stock (2,500,000,000 shares authorized at $.01 par value)		
Issued (2013—633,238,946 shares; 2012—631,149,613 shares)		
Par value	6	6
Capital in excess of par	18,775	18,726
Treasury stock (at cost: 2013—14,006,503 shares; 2012—7,603,896 shares)	(738)	(356)
Retained earnings	3,923	2,713
Accumulated other comprehensive loss	(622)	(314)
Total Stockholders' Equity	21,344	20,775
Noncontrolling interests	34	31
Total Equity	21,378	20,806
Total Liabilities and Equity	$51,151	48,073

See Notes to Consolidated Financial Statements.

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Consolidated Statement of Cash Flows Phillips 66

	Millions of Dollars Three Months Ended March 31	
	2013	2012
Cash Flows From Operating Activities		
Net income	$1,410	638
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation and amortization	245	216
Impairments	24	43
Accretion on discounted liabilities	6	5
Deferred taxes	81	169
Undistributed equity earnings	77	(349)
Net gain on dispositions	(1)	(2)
Other	(34)	(178)
Working capital adjustments		
Decrease (increase) in accounts and notes receivable	285	(1,291)
Decrease (increase) in inventories	(2,442)	(1,518)
Decrease (increase) in prepaid expenses and other current assets	(71)	(183)
Increase (decrease) in accounts payable	2,466	1,996
Increase (decrease) in taxes and other accruals	167	93
Net Cash Provided by (Used in) Operating Activities	2,213	(361)
Cash Flows From Investing Activities		
Capital expenditures and investments	(387)	(218)
Proceeds from asset dispositions	9	6
Collection of advances/loans—related parties	55	—
Net Cash Used in Investing Activities	(323)	(212)
Cash Flows From Financing Activities		
Contributions from ConocoPhillips	—	891
Issuance of debt	—	5,794
Repayment of debt	(3)	(7)
Change in restricted cash	—	(6,050)
Issuance of common stock	(6)	—
Repurchase of common stock	(382)	—
Dividends paid on common stock	(194)	—
Other	—	(55)
Net Cash Provided by (Used in) Financing Activities	(585)	573
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(26)	—
Net Change in Cash and Cash Equivalents	1,279	—
Cash and cash equivalents at beginning of period	3,474	—
Cash and Cash Equivalents at End of Period	$4,753	—

See Notes to Consolidated Financial Statements.

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Consolidated Statement of Changes in Equity Phillips 66

	Millions of Dollars							
	Attributable to Phillips 66							
	Common Stock							
	Par Value	Capital in Excess of Par	Treasury Stock	Retained Earnings	Net Parent Company Investment	Accum. Other Comprehensive Income (Loss)	Noncontrolling Interests	Total
December 31, 2011	$—	—	—	—	23,142	122	29	23,293
Net income	—	—	—	—	636	—	2	638
Net transfers from ConocoPhillips	—	—	—	—	974	—	—	974
Other comprehensive income	—	—	—	—	—	38	—	38
March 31, 2012	$—	—	—	—	24,752	160	31	24,943
December 31, 2012	$6	18,726	(356)	2,713	—	(314)	31	20,806
Net income	—	—	—	1,407	—	—	3	1,410
Other comprehensive loss	—	—	—	—	—	(308)	—	(308)
Cash dividends paid on common stock	—	—	—	(194)	—	—	—	(194)
Repurchase of common stock	—	—	(382)	—	—	—	—	(382)
Benefit plan activity	—	52	—	(3)	—	—	—	49
Distributions to noncontrolling interests and other	—	(3)	—	—	—	—	—	(3)
March 31, 2013	$6	18,775	(738)	3,923	—	(622)	34	21,378

	Shares in Thousands	
	Common Stock Issued	Treasury Stock
December 31, 2012	631,150	7,604
Repurchase of common stock	—	6,403
Shares issued—stock-based compensation	2,089	—
March 31, 2013	633,239	14,007

See Notes to Consolidated Financial Statements.

Note 1—Separation and Basis of Presentation

The Separation
On April 4, 2012, the ConocoPhillips Board of Directors approved the separation of its downstream businesses (as defined below) into an independent, publicly traded company named Phillips 66. In accordance with the Separation and Distribution Agreement, the two companies were separated by ConocoPhillips distributing to its stockholders all 625,272,302 shares of common stock of Phillips 66 after the market closed on April 30, 2012 (the Separation). Each ConocoPhillips stockholder received one share of Phillips 66 stock for every two shares of ConocoPhillips stock. Following the Separation, ConocoPhillips retained no ownership interest in Phillips 66, and each company has had separate public ownership, boards of directors and management.

Basis of Presentation
Prior to the Separation, our results of operations, financial position and cash flows consisted of ConocoPhillips' refining, marketing and transportation operations; its natural gas gathering, processing, transmission and marketing operations, primarily conducted through its equity investment in DCP Midstream, LLC (DCP Midstream); its petrochemical operations, conducted through its equity investment in Chevron Phillips Chemical Company LLC (CPChem); its power generation operations; and an allocable portion of its corporate costs (together, the “downstream businesses”). These financial statements have been presented as if the downstream businesses had been combined for the 2012 period presented. All intercompany transactions and accounts within the downstream businesses were eliminated. The statement of income for the period prior to the Separation includes expense allocations for certain corporate functions historically performed by ConocoPhillips and not allocated to its operating segments, including allocations of general corporate expenses related to executive oversight, accounting, treasury, tax, legal, procurement and information technology. These allocations were based primarily on specific identification of time and/or activities associated with the downstream businesses, employee headcount or capital expenditures, and our management believes the assumptions underlying the allocations were reasonable. The combined financial statements may not necessarily reflect all of the actual expenses that would have been incurred had we been a stand-alone company during the period presented prior to the Separation. All financial information presented after the Separation represents the consolidated results of operations, financial position and cash flows of Phillips 66. Accordingly:

- Our consolidated statements of income, comprehensive income and cash flows for the three months ended March 31, 2013, consist entirely of the consolidated results of Phillips 66. Our consolidated statements of income, comprehensive income and cash flows for the three months ended March 31, 2012, consist entirely of the combined results of the downstream businesses.

