
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended August 3, 2019

OR

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

Commission file number: 001-35535

TILLY'S, INC.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

45-2164791
(I.R.S. Employer
Identification No.)

10 Whatney
Irvine, CA 92618
(Address of principal executive offices)

(949) 609-5599
(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Class A Common Stock, \$0.001 par value per share	TLYS	New York Stock Exchange

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

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

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

Large accelerated filer

Accelerated filer

X

Non-accelerated filer

Smaller reporting company

X

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 Exchange Act Rule 12b-2) Yes No

As of September 6, 2019, the registrant had the following shares of common stock outstanding:

Class A common stock \$0.001 par value	22,050,632
Class B common stock \$0.001 par value	7,526,108

TILLY'S, INC.
FORM 10-Q
For the Quarterly Period Ended August 3, 2019

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Part I. Financial Information

Item 1. Financial Statements (Unaudited)

TILLY'S, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)
(Unaudited)

	August 3, 2019	February 2, 2019	August 4, 2018
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 62,388	\$ 68,160	\$ 45,638
Marketable securities	62,413	75,919	78,588
Receivables	11,758	6,082	11,182
Merchandise inventories	72,635	55,809	74,815
Prepaid expenses and other current assets	4,845	11,171	9,062
Total current assets	214,039	217,141	219,285
Operating lease assets	256,048	—	—
Property and equipment, net	68,010	73,842	78,906
Other assets	2,194	2,185	3,391
Total assets	\$ 540,291	\$ 293,168	\$ 301,582
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	\$ 39,475	\$ 24,207	\$ 42,786
Accrued expenses	23,112	18,756	29,521
Deferred revenue	8,330	10,373	7,193
Accrued compensation and benefits	6,132	8,930	7,392
Dividends payable	—	29,453	—
Current portion of operating lease liabilities	53,744	—	—
Current portion of deferred rent	—	5,540	5,868
Total current liabilities	130,793	97,259	92,760
Noncurrent operating lease liabilities	233,876	—	—
Noncurrent deferred rent	—	30,825	31,239
Other	1,182	1,757	2,236
Total liabilities	365,851	129,841	126,235
Commitments and contingencies (Note 5)			
Stockholders' equity:			
Common stock (Class A), \$0.001 par value; 100,000 shares authorized; 21,980, 21,642 and 15,599 shares issued and outstanding, respectively	22	21	15
Common stock (Class B), \$0.001 par value; 35,000 shares authorized; 7,586, 7,844 and 13,708 shares issued and outstanding, respectively	8	8	14
Preferred stock, \$0.001 par value; 10,000 shares authorized; no shares issued or outstanding	—	—	—
Additional paid-in capital	150,877	149,737	146,476
Retained earnings	23,296	13,335	28,756
Accumulated other comprehensive income	237	226	86
Total stockholders' equity	174,440	163,327	175,347
Total liabilities and stockholders' equity	\$ 540,291	\$ 293,168	\$ 301,582

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

TILLY'S, INC.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Net sales	\$ 161,738	\$ 157,406	\$ 292,041	\$ 281,040
Cost of goods sold (includes buying, distribution, and occupancy costs)	110,019	107,301	204,638	195,957
Gross profit	51,719	50,105	87,403	85,083
Selling, general and administrative expenses	39,609	37,627	75,147	71,275
Operating income	12,110	12,478	12,256	13,808
Other income, net	572	490	1,401	873
Income before income taxes	12,682	12,968	13,657	14,681
Income tax expense	3,398	3,279	3,696	3,770
Net income	<u>\$ 9,284</u>	<u>\$ 9,689</u>	<u>\$ 9,961</u>	<u>\$ 10,911</u>
Basic income per share of Class A and Class B common stock	\$ 0.31	\$ 0.33	\$ 0.34	\$ 0.37
Diluted income per share of Class A and Class B common stock	\$ 0.31	\$ 0.33	\$ 0.33	\$ 0.37
Weighted average basic shares outstanding	29,505	29,209	29,487	29,145
Weighted average diluted shares outstanding	29,678	29,681	29,739	29,567

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

TILLY'S, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Net income	\$ 9,284	\$ 9,689	\$ 9,961	\$ 10,911
Other comprehensive income (loss), net of tax:				
Net change in unrealized gain on available-for-sale securities, net of tax	80	(25)	11	72
Other comprehensive income (loss), net of tax	80	(25)	11	72
Comprehensive income	\$ 9,364	\$ 9,664	\$ 9,972	\$ 10,983

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

TILLY'S, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In thousands)
(Unaudited)

	Number of Shares		Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Common Stock (Class A)	Common Stock (Class B)					
Balance at May 4, 2019	21,816	7,706	\$ 30	\$ 150,331	\$ 14,012	\$ 157	\$ 164,530
Net income	—	—	—	—	9,284	—	9,284
Restricted stock	44	—	—	—	—	—	—
Class B common stock converted to Class A common stock	120	(120)	—	—	—	—	—
Share-based compensation expense	—	—	—	546	—	—	546
Net change in unrealized gain on available-for-sale securities	—	—	—	—	—	80	80
Balance at August 3, 2019	21,980	7,586	\$ 30	\$ 150,877	\$ 23,296	\$ 237	\$ 174,440

	Number of Shares		Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Common Stock (Class A)	Common Stock (Class B)					
Balance at May 5, 2018	15,197	13,948	\$ 29	\$ 144,550	\$ 19,068	\$ 111	\$ 163,758
Net income	—	—	—	—	9,689	—	9,689
Restricted stock	24	—	—	—	—	—	—
Taxes paid in lieu of shares issued for stock-based compensation	(1)	—	—	(12)	—	—	(12)
Class B common stock converted to Class A common stock	240	(240)	—	—	—	—	—
Stock-based compensation expense	—	—	—	547	—	—	547
Exercises of stock options	139	—	—	1,391	—	—	1,391
Net change in unrealized gain on available-for-sale securities	—	—	—	—	—	(25)	(25)
Rounding difference	—	—	—	—	(1)	—	(1)
Balance at August 4, 2018	15,599	13,708	\$ 29	\$ 146,476	\$ 28,756	\$ 86	\$ 175,347

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

TILLY'S, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (continued)
(In thousands)
(Unaudited)

	Number of Shares		Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Common Stock (Class A)	Common Stock (Class B)					
Balance at February 2, 2019	21,642	7,844	\$ 29	\$ 149,737	\$ 13,335	\$ 226	\$ 163,327
Net income	—	—	—	—	9,961	—	9,961
Restricted stock	70	—	—	—	—	—	—
Taxes paid in lieu of shares issued for stock-based compensation	(8)	—	—	(85)	—	—	(85)
Class B common stock converted to Class A common stock	258	(258)	—	—	—	—	—
Share-based compensation expense	—	—	—	1,075	—	—	1,075
Exercise of stock options	18	—	1	150	—	—	151
Net change in unrealized gain on available-for-sale securities	—	—	—	—	—	11	11
Balance at August 3, 2019	21,980	7,586	\$ 30	\$ 150,877	\$ 23,296	\$ 237	\$ 174,440

	Number of Shares		Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Common Stock (Class A)	Common Stock (Class B)					
Balance at February 3, 2018	14,927	14,188	\$ 29	\$ 143,984	\$ 16,398	\$ 14	\$ 160,425
Cumulative-effect adjustment from adoption of ASC 606	—	—	—	—	1,447	—	1,447
Net income	—	—	—	—	10,911	—	10,911
Restricted stock	52	—	—	—	—	—	—
Taxes paid in lieu of shares issued for stock-based compensation	(10)	—	—	(111)	—	—	(111)
Class B common stock converted to Class A common stock	480	(480)	—	—	—	—	—
Stock-based compensation expense	—	—	—	1,127	—	—	1,127
Exercises of stock options	150	—	—	1,476	—	—	1,476
Net change in unrealized gain on available-for-sale securities	—	—	—	—	—	72	72
Balance at August 4, 2018	15,599	13,708	\$ 29	\$ 146,476	\$ 28,756	\$ 86	\$ 175,347

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

TILLY'S, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018
Cash flows from operating activities		
Net income	\$ 9,961	\$ 10,911
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,286	11,503
Share-based compensation expense	1,075	1,127
Impairment of assets	—	786
Loss on disposal of assets	145	17
Gain on marketable securities	(848)	(599)
Deferred income taxes	(218)	(203)
Changes in operating assets and liabilities:		
Receivables	(3,605)	(6,830)
Merchandise inventories	(16,826)	(21,789)
Prepaid expenses and other assets	717	461
Accounts payable	15,055	21,571
Accrued expenses	4,243	4,688
Accrued compensation and benefits	(2,798)	1,273
Operating lease liabilities and deferred rent	(1,059)	547
Deferred revenue	(2,043)	(1,513)
Net cash provided by operating activities	<u>14,085</u>	<u>21,950</u>
Cash flows from investing activities		
Purchase of property and equipment	(4,848)	(6,668)
Purchases of marketable securities	(62,079)	(79,822)
Maturities of marketable securities	76,457	84,678
Net cash provided by (used in) investing activities	<u>9,530</u>	<u>(1,812)</u>
Cash flows from financing activities		
Dividends paid	(29,453)	(29,067)
Proceeds from exercise of stock options	151	1,476
Taxes paid in lieu of shares issued for share-based compensation	(85)	(111)
Net cash used in financing activities	<u>(29,387)</u>	<u>(27,702)</u>
Change in cash and cash equivalents	(5,772)	(7,564)
Cash and cash equivalents, beginning of period	68,160	53,202
Cash and cash equivalents, end of period	<u>\$ 62,388</u>	<u>\$ 45,638</u>
Supplemental disclosures of cash flow information		
Income taxes paid	\$ 4,647	\$ 3,999
Supplemental disclosure of non-cash activities		
Unpaid purchases of property and equipment	\$ 2,012	\$ 1,223
Leased assets obtained in exchange for new operating lease liabilities	\$ 313,602	\$ —