- Our consolidated balance sheet at March 31, 2013, and December 31, 2012, consists of the consolidated balances of Phillips 66.

Effective January 1, 2013, we changed the organizational structure of the internal financial information reviewed by our chief executive officer, and determined this resulted in a change in the composition of our operating segments. The primary effects of this reporting reorganization were:

- We disaggregated the former Refining and Marketing (R&M) segment into two separate operating segments titled "Refining" and "Marketing and Specialties."

- We moved our transportation and power businesses from the former R&M segment to the Midstream and Marketing and Specialties (M&S) segments, respectively.

The new segment alignment is presented for the first quarter of 2013, with the prior period recast for comparability.

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Note 2—Interim Financial Information

The interim-period financial information presented in the financial statements included in this report is unaudited and includes all known accruals and adjustments necessary, in the opinion of management, for a fair presentation of the consolidated financial position of Phillips 66 and its results of operations and cash flows for the periods presented. Unless otherwise specified, all such adjustments are of a normal and recurring nature. Certain notes and other information have been condensed or omitted from the interim financial statements included in this report. Therefore, these interim financial statements should be read in conjunction with the consolidated financial statements and notes included in our 2012 Annual Report on Form 10-K. The results of operations for the three months ended March 31, 2013, are not necessarily indicative of the results to be expected for the full year.

Note 3—Variable Interest Entities (VIEs)

We hold significant variable interests in VIEs that have not been consolidated because we are not considered the primary beneficiary. Information on these VIEs follows:

Merey Sweeny, L.P. (MSLP) is a limited partnership that owns a delayed coker and related facilities at the Sweeny Refinery. As discussed more fully in Note 6—Investments, Loans and Long-Term Receivables, in August 2009 a call right was exercised to acquire the 50 percent ownership interest in MSLP of the co-venturer, Petróleos de Venezuela S.A. (PDVSA). That exercise has been challenged, and the dispute is being arbitrated. Because the exercise has been challenged by PDVSA, we continue to use the equity method of accounting for MSLP, and the VIE analysis below is based on the ownership and governance structure in place prior to the exercise of the call right. MSLP is a VIE because, in securing lender consents in connection with the Separation, we provided a 100 percent debt guarantee to the lender of the 8.85% senior notes issued by MSLP. PDVSA did not participate in the debt guarantee. In our VIE assessment, this disproportionate debt guarantee, plus other liquidity support provided jointly by us and PDVSA independently of equity ownership, results in MSLP not being exposed to all potential losses. We have determined we are not the primary beneficiary while our call exercise is in dispute because under the partnership agreement the co-venturers jointly direct the activities of MSLP that most significantly impact economic performance. At March 31, 2013, our maximum exposure represented the outstanding principal debt balance of $233 million. Our book value in MSLP at March 31, 2013, was $59 million.

We have a 50 percent ownership interest with a 50 percent governance interest in Excel Paralubes (Excel). Excel is a VIE because, in securing lender consents in connection with the Separation, ConocoPhillips provided a 50 percent debt guarantee to the lender of the 7.43% senior secured bonds issued by Excel. We provided a full indemnity to ConocoPhillips for this debt guarantee. Our co-venturer did not participate in the debt guarantee. In our assessment of the VIE, this debt guarantee, plus other liquidity support up to $60 million provided jointly by us and our co-venturer independently of equity ownership, results in Excel not being exposed to all potential losses. We have determined we are not the primary beneficiary because we and our co-venturer jointly direct the activities of Excel that most significantly impact economic performance. We continue to use equity method accounting for this investment. At March 31, 2013, our maximum exposure represented 50 percent of the outstanding principal debt balance of $164 million, or $82 million, plus half of the $60 million liquidity support, or $30 million. Our book value in Excel at March 31, 2013, was $110 million.

Note 4—Inventories

Inventories consisted of the following:

	Millions of Dollars	
	March 31 2013	December 31 2012
Crude oil and petroleum products	$5,517	3,138
Materials and supplies	294	292
	$5,811	3,430

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Inventories valued on the last-in, first-out (LIFO) basis totaled $5,387 million and $2,987 million at March 31, 2013, and December 31, 2012, respectively. The estimated excess of current replacement cost over LIFO cost of inventories amounted to approximately $8,100 million and $7,700 million at March 31, 2013, and December 31, 2012, respectively.

Note 5—Assets Held for Sale or Sold

In the first quarter of 2013, we entered into an agreement to sell our E-Gas™ Technology business. The business is included in our M&S segment and at March 31, 2013, had a net carrying value of approximately $13 million, including a goodwill allocation.

In March 2013, corporate property with a carrying amount of $50 million was classified as held for sale and included in the "Prepaid expenses and other current assets" line of our consolidated balance sheet.