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

TILLY'S, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1: Description of the Company and Basis of Presentation

Tillys is a leading destination specialty retailer of casual apparel, footwear and accessories for young men, young women, boys and girls with an extensive assortment of iconic global, emerging, and proprietary brands rooted in an active and social lifestyle. Tillys is headquartered in Irvine, California and operated 229 stores, including two RSQ-branded pop-up stores, in 33 states as of August 3, 2019. Our stores are located in malls, lifestyle centers, 'power' centers, community centers, outlet centers and street-front locations. Customers may also shop online, where we feature the same assortment of products as carried in our brick-and-mortar stores, supplemented by additional online-only styles. Our goal is to serve as a destination for the latest, most relevant merchandise and brands important to our customers.

The Tillys concept began in 1982, when our co-founders, Hezy Shaked and Tilly Levine, opened their first store in Orange County, California. Since 1984, the business has been conducted through World of Jeans & Tops, a California corporation, or "WOJT", which operates under the name "Tillys". In May 2011, Tilly's, Inc., a Delaware corporation, was formed solely for the purpose of reorganizing the corporate structure of WOJT in preparation for an initial public offering. As part of the initial public offering in May 2012, WOJT became a wholly owned subsidiary of Tilly's, Inc.

As used in these Notes to the Consolidated Financial Statements, except where the context otherwise requires or where otherwise indicated, the terms "the Company", "World of Jeans and Tops", "WOJT", "we", "our", "us" and "Tillys" refer to WOJT before our initial public offering, and to Tilly's, Inc. and its subsidiary after our initial public offering.

We have prepared the accompanying unaudited consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial reporting. These unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted from this Quarterly Report on Form 10-Q as is permitted by SEC rules and regulations.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all normal and recurring adjustments necessary to present fairly the financial condition, results of operations and cash flows for the interim periods presented. The results of operations for the thirteen and twenty-six week periods ended August 3, 2019 and August 4, 2018 are not necessarily indicative of results to be expected for the full fiscal year. The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the fiscal year ended February 2, 2019 ("fiscal 2018").

Fiscal Periods

Our fiscal year ends on the Saturday closest to January 31. References to fiscal 2019 refer to the fiscal year ending February 1, 2020. References to the fiscal quarters or first halves ended August 3, 2019 and August 4, 2018 refer to the thirteen and twenty-six week periods ended as of those dates, respectively.

Note 2: Summary of Significant Accounting Policies

Information regarding our significant accounting policies is contained in Note 2, "Summary of Significant Accounting Policies", of the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended February 2, 2019.

Revenue Recognition

Revenue is recognized for store sales when the customer receives and pays for the merchandise at the register, net of estimated returns. Taxes collected from our customers are recorded on a net basis. For e-commerce sales, we recognize revenue, net of sales taxes and estimated sales returns, and the related cost of goods sold at the time the merchandise is shipped to the customer. Amounts related to shipping and handling that are billed to customers are reflected in net sales, and the related costs are reflected in cost of goods sold in the Consolidated Statements of Income.

The following table summarizes net sales from our retail stores and e-commerce (in thousands):

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Retail stores	\$ 138,918	\$ 137,734	\$ 249,554	\$ 246,235
E-commerce	22,820	19,672	42,487	34,805
Total net sales	\$ 161,738	\$ 157,406	\$ 292,041	\$ 281,040

The following table summarizes the percentage of net sales by department:

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Mens	33%	32%	33%	33%
Womens	25%	27%	26%	27%
Accessories	19%	19%	18%	18%
Footwear	12%	12%	13%	12%
Boys	6%	5%	5%	5%
Girls	5%	5%	5%	5%
Total net sales	100%	100%	100%	100%

The following table summarizes the percentage of net sales by third-party and proprietary branded merchandise:

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Third-party	74%	75%	74%	74%
Proprietary	26%	25%	26%	26%
Total net sales	100%	100%	100%	100%

We accrue for estimated sales returns by customers based on historical sales return results. As of August 3, 2019, February 2, 2019 and August 4, 2018, our reserve for sales returns was \$3.3 million, \$1.4 million and \$3.3 million, respectively.