Note 6—Investments, Loans and Long-Term Receivables

Equity Investments

Summarized 100 percent financial information for WRB Refining LP (WRB) and CPChem were as follows:

	Millions of Dollars Three Months Ended March 31	
	2013	2012
Revenues	$8,137	8,535
Income before income taxes	1,768	1,099
Net income	1,750	1,082

Loans and Long-Term Receivables

In 2012, we entered into a market-based shareholder financing agreement for up to $100 million with the Malaysian Refining Company Sdn. Bhd. (MRC). At December 31, 2012, MRC had drawn the total $100 million facility. In the first quarter of 2013, MRC remitted $55 million and at March 31, 2013, the balance on the facility was $45 million. On April 19, 2013, MRC repaid the outstanding loan balance. The advance was recorded as a short-term related party advance with interest income recorded in equity earnings to offset the corresponding interest expense by MRC.

Other

MSLP owns a delayed coker and related facilities at the Sweeny Refinery. MSLP processes long residue, which is produced from heavy sour crude oil, for a processing fee. Fuel-grade petroleum coke is produced as a by-product and becomes the property of MSLP. Prior to August 28, 2009, MSLP was owned 50/50 by ConocoPhillips and PDVSA. Under the agreements that govern the relationships between the partners, certain defaults by PDVSA with respect to supply of crude oil to the Sweeny Refinery triggered the right to acquire PDVSA’s 50 percent ownership interest in MSLP, which was exercised on August 28, 2009. PDVSA has initiated arbitration with the International Chamber of Commerce challenging the exercise of the call right and claiming it was invalid. The arbitral tribunal held hearings on the merits of the dispute in December 2012, and post-hearing briefs were exchanged in March 2013. We expect a final ruling in the third quarter of 2013. We continue to use the equity method of accounting for our investment in MSLP.

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Note 7—Properties, Plants and Equipment

Our investment in properties, plants and equipment (PP&E), with the associated accumulated depreciation and amortization (Accum. D&A), was:

	Millions of Dollars					
	March 31, 2013			December 31, 2012		
	Gross PP&E	Accum. D&A	Net PP&E	Gross PP&E	Accum. D&A	Net PP&E
Midstream	$2,533	1,045	1,488	2,460	1,016	1,444
Chemicals	—	—	—	—	—	—
Refining	18,216	6,219	11,997	17,989	5,913	12,076
Marketing and Specialties	2,274	922	1,352	2,500	1,078	1,422
Corporate and Other	762	342	420	880	415	465
	$23,785	8,528	15,257	23,829	8,422	15,407

Note 8—Goodwill

Effective January 1, 2013, we realigned our operating segments and determined that goodwill (which, prior to the realignment, had been assigned 100 percent to our former R&M segment) should now be assigned to three of the realigned operating segments—Midstream, Refining and M&S. We further determined that, for the Midstream segment, Transportation constituted a reporting unit. For Refining and M&S segments, we determined the goodwill reporting unit was at the operating segment level, due to the economic similarities of the components of those segments.

Goodwill was reassigned to the realigned reporting units using a relative fair value approach. Goodwill impairment testing was completed and no impairment recognition was required.

The carrying amount of goodwill reflecting the segment realignment was as follows:

	Millions of Dollars	
	March 31 2013	December 31 2012
Midstream	$518	518
Refining	1,934	1,934
Marketing and Specialties	892	892
	$3,344	3,344

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Note 9—Impairments

The three-month periods ended March 31, 2013 and 2012, included the following before-tax impairment charges:

	Millions of Dollars Three Months Ended March 31	
	2013	2012
Midstream	$—	

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.
On April 18, 2012, the Company completed a non-taxable acquisition of Parlux. As part of the acquisition, the Company recorded various deferred tax liabilities related to the acquisition accounting resulting in an increase in goodwill. Due to the change in control of Parlux, there may be limitations, under Internal Revenue Code Section 382, on the Company's ability to utilize Parlux's net operating losses. The limitation is not anticipated to be significant.
The Company continues to provide a full valuation allowance against its net 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 or thirty-nine weeks ended November 1, 2014.
During the thirteen and thirty-nine weeks ended November 1, 2014, 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 November 1, 2014 and February 1, 2014 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.
On April 15, 2014, the Company filed a request with the Internal Revenue Service (“IRS”) to change its tax year from June 30 to a fifty-two/fifty-three week year ending on the Saturday closest to January 31, which will correspond with its accounting year-end. On June 2, 2014, the IRS notified the Company that the Company’s request to change its tax year has been accepted. The Company filed a short-period return for the period July 1, 2013 through February 1, 2014 in October 2014.

NOTE 7 - BASIC AND DILUTED NET INCOME (LOSS) PER COMMON SHARE
Basic net 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 (loss) per common share includes, in periods in which they are dilutive, the effect of those potentially dilutive securities where the average market price of the common stock exceeds the exercise prices for the respective periods.

	Thirteen Weeks Ended November 1, 2014	Thirteen Weeks Ended November 2, 2013	Thirty-nine Weeks Ended November 1, 2014	Thirty-nine Weeks Ended November 2, 2013
Weighted average number of shares - basic	15,445,951	15,355,656	15,408,105	15,354,072
Potentially dilutive securities	50,767	41,274	—	—
Weighted average number of shares - diluted	15,496,718	15,396,930	15,408,105	15,354,072

During the thirteen and thirty-nine weeks ended November 1, 2014 there were 7,348,694 and 7,399,461 potential shares of common stock related to stock options and warrants which were excluded from the diluted income (loss) per share calculation because the effect of including these potential shares was antidilutive. During the thirteen and thirty-nine weeks ended November 2, 2013 there were 7,255,094 and 7,489,489 potential shares of common stock related to stock options and warrants which were excluded from the diluted income (loss) per share calculation because the effect of including these potential shares was antidilutive.