We recognize revenue from gift cards as they are redeemed for merchandise. Prior to redemption, we maintain a current liability for unredeemed gift card balances. The customer liability balance was \$6.6 million, \$8.7 million and \$5.7 million as of August 3, 2019, February 2, 2019 and August 4, 2018, respectively, and is included in deferred revenue on the accompanying Consolidated Balance Sheets. Our gift cards do not have expiration dates and in most cases there is no legal obligation to remit unredeemed gift cards to relevant jurisdictions. Based on actual historical redemption patterns, we determined that a small percentage of gift cards are unlikely to be redeemed (which we refer to as gift card "breakage"). Based on our historical gift card breakage rate, we recognize breakage revenue over the redemption period in proportion to actual gift card redemptions. Revenue recognized from gift cards was \$3.8 million and \$8.0 million for the thirteen and twenty-six week periods ended August 3, 2019, respectively, and \$3.4 million and \$7.2 million for the thirteen and twenty-six week periods ended August 4, 2018, respectively.

We have a customer loyalty program where customers accumulate points based on purchase activity. Once a loyalty member achieves a certain point level, the member earns awards that may be redeemed for merchandise. Unredeemed awards and accumulated partial points are accrued as deferred revenue and awards redeemed by the member for merchandise are recorded as an increase to net sales. During the second quarter ended August 3, 2019, we launched an enhanced loyalty program that includes the ability for customers to redeem their awards instantly rather than build up to an award over time. In connection with the launch of this enhanced loyalty program, we also extended the award expiration period for unredeemed awards from 45 days to 365 days and, as a result, we currently expire unredeemed awards and accumulated partial points 365 days after the last purchase activity. A liability is estimated based on the standalone selling price of awards and partial points earned and estimated redemptions. The deferred revenue for this program was \$1.8 million, \$1.7 million and \$1.5 million as of August 3, 2019, February 2, 2019 and August 4, 2018, respectively. Revenue recognized from our loyalty program was \$1.4 million and \$1.7 million for each of the thirteen and twenty-six week periods ended August 3, 2019, respectively, and \$0.4 million and \$0.7 million for the thirteen and twenty-six week periods ended August 4, 2018, respectively.

Leases

We conduct all of our retail sales and corporate operations in leased facilities. Lease terms for our stores are generally for ten years (subject to extensions) and provide for escalations in base rents. Many of our store leases contain one or more options to renew the lease at our sole discretion. Generally, we do not consider any additional renewal periods to be reasonably certain of being exercised.

Most store leases include tenant allowances from landlords, rent escalation clauses and/or contingent rent provisions. Certain leases provide for additional rent based on a percentage of sales and annual rent increases generally based upon the Consumer Price Index. In addition, many of the store leases contain certain co-tenancy provisions that permit us to pay rent based on a pre-determined percentage of sales when the occupancy of the retail center falls below minimums established in the lease. For non-cancelable operating lease agreements, operating lease assets and operating lease liabilities are established for leases with an expected term greater than one year and we recognize lease expense on a straight-line basis. Contingent rent, determined based on a percentage of sales in excess of specified levels, is recognized as rent expense when the achievement of the specified sales that triggers the contingent rent is probable.

Refer to "Accounting Standard Adopted" in this Note 2 to the Consolidated Financial Statements for further information.

We lease approximately 172,000 square feet of office and warehouse space (10 and 12 Whatney, Irvine, California) from a company that is owned by the co-founders of Tillys. The lease expires on December 31, 2027. During each of the thirteen and twenty-six week periods ended August 3, 2019 and August 4, 2018, we incurred rent expense of \$0.5 million and \$1.1 million, respectively, related to this lease.

We lease approximately 26,000 square feet of office and warehouse space (11 Whatney, Irvine, California) from a company that is owned by one of the co-founders of Tillys. During each of the thirteen and twenty-six week periods ended August 3, 2019, and August 4, 2018, we incurred rent expense of \$0.1 million and \$0.2 million, respectively, related to this lease. Pursuant to the lease agreement, the lease payment adjusts annually based upon the Los Angeles/Anaheim/Riverside Urban Consumer Price Index, with the adjustment not to be below 3% nor exceed 7% in any one annual increase. The lease expires on June 30, 2022.

We lease approximately 81,000 square feet of office and warehouse space (17 Pasteur, Irvine, California) from a company that is owned by one of the co-founders of Tillys. We use this property as our e-commerce distribution center. During each of the thirteen week periods ended August 3, 2019 and August 4, 2018, we incurred rent expense of \$0.2 million related to this lease. During the twenty-six week periods ended August 3, 2019 and August 4, 2018 we incurred rent expense of \$0.4 million and \$0.5 million, respectively, related to this lease. Pursuant to the lease agreement, the lease payment adjusts annually based upon the Los Angeles/Anaheim/Riverside Urban Consumer Price Index, with the adjustment not to be below 3% nor exceed 7% in any one annual increase. The lease expires on October 31, 2021.

The maturity of operating lease liabilities as of August 3, 2019 were as follows (in thousands):

Fiscal Year		
2019		\$ 33,040
2020		62,666
2021		57,167
2022		49,710
2023		39,950
Thereafter		84,407
Total minimum lease payments		326,940
Less: Amount representing interest		39,320
Present value of operating lease liabilities		\$ 287,620

Future minimum rental commitments, including fixed non-lease components, under non-cancellable operating leases as of February 2, 2019 were as follows (in thousands):

Fiscal Year	Related Party	Other	Total
2019	\$ 3,351	\$ 60,542	\$ 63,893
2020	3,451	56,681	60,132
2021	3,274	50,541	53,815
2022	2,278	41,893	44,171
2023	2,163	32,948	35,111
Thereafter	9,112	57,833	66,945
Total	\$ 23,629	\$ 300,438	\$ 324,067

As of August 3, 2019, additional operating lease contracts that have not yet commenced are immaterial.

Lease expense for the thirteen and twenty-six week periods ended August 3, 2019 was as follows (in thousands):

	Thirteen Weeks Ended			Twenty-Six Weeks Ended		
	Cost of goods sold	SG&A	Total	Cost of goods sold	SG&A	Total
Fixed operating lease expense	\$ 12,437	\$ 373	\$ 12,810	\$ 24,671	\$ 762	\$ 25,433
Variable lease expense	7,124	7	7,131	14,215	45	14,260
Total lease expense	<u>\$ 19,561</u>	<u>\$ 380</u>	<u>\$ 19,941</u>	<u>\$ 38,886</u>	<u>\$ 807</u>	<u>\$ 39,693</u>

Supplemental lease information for the twenty-six weeks ended August 3, 2019 was as follows:

Cash paid for amounts included in the measurement of operating lease liabilities (in thousands)	\$32,024
Weighted average remaining lease term (in years)	5.6 years
Weighted average interest rate (1)	4.17%

(1) Since our leases do not provide an implicit rate, we used our incremental borrowing rate on date of adoption or at lease inception in determining the present value of future minimum payments.

Accounting Standard Adopted

On February 3, 2019, we adopted Accounting Standards Update ("ASU") No. 2016-02, *Leases* (ASC 842), using the additional modified retrospective transition method. By electing this additional transition method, we were not required to recast our comparative financial statements or provide disclosures required by the new standard for comparative periods. The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification determines whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months, regardless of lease classification.

We elected the 'package of practical expedients', which allowed us not to reassess our previous conclusions about lease identification, lease classification and initial direct costs. In addition, we elected the practical expedient to not separate lease and non-lease components for all of our leases. We did not elect the use of the hindsight practical expedient.

New Accounting Standard Not Yet Adopted

In June 2016, the FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments* (ASU 2016-13), which modifies or replaces existing models for impairment of trade and other receivables, debt securities, loans, beneficial interests held as assets, purchased-credit impaired financial assets and other instruments. The new standard requires entities to measure expected losses over the life of the asset and recognize an allowance for estimated credit losses upon recognition of the financial instrument. ASU 2016-13 will become effective for us in the first quarter of fiscal 2020, with early adoption permitted and must be adopted using the modified retrospective method. We are in the process of evaluating the impact of adopting this new standard on our consolidated financial statements and related disclosures.

Note 3: Marketable Securities

Marketable securities as of August 3, 2019 consisted of commercial paper, classified as available-for-sale, and fixed income securities, classified as held-to-maturity as we have the intent and ability to hold them to maturity. Our investments in commercial paper and fixed income securities are recorded at fair value and amortized cost, respectively, which approximates fair value. All of our marketable securities are less than one year from maturity.

The following table summarizes our investments in marketable securities at August 3, 2019, February 2, 2019 and August 4, 2018 (in thousands):

	August 3, 2019		
	Cost or Amortized Cost	Gross Unrealized Holding Gains	Estimated Fair Value
Commercial paper	\$ 49,411	\$ 325	\$ 49,736
Fixed income securities	12,677	—	12,677
	<u>\$ 62,088</u>	<u>\$ 325</u>	<u>\$ 62,413</u>

	February 2, 2019		
	Cost or Amortized Cost	Gross Unrealized Holding Gains	Estimated Fair Value
Commercial paper	\$ 49,402	\$ 302	\$ 49,704
Fixed income securities	26,215	—	26,215
	<u>\$ 75,617</u>	<u>\$ 302</u>	<u>\$ 75,919</u>

	August 4, 2018		
	Cost or Amortized Cost	Gross Unrealized Holding Gains	Estimated Fair Value
Commercial paper	\$ 54,389	\$ 118	\$ 54,507
Fixed income securities	24,081	—	24,081
	<u>\$ 78,470</u>	<u>\$ 118</u>	<u>\$ 78,588</u>

We recognized gains on investments for commercial paper that matured during the thirteen and twenty-six week periods ended August 3, 2019 and August 4, 2018. Upon recognition of the gains, we reclassified these amounts out of Accumulated Other Comprehensive Income and into "Other income, net" on the Consolidated Statements of Income.