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 November 1, 2014, the Company had no material financial assets or liabilities measured on a recurring basis at 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 thirty-nine weeks ended November 1, 2014 and November 2, 2013.

The fair values of the Company's assets and liabilities that qualify as financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, short-term debt, and accrued expenses, are carried at cost, which approximates fair value due to the short-term maturity of these instruments. The reported amounts of long-term obligations approximate fair value, given management's evaluation of the instruments' current rates compared to market rates of interest and other factors.

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 or any of the above 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, Stephen and Arlene Nussdorf owned an aggregate 7,742,282 shares or approximately 50.0% of the total number of shares of the Company's common stock as of November 1, 2014, excluding shares issuable upon exercise of certain warrants and not assuming the exercise of any outstanding options. Stephen Nussdorf has served as the Chairman of the Company's Board of Directors since February 2004 and Executive Chairman of the Board since April 2011.

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

See Note 5 for a discussion of notes payable to affiliates.

Transactions With Affiliated Companies

Glenn Nussdorf has an ownership interest in Lighthouse Beauty Marketing, LLC, Lighthouse Beauty, LLC and Lighthouse Beauty KLO, LLC (collectively the "Lighthouse Companies"), all of which are manufacturers and distributors of prestige fragrances. He also has an ownership interest in Cloudbreak Holdings, LLC ("Cloudbreak"), a manufacturer and distributor of prestige fragrances. The Company purchases merchandise from the Lighthouse Companies and Cloudbreak.

The Company purchases merchandise from Jacavi Beauty Supply, LLC ("Jacavi"), a fragrance distributor. Jacavi's managing member is Rene Garcia. Rene Garcia, his family trusts and related entities are members of a group (the "Garcia Group") that owned an aggregate 2,211,269 shares, or approximately 14.3%, of the total number of shares of the Company's common stock as of November 1, 2014, excluding shares issuable upon exercise of certain warrants. During the thirty-nine weeks ended November 1, 2014, Perfumania purchased merchandise from Jacavi.

The amounts due to these related companies are non-interest bearing and are included in accounts payable-affiliates in the accompanying condensed consolidated balance sheets. Transactions for merchandise purchases with these related companies during the thirteen and thirty-nine weeks ended November 1, 2014 and November 2, 2013 were as follows (in thousands):

	Total Purchases Thirteen Weeks Ended	Total Purchases Thirteen Weeks Ended	Total Purchases Thirty-nine Weeks Ended	Total Purchases Thirty-nine Weeks Ended	Balance Due November 1, 2014	Balance Due February 1, 2014

	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013		
Lighthouse Companies	$ 716	$ 3,164	$ 1,463	$ 10,385	$728	$—
Jacavi	453	202	4,258	619	54	1,492
Quality King	1	—	113	—	3	—
Cloudbreak	—	75	831	821	553	5
	$ 1,170	$ 3,441	$ 6,665	$ 11,825	$ 1,338	$ 1,497

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On May 1, 2014, pursuant to a termination and trademark license agreement and in consideration for $0.1 million, the Company acquired the license for Isaac Mizrahi fragrances and related products from Cloudbreak. The license agreement has a three-year term with applicable renewal options. The Company will repay Cloudbreak $0.3 million of advance royalty payments which have been paid by Cloudbreak to the licensor, as such royalties are earned under the new agreement between the Company and the licensor.
Effective May 1, 2014, and pursuant to certain termination, consent, representation and trademark license agreements, the Company acquired the license for Major League Baseball (“MLB”) fragrances and related products from Cloudbreak. Pursuant to these agreements, the Company paid approximately $0.1 million of fees that were due by Cloudbreak and is permitted to purchase Cloudbreak’s May 1, 2014 on-hand MLB finished goods fragrance inventory. The license agreement terminates on December 31, 2017.
As of November 1, 2014, the Company has a receivable of $0.1 million from the Lighthouse Companies. This amount is non-interest bearing and is included in prepaid expenses and other current assets on the condensed consolidated balance sheet as of November 1, 2014.
Glenn, Stephen and Arlene Nussdorf own GSN Trucking, Inc. (“GSN”) which provides general transportation and freight services. The Company periodically utilizes GSN to transport both inbound purchases of merchandise and outbound shipments to wholesale customers. During the thirty-nine weeks ended November 1, 2014 and November 2, 2013, total payments to GSN for transportation services provided were less than $0.1 million. The balance due to GSN at November 1, 2014 was less than $0.1 million. There was no balance due to GSN at February 1, 2014.
Quality King occupies a leased 560,000 square foot facility in Bellport, NY. The Company began occupying approximately half of this facility in December 2007 under a sublease that terminates on September 30, 2027 and this location serves as the Company’s principal offices. As of November 1, 2014, the monthly current sublease payments are approximately $220,000 and increase by 3% annually. Total payments by the Company to Quality King were approximately $0.7 million and $0.6 million during the thirteen weeks ended November 1, 2014 and November 2, 2013, and $2.0 million and $1.9 million during the thirty-nine weeks ended November 1, 2014 and November 2, 2013 for this sublease.
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. The expenses charged under these arrangements to the Company were less than $0.1 million during the thirteen weeks ended November 1, 2014 and November 2, 2013 and $0.2 million and $0.3 million during the thirty-nine weeks ended November 1, 2014 and November 2, 2013, respectively. The balance due to Quality King for expenses charged under the Services Agreement was less than $0.1 million at both November 1, 2014 and February 1, 2014, respectively.
On December 23, 2011, the Company, Parlux Fragrances, Inc., the predecessor company of Parlux, Artistic Brands Development LLC (“Artistic Brands”) (a company controlled by Rene Garcia) and Rene Garcia entered into a Letter Agreement (the “Proposal Agreement”). In connection with the Parlux merger, on April 18, 2012, Parlux, Artistic Brands, Shawn Carter and S. Carter Enterprises, LLC entered into a sublicense agreement and Artistic Brands, Shawn Carter and S. Carter Enterprises, LLC entered into a license agreement pursuant to the Proposal Agreement under which Artistic Brands obtained the exclusive right and license to manufacture, promote, distribute, and sell prestige fragrances and related products under the Jay-Z trademark. The initial term of the license agreement expires at the earlier of (i) five years following the first date on which licensed products are shipped and (ii) December 31, 2018. Artistic Brands has the right to renew the license agreement, so long as certain financial conditions are met and it has not otherwise breached the agreement. Pursuant to the license agreement, Artistic Brands agreed to make certain royalty payments, including certain guaranteed minimum royalties. Pursuant to the sublicense agreement, Artistic Brands sublicensed all rights granted under the license agreement to the Company, and in return the Company assumed all of Artistic Brands' obligations under the license agreement, including making all royalty payments and certain guaranteed minimum royalties owed to S. Carter Enterprises, LLC. The Company paid $0.8 million of

guaranteed minimum royalties pursuant to the sublicense agreement during fiscal 2013.

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 SOW consignment business and the Company’s internet site, Perfumania.com. Wholesale sales include sales through QFG, Parlux and Five Star to unrelated customers. 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 February 1, 2014. The Company’s chief operating decision maker, who is its Chief

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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:

	Thirteen Weeks Ended November 1, 2014	Thirteen Weeks Ended November 2, 2013	Thirty-nine Weeks Ended November 1, 2014	Thirty-nine Weeks Ended November 2, 2013
	(in thousands)			
Net sales:				
Retail	$75,477	$76,095	$220,280	$228,115
Wholesale	78,852	79,584	180,169	162,713
	$154,329	$155,679	$400,449	$390,828
Gross profit:				
Retail	$37,197	$35,498	$106,098	$105,435
Wholesale	35,930	34,869	80,678	64,567
	$73,127	$70,367	$186,776	$170,002

	November 1, 2014	February 1, 2014
Total assets:		
Wholesale	$670,934	$585,884
Retail	371,746	348,728
	1,042,680	934,612
Eliminations (a)	(571,061)	(511,208)
Consolidated assets	$471,619	$423,404

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

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

We are an independent, national, vertically integrated wholesale distributor and specialty retailer of designer perfumes and fragrances. We source the majority of these products directly from the brand owners/manufacturers. We also own and license certain designer brands that we manufacture, through subcontractors, and sell through our wholesale and retail operating subsidiaries.

Net sales during the thirteen weeks ended November 1, 2014, our third quarter in fiscal 2014, decreased 0.9% compared to the third quarter of fiscal 2013, while net sales on a year-to-date basis in fiscal 2014 increased 2.5% compared to fiscal 2013. Our wholesale segment's net sales during the third quarter of fiscal 2014 decreased by 0.9% over the third quarter of fiscal 2013 while wholesale sales on a year-to-date basis in fiscal 2014 increased by 10.7% over fiscal 2013. During the year, wholesale sales fluctuate due to seasonal demand, new product launches, the size and timing of certain orders from our customers, additions or losses of brand distribution rights, changes in foreign exchange rates against the U.S. dollar and the timing of industry trade shows, and accordingly sales and results of operations can vary significantly from quarter to quarter. Our retail segment's net sales decreased by 0.8% from the third quarter of fiscal 2013 and retail sales on a year-to-date basis decreased by 3.4% compared with the same period of fiscal 2013, as we had fewer Perfumania stores in operation compared with last year's third quarter, and SOW had two fewer consignment accounts.

Gross profit during the thirteen weeks ended November 1, 2014 was $73.1 million, an increase of 3.9% compared to last year's third quarter. Gross profit during the thirty-nine weeks ended November 1, 2014 was $186.8 million, an increase of 9.9% over the comparative period last year. The increases in gross profit are due to higher retail gross margins and the purchase accounting adjustments recorded during the thirteen and thirty-nine weeks ended November 2, 2013 discussed below, which did not reoccur in the thirteen and thirty-nine weeks ended November 1, 2014.

Total operating expenses were $63.3 million and $182.5 million during the thirteen and thirty-nine weeks ended November 1, 2014, increases of 5.0% and 3.6% versus the comparative periods last year. The increases are primarily attributable to higher advertising expense to promote launches of new licensed brands.

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As a result of the above, our net income increased by 3.1% to $7.5 million during the thirteen weeks ended November 1, 2014 from $7.3 million during last year’s third quarter, and our net loss decreased by 79.4% to $2.9 million during the thirty-nine weeks ended November 1, 2014 from $13.9 million during the thirty-nine weeks ended November 2, 2013.

Comparison of the Thirteen Weeks Ended November 1, 2014 with the Thirteen Weeks Ended November 2, 2013.