The following table summarizes our gains on investments for commercial paper (in thousands):

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Gains on investments	\$ 211	\$ 240	\$ 598	\$ 435

Note 4: Line of Credit

Our amended and restated credit agreement with Wells Fargo Bank, N.A. (the "Bank") provides for a \$25.0 million revolving line of credit with a maturity date of June 26, 2020. The interest rate charged on borrowings is selected at our discretion at the time of draw between the London Interbank Offered Rate, plus 0.75%, or at the Bank's prime rate. The agreement allows for the declaration and payment of dividends or distributions to stockholders, subject to certain limitations. On February 27, 2019 and February 20, 2018, we paid a special cash dividend of \$1.00 per share to all holders of record of issued and outstanding shares of both our Class A and Class B common stock. The line of credit is secured by substantially all of our assets. As a sub-feature under the credit agreement, the Bank may also issue stand-by and/or commercial letters of credit up to \$15.0 million.

We are required to maintain certain financial and non-financial covenants in accordance with the line of credit. The financial covenants require certain levels of leverage and profitability, such as (i) income before income taxes must not be less than \$1.0 million (calculated at the end of each fiscal quarter on a trailing 12-month basis), (ii) a maximum ratio of 4.00 to 1.00 as of each quarter end for "Funded Debt to EBITDAR", defined as the sum of total debt, capital leases and annual rent expense multiplied by six divided by the sum of net income, interest expense, taxes, depreciation, amortization and annual rent expense on a trailing 12-month basis, and (iii) requires minimum eligible inventory, cash, cash equivalents and marketable securities totaling \$50.0 million as of the end of each quarter. In addition, maximum investment in fixed assets in any fiscal year must not exceed \$50.0 million.

Our standby letter of credit of \$1.1 million was established for security against insurance claims as required by our workers' compensation insurance policy. There has been no activity or borrowings under this letter of credit since its inception.

As of August 3, 2019, we were in compliance with all of our covenants and had no outstanding borrowings under the revolving credit facility.

Note 5: Commitments and Contingencies

From time to time, we may become involved in lawsuits and other claims arising from our ordinary course of business. We are currently unable to predict the ultimate outcome, determine whether a liability has been incurred or make an estimate of the reasonably possible liability that could result from an unfavorable outcome because of the uncertainties related to the incurrence, amount and range of loss on any pending litigation or claim. Because of the unpredictable nature of these matters, we cannot provide any assurances regarding the outcome of any litigation or claim to which we are a party or that the ultimate outcome of any of the matters threatened or pending against us, including those disclosed below, will not have a material adverse effect on our financial condition, results of operations or cash flows.

Juan Carlos Gonzales, on behalf of himself and all others similarly situated, v. Tilly's Inc. et al, Superior Court of California, County of Orange, Case No. 30-2017-00948710-CU-OE-CXC. In October 2017, the plaintiff filed a putative class action against us, alleging various violations of California's wage and hour laws. The complaint seeks class certification, unspecified damages, unpaid wages, penalties, restitution, interest, and attorneys' fees and costs. In December 2017, we filed an answer to the complaint, denying all of the claims and asserting various defenses. In April 2018, the plaintiff filed a separate action under the Private Attorneys General Act against us seeking penalties on behalf of himself and other similarly situated employees for the same alleged violations of California's wage and hour laws. We requested the plaintiff to dismiss the class action claims based on an existing class action waiver in an arbitration agreement which plaintiff signed with our co-defendant, BaronHR, the staffing company that employed plaintiff to work at the Company. In June 2018, the plaintiff's class action complaint was dismissed. The court set a deadline of October 31, 2019 for the parties to participate in a mediation. The court has not yet issued a trial date. We have defended this case vigorously, and will continue to do so.