Net Sales

	Thirteen Weeks Ended November 1, 2014 ($ in thousands)	Percentage of Net Sales	Thirteen Weeks Ended November 2, 2013	Percentage of Net Sales	Dollar Change
Retail	$75,477	48.9%	$76,095	48.9%	$(618)
Wholesale	78,852	51.1%	79,584	51.1%	(732)
Total net sales	$154,329	100.0%	$155,679	100.0%	$(1,350)

Net sales decreased 0.9% from $155.7 million in the thirteen weeks ended November 2, 2013 to $154.3 million in the thirteen weeks ended November 1, 2014. The decrease in sales included a $0.7 million decrease in wholesale sales and a $0.6 million decrease in retail sales.

Wholesale sales decreased by 0.9% from $79.6 million in the thirteen weeks ended November 2, 2013 to $78.9 million in the thirteen weeks ended November 1, 2014. QFG's sales increased from $50.6 million in the thirteen weeks ended November 2, 2013 to $51.2 million in the thirteen weeks ended November 1, 2014 due primarily to higher customer demand and additional distribution of owned and licensed brands as well as distributed brands. Parlux's sales decreased from $28.1 million in the thirteen weeks ended November 2, 2013 to $27.8 million in the thirteen weeks ended November 1, 2014.

Retail sales decreased by 0.8% from $76.1 million in the thirteen weeks ended November 2, 2013 to $75.5 million in the thirteen weeks ended November 1, 2014. Perfumania's retail sales decreased by $1.3 million while SOW's consignment sales increased by $0.7 million.

Perfumania's retail sales decreased from $61.6 million in the thirteen weeks ended November 2, 2013 to $60.3 million in the thirteen weeks ended November 1, 2014. The decrease in Perfumania's sales was due primarily to fewer stores being operated, as the average number of stores operated was 325 in the thirteen weeks ended November 1, 2014 and 335 in the thirteen weeks ended November 2, 2013. Perfumania's comparable store sales decreased by 0.1% during the thirteen weeks ended November 1, 2014 from the same period in 2013. 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 November 1, 2014 decreased by 3.1% from the prior year's comparable period, while the total number of units sold increased by 0.8%.

SOW's consignment sales increased from $14.5 million in the thirteen weeks ended November 2, 2013 to $15.2 million in the thirteen weeks ended November 1, 2014. The increase in SOW's net sales is due to an increase in sales at SOW's largest account offset by SOW having two less consignment accounts during the thirteen weeks ended November 1, 2014 compared with the thirteen weeks ended November 2, 2013.

Gross Profit

	Thirteen Weeks Ended	Thirteen Weeks Ended	Dollar Change

	November 1, 2014	November 2, 2013	
	($ in thousands)		
Retail	$37,197	$35,498	$1,699
Wholesale	35,930	34,869	1,061
Total gross profit	$73,127	$70,367	$2,760

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Gross Profit Percentages

	Thirteen Weeks Ended November 1, 2014	Thirteen Weeks Ended November 2, 2013
Retail	49.3%	46.6%
Wholesale	45.6%	43.8%
Total gross profit percentage	47.4%	45.2%

Gross profit increased 3.9% from $70.4 million in the thirteen weeks ended November 2, 2013 to $73.1 million in the thirteen weeks ended November 1, 2014. During the thirteen weeks ended November 2, 2013, gross profit was reduced by approximately $1.8 million to expense a portion of the purchase accounting adjustment to record Parlux's acquired inventory at fair market value at the acquisition date. The entire purchase accounting adjustment was expensed in fiscal 2013. Excluding the effect of the purchase accounting adjustment, retail and wholesale gross profit percentages during the thirteen weeks ended November 2, 2013 were 47.2% and 45.5%, respectively.

Perfumania's retail gross profit dollars increased from $28.3 million during the thirteen weeks ended November 2, 2013 to $29.6 million during the thirteen weeks ended November 1, 2014. For these same periods, Perfumania's retail gross margins were 46.0% and 49.1%, respectively. The increase in gross margins is attributable to higher selling prices and the purchase accounting adjustment discussed above.

Wholesale gross profit percentage increased from 43.8% during the thirteen weeks ended November 2, 2013 to 45.6% during the thirteen weeks ended November 1, 2014. See discussion of purchase accounting adjustment above which impacted gross profit dollars and percentage during the thirteen weeks ended November 2, 2013.

Expenses

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, royalties, insurance, supplies, freight out, and other administrative expenses.

Selling, general and administrative expenses were $60.8 million in the thirteen weeks ended November 1, 2014, compared to $57.3 million in the thirteen weeks ended November 2, 2013. The increase in selling, general and administrative expenses is primarily attributable to higher advertising expenses to support licensed brands. Included in selling, general and administrative expenses are expenses in connection with the Services Agreement with Quality King, which were less than $0.1 million during the thirteen weeks ended November 1, 2014 and November 2, 2013.

Depreciation and amortization was approximately $2.4 million and $2.8 million in the thirteen weeks ended November 1, 2014 and November 2, 2013, respectively.

Interest expense was approximately $2.4 million for the thirteen weeks ended November 1, 2014 compared with approximately $2.8 million for the thirteen weeks ended November 2, 2013. The decrease in interest expense is due to a lower average interest rate on the Company's revolving credit facility compared with the thirteen weeks ended November 2, 2013.