Skylar Ward, on behalf of herself and all others similarly situated, v. Tilly's, Inc., Superior Court of California, County of Los Angeles, Case No. BC595405. In September 2015, the plaintiff filed a putative class action lawsuit against us alleging, among other things, various violations of California's wage and hour laws. The complaint sought class certification, unspecified damages, unpaid wages, penalties, restitution, and attorneys' fees. In June 2016, the court granted our demurrer to the plaintiff's complaint on the grounds that the plaintiff failed to state a cause of action against Tilly's and dismissed the complaint. Specifically, the court agreed with us that the plaintiff's cause of action for reporting-time pay fails as a matter of law as the plaintiff and other putative class members did not "report for work" with respect to certain shifts on which the plaintiff's claims are based. In November 2016, the court entered a written order sustaining our demurrer to the plaintiff's complaint and dismissing all of plaintiff's causes of action with prejudice. In January 2017, the plaintiff filed an appeal of the order to the California Court of Appeal. In October 2017, the plaintiff filed her opening appellate brief, and our responding appellate brief was filed in December 2017. In May 2018, the plaintiff filed her reply appellate brief. Later in May 2018, an amicus brief was filed by Abercrombie & Fitch Stores, Inc., in support of Tilly's position in this appeal. Oral argument was heard by the California Court of Appeal in November 2018. On February 4, 2019, the Court of Appeal issued an opinion overturning the trial court's decision, holding that the plaintiff's allegations stated a claim. In March 2019, we filed a petition for review with the California Supreme Court seeking its discretionary review of the Court of Appeal's decision. In May 2019, the California Supreme Court denied the petition for review and remanded the case to the trial court for further proceedings. In July 2019, we filed an answer to the first amended complaint, denying all claims and asserting various defenses. The parties are currently engaged in the initial round of discovery. We have defended this case vigorously, and will continue to do so.

Note 6: Fair Value Measurements

We determine fair value based on a three-level valuation hierarchy as described below. Fair value is defined as the exit price associated with the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date. The three-level hierarchy of inputs used to determine fair value is as follows:

- *Level 1* – Quoted prices in active markets for identical assets and liabilities.
- *Level 2* – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- *Level 3* – Unobservable inputs (i.e., projections, estimates, interpretations, etc.) that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

We measure certain financial assets at fair value on a recurring basis, including our marketable securities, which are classified as either available-for-sale or held-to-maturity securities, and certain cash equivalents, specifically money market securities, commercial paper and bonds. The money market accounts are valued based on quoted market prices in active markets. The marketable securities are valued based on other observable inputs for those securities (including market corroborated pricing or other models that utilize observable inputs such as interest rates and yield curves) based on information provided by independent third party entities.

From time to time, we measure certain assets at fair value on a non-recurring basis, including evaluation of long-lived assets for impairment using Company specific assumptions which would fall within Level 3 of the fair value hierarchy.

Fair value calculations contain significant judgments and estimates, which may differ from actual results due to, among other things, economic conditions, changes to the business model or changes in operating performance.

During the thirteen and twenty-six week periods ended August 3, 2019 and August 4, 2018, we did not make any transfers between Level 1 and Level 2 financial assets. Furthermore, as of August 3, 2019, February 2, 2019 and August 4, 2018, we did not have any Level 3 financial assets. We conduct reviews on a quarterly basis to verify pricing, assess liquidity and determine if significant inputs have changed that would impact the fair value hierarchy disclosure.

Financial Assets

We have categorized our financial assets based on the priority of the inputs to the valuation technique for the instruments as follows (in thousands):

	August 3, 2019			February 2, 2019			August 4, 2018		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Cash equivalents (1):									
Money market securities	\$ 51,677	\$ —	\$ —	\$ 56,856	\$ —	\$ —	\$ 32,556	\$ —	\$ —
Commercial paper	—	—	—	—	4,975	—	—	—	—
Marketable securities:									
Commercial paper	\$ —	\$ 49,736	\$ —	\$ —	\$ 49,704	\$ —	\$ —	\$ 54,507	\$ —
Fixed income securities	—	12,677	—	—	26,215	—	—	24,081	—

(1) Excluding cash.

Impairment of Long-Lived Assets

An impairment is recorded on a long-lived asset used in operations whenever events or changes in circumstances indicate that the net carrying amounts for such asset may not be recoverable. Important factors that could result in an impairment review include, but are not limited to, significant under-performance relative to historical or planned operating results, significant changes in the manner of use of the assets, a decision to relocate or close a store or significant changes in our business strategies.

An evaluation is performed using estimated undiscounted future cash flows from operating activities compared to the carrying value of related assets for the individual stores. If the undiscounted future cash flows are less than the carrying value, an impairment loss is recognized for the difference between the carrying value and the estimated fair value of the assets based on the discounted cash flows of the assets using a rate that approximates our weighted average cost of capital. With regard to retail store assets, which are comprised of leasehold improvements, fixtures, computer hardware and software, and operating lease assets, we consider the assets at each individual retail store to represent an asset group. In addition, we have considered the relevant valuation techniques that could be applied without undue cost and effort and have determined that the discounted estimated future cash flow approach provides the most relevant and reliable means by which to determine fair value in this circumstance.

On a quarterly basis, we assess whether events or changes in circumstances have occurred that potentially indicate the carrying value of long-lived assets may not be recoverable. During the thirteen and twenty-six weeks ended August 3, 2019, based on Level 3 inputs of historical operating performance, including sales trends, gross margin rates, current cash flows from

operations and the projected outlook for each of our stores, we determined that none of our stores would not be able to generate sufficient cash flows over the remaining term of the related lease to recover our investment in the respective store.