The Company continues to record a full valuation allowance against all deferred tax assets, thus no income tax benefit was recorded during the thirteen weeks ended November 1, 2014 and November 2, 2013. On April 15, 2014, the Company filed a request with the Internal Revenue Service (“IRS”) to change its tax year from June 30 to a fifty-two/fifty-three week year ending on the Saturday closest to January 31, which will correspond with its accounting year-end. On June 2, 2014, the IRS notified the Company that the Company’s request to change its tax year has been accepted. The Company filed a short-period return for the period July 1, 2013 through February 1, 2014 in October 2014.

As a result of the foregoing, we realized net income of approximately $7.5 million in the thirteen weeks ended November 1, 2014 compared to net income of $7.3 million in the thirteen weeks ended November 2, 2013.

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Comparison of the Thirty-nine Weeks Ended November 1, 2014 with the Thirty-nine Weeks Ended November 2, 2013.

Net Sales

	Thirty-nine Weeks Ended November 1, 2014	Percentage of Net Sales	Thirty-nine Weeks Ended November 2, 2013	Percentage of Net Sales	Dollar Change
	($ in thousands)				
Retail	$220,280	55.0%	$228,115	58.4%	$(7,835)
Wholesale	180,169	45.0%	162,713	41.6%	17,456
Total net sales	$400,449	100.0%	$390,828	100.0%	$9,621

Net sales increased 2.5% from $390.8 million in the thirty-nine weeks ended November 2, 2013 to $400.5 million in the thirty-nine weeks ended November 1, 2014. The increase in sales included an increase in wholesale sales of $17.4 million offset by a decrease in retail sales of $7.8 million.

Wholesale sales increased by 10.7% from $162.7 million in the thirty-nine weeks ended November 2, 2013 to $180.2 million in the thirty-nine weeks ended November 1, 2014. QFG's sales increased from $107.0 million in the thirty-nine weeks ended November 2, 2013 to $116.5 million in the thirty-nine weeks ended November 1, 2014 due primarily to higher customer demand and additional distribution of owned and licensed brands as well as distributed brands. Parlux's sales increased from $54.1 million in the thirty-nine weeks ended November 2, 2013 to $63.0 million during the thirty-nine weeks ended November 1, 2014 primarily due to several new product launches.

Retail sales decreased by 3.4% from $228.1 million in the thirty-nine weeks ended November 2, 2013 to $220.3 million in the thirty-nine weeks ended November 1, 2014. The decrease included a decrease in Perfumania's retail sales of $5.3 million and a decrease in SOW's consignment sales of $2.5 million.

Perfumania's retail sales decreased from $182.1 million in the thirty-nine weeks ended November 2, 2013 to $176.8 million in the thirty-nine weeks ended November 1, 2014. Perfumania's comparable store sales decreased by 0.9% during the thirty-nine weeks ended November 1, 2014. The average retail price per unit sold during the thirty-nine weeks ended November 1, 2014 decreased 2.8% from the prior year's comparable period while the total number of units sold increased by 0.1%. The average number of stores operated was 325 in the thirty-nine weeks ended November 1, 2014, versus 336 in the prior year's comparable period.

SOW's consignment sales decreased from $46.0 million in the thirty-nine weeks ended November 2, 2013 to $43.5 million in the thirty-nine weeks ended November 1, 2014. The decrease in SOW's net sales is due primarily to the termination of two consignment relationships.

Gross Profit

	Thirty-nine Weeks Ended November 1, 2014	Thirty-nine Weeks Ended November 2, 2013	Dollar Change
	($ in thousands)		
Retail	$106,098	$105,435	$663
Wholesale	80,678	64,567	16,111

Total gross profit	$186,776	$170,002	$16,774

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Gross Profit Percentages

	Thirty-nine Weeks Ended November 1, 2014	Thirty-nine Weeks Ended November 2, 2013
Retail	48.2%	46.2%
Wholesale	44.8%	39.7%
Total gross profit percentage	46.6%	43.5%

Gross profit increased 9.9% from $170.0 million in the thirty-nine weeks ended November 2, 2013 to $186.8 million in the thirty-nine weeks ended November 1, 2014. During the thirty-nine weeks ended November 2, 2013, gross profit was reduced by approximately $9.3 million to expense a portion of the purchase accounting adjustment to record Parlux's acquired inventory at fair market value at the acquisition date. The entire purchase accounting adjustment was expensed in fiscal 2013. Excluding the effect of the purchase accounting adjustment, retail and wholesale gross profit percentages during the thirty-nine weeks ended November 2, 2013 were 47.2% and 44.0%, respectively.
Perfumania's retail gross profit for the thirty-nine weeks ended November 1, 2014 decreased by 0.1% to $85.3 million compared with the comparable period in 2013. For these same periods, Perfumania's retail gross margins were 48.2% and 46.8%, respectively. The increase in gross margins is attributable to the purchase accounting adjustment discussed above.
Wholesale gross profit dollars increased by 25.0% due to the increases in Parlux and QFG's sales discussed above. Wholesale gross profit percentage increased from 39.7% during the thirty-nine weeks ended November 2, 2013 to 44.8% during the thirty-nine weeks ended November 1, 2014. See discussion of purchase accounting adjustment above which impacted gross profit dollars and percentage during the thirty-nine weeks ended November 2, 2013.

Expenses
Selling, general and administrative expenses were $174.5 million in the thirty-nine weeks ended November 1, 2014, compared to $166.5 million in the thirty-nine weeks ended November 2, 2013. The increase in selling, general and administrative expenses is primarily attributable to higher advertising expenses to support licensed brands. Also included in selling, general and administrative expenses are expenses in connection with the Services Agreement with Quality King, which were $0.2 million and $0.3 million for the thirty-nine weeks ended November 1, 2014 and November 2, 2013, respectively.
Depreciation and amortization was approximately $7.7 million in the thirty-nine weeks ended November 1, 2014, compared to $9.3 million for the thirty-nine weeks ended November 2, 2013.
Share-based compensation expense of approximately $0.3 million during both thirty-nine week periods ended November 1, 2014 and November 2, 2013 represents the expense incurred on outstanding stock options.
Interest expense was approximately $7.1 million for the thirty-nine weeks ended November 1, 2014 compared with approximately $7.8 million for the thirty-nine weeks ended November 2, 2013.
Since the Company continues to record a full valuation allowance against all deferred tax assets, no income tax benefit was recorded during either of the thirty-nine week periods ended November 1, 2014 and November 2, 2013.
As a result of the foregoing, we realized a net loss of approximately $2.9 million in the thirty-nine weeks ended November 1, 2014, compared to a net loss of $13.9 million in the thirty-nine weeks ended November 2, 2013.

LIQUIDITY AND CAPITAL RESOURCES
Net cash used in operating activities during the thirty-nine weeks ended November 1, 2014 was approximately $21.2 million, compared with approximately $49.3 million used in operating activities during the thirty-nine weeks ended November 2, 2013. The seasonality of our operations may lead to significant fluctuations in certain asset and liability accounts between fiscal year-end and subsequent interim periods.

Net cash used in investing activities was approximately $9.2 million in the thirty-nine weeks ended November 1, 2014 compared to $4.0 million in the thirty-nine weeks ended November 2, 2013. Investing activities during the thirty-nine weeks ended November 1, 2014 consisted of Perfumania store construction and remodels, capital expenditures related to an ongoing purchase and implementation of new computer systems and other corporate and information technology enhancements. During the thirty-nine weeks ended November 1, 2014, Perfumania opened 11 new stores, relocated 4 stores and closed 14 stores. We plan to open approximately 2 stores and close 5 stores for the remainder of fiscal 2014. We continuously evaluate the appropriate new store growth rate in light of economic conditions and may adjust the growth rate as conditions change. Furthermore, we continue to evaluate the need to close, remodel or relocate existing stores.

Net cash provided by financing activities during the thirty-nine weeks ended November 1, 2014 was approximately $32.6 million, compared with $53.3 million provided by financing activities for the thirty-nine weeks ended November 2, 2013. The $20.7 million decrease in cash provided by financing activities is due to lower borrowings under our bank line of credit.

The Company has a $175 million revolving credit facility with a syndicate of banks (the "Senior Credit Facility"), which 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 Company was in compliance with all financial and operating covenants under the Senior Credit facility as of November 1, 2014. As of November 1, 2014, the Company had $47.3 million available to borrow under the Senior Credit Facility based on the borrowing base at that date.

The Company has various unsecured notes payable outstanding to affiliates which in aggregate total $125.4 million of principal. No payments of principal may be made on any of these notes payable to affiliates before the maturity of the Senior Credit Facility although interest payments are permitted under certain conditions. See further discussion of our notes payable to affiliates and our Senior Credit Facility in Note 5 of our condensed consolidated financial statements included in this Form 10-Q.

Our liquidity is impacted by a number of factors, including our sales levels, the amount of credit that our vendors extend to us and our borrowing capacity under our Senior Credit Facility. Our principal funding requirements are for inventory purchases, financing extended terms on accounts receivable, paying down accounts payable and debt, information system enhancements, opening new stores and renovation of existing stores. These capital requirements generally have been satisfied through borrowings under the Senior Credit Facility, notes payable to affiliates and funds from operations. Based on current internal sales and cash flow projections, current vendor payable support and our projected available borrowing capacity under our Senior Credit Facility, as well as other initiatives to maximize cash flow, we believe that these resources will be adequate to meet our requirements in both the short and long-term.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our condensed 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 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 February 1, 2014.

ITEM 3.QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report (November 1, 2014), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

During the third quarter of fiscal 2014 there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that 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
There have been no material changes to the risk factors described in Item 1A to our Annual Report on Form 10-K for the year ended February 1, 2014.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-Q, may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are typically identified by words or phrases such as "may," "will," "anticipate," "estimate," "expect," "project," "intend," "plan," "believe," "target," "forecast," "objective," "assume," "strategie words and terms of similar meaning. Forward-looking statements involve estimates, expectations, projections, goals, forecasts, assumptions, risks and uncertainties. We caution readers that any forward-looking statement is not a guarantee of future performance and that actual results could differ materially from those contained in the forward-looking statement.

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 service our obligations, our ability to comply with the covenants in our Senior Credit Facility, any deterioration of general economic conditions, including weaker than anticipated 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. Copies of our SEC filings are available from the SEC or may be obtained upon request from us.

You should also consider carefully the statements under "Risk Factors" in our Form 10-K which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements and could materially and adversely affect our business, operating results and financial condition. We cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES
None.

ITEM 4. MINE SAFETY DISCLOSURES
Not applicable.

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	Articles of Amendment to Amended and Restated Articles of Incorporation, filed April 17, 2012 (incorporated by reference to Exhibit 3.1 to the Company's Form 8-K filed April 19, 2012).
3.3	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.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES

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: December 16, 2014	By:	By: /s/ Michael W. Katz Michael W. Katz President and Chief Executive Officer (Principal Executive Officer)
	By:	By: /s/ Donna L. Dellomo Donna L. Dellomo Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

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