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
	(\$ in thousands)			
Carrying value of assets with impairment	*	\$641	*	\$786
Number of stores tested for impairment	3	4	4	5
Number of stores with impairment	—	1	—	2

* Not applicable

Note 7: Share-Based Compensation

The Tilly's, Inc. 2012 Amended and Restated Equity and Incentive Plan, as amended in June 2014 (the "2012 Plan"), authorizes up to 4,413,900 shares for issuance of options, shares or rights to acquire our Class A common stock and allows for, among other things, operating income and comparable store sales growth targets as additional performance goals that may be used in connection with performance-based awards granted under the 2012 Plan. As of August 3, 2019, there were 1,116,995 shares still available for future issuance under the 2012 Plan.

Stock Options

We grant stock options to certain employees that give them the right to acquire our Class A common stock under the 2012 Plan. The exercise price of options granted is equal to the closing price per share of our stock at the date of grant. The nonqualified options vest at a rate of 25% on each of the first four anniversaries of the grant date provided that the award recipient continues to be employed by us through each of those vesting dates, and expire ten years from the date of grant.

The following table summarizes the stock option activity for the twenty-six weeks ended August 3, 2019 (aggregate intrinsic value in thousands):

	Stock Options	Grant Date Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value (1)
Outstanding at February 2, 2019	1,736,250	\$ 9.47		
Granted	433,500	\$ 11.41		
Exercised	(18,375)	\$ 8.18		
Forfeited	(70,280)	\$ 10.14		
Expired	(250)	\$ 11.33		
Outstanding at August 3, 2019	2,080,845	\$ 9.86	7.0	\$ 1,140
Exercisable at August 3, 2019	1,111,954	\$ 9.89	5.5	\$ 825

(1) Intrinsic value for stock options is defined as the difference between the market price of our Class A common stock on the last business day of the fiscal period and the weighted average exercise price of in-the-money stock options outstanding at the end of the fiscal period. The market value per share was \$7.86 at August 3, 2019.

The stock option awards were measured at fair value on the grant date using the Black-Scholes option valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, expected volatility of our stock over the option's expected term, the risk-free interest rate over the option's expected term and our expected annual dividend yield, if any. We account for forfeitures as they occur. We will issue shares of Class A common stock when the options are exercised.

The fair values of stock options granted during the twenty-six weeks ended August 3, 2019 and twenty-six weeks ended August 4, 2018 were estimated on the grant date using the following assumptions.

	Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018
Weighted average grant-date fair value per option granted	\$5.50	\$5.35
Expected option term (1)	5.0 years	5.0 years
Weighted average expected volatility factor (2)	53.2%	51.6%
Weighted average risk-free interest rate (3)	2.4%	2.6%
Expected annual dividend yield (4)	—%	—%

(1) We have limited historical information regarding expected option term. Accordingly, we determine the expected option term of the awards using the latest historical data available from comparable public companies and management's expectation of exercise behavior.

(2) Stock volatility for each grant is measured using the historical daily price changes of our common stock over the most recent period equal to the expected option term of the awards.

(3) The risk-free interest rate is determined using the rate on treasury securities with the same term as the expected life of the stock option as of the grant date.

(4) We do not currently have a dividend policy and we do not anticipate paying any additional cash dividends on our common stock at this time.

Restricted Stock

Restricted stock awards ("RSAs") represent restricted shares of our common stock issued upon the date of grant in which the recipient's rights in the stock are restricted until the shares are vested, and restricted stock units ("RSUs") represent a commitment to issue shares of our common stock in the future upon vesting. Under the 2012 Plan, we may grant RSAs to independent members of our Board of Directors and RSUs to certain employees. RSAs granted to our Board of Directors vest at a rate of 50% on each of the first two anniversaries of the grant date provided that the respective award recipient continues to vest on our Board of Directors through each of those vesting dates. RSUs granted to certain employees vest at a rate of 25% on each of the first four anniversaries of the grant date provided that the respective recipient continues to be employed by us through each of those vesting dates. We determine the fair value of restricted stock underlying the RSAs and RSUs based upon the closing price of our Class A common stock on the date of grant.

A summary of the status of non-vested restricted stock changes during the twenty-six weeks ended August 3, 2019 are presented below:

	Restricted Stock	Weighted Average Grant-Date Fair Value
Nonvested at February 2, 2019	60,901	\$ 14.32
Granted	41,184	\$ 7.77
Vested	(50,165)	\$ 14.20
Nonvested at August 3, 2019	<u>51,920</u>	<u>\$ 9.24</u>

Share-based compensation expense associated with stock options and restricted stock is recognized on a straight-line basis over the requisite service period. The following table summarizes share-based compensation recorded in the Consolidated Statements of Income (in thousands):

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Cost of goods sold	\$ 92	\$ 127	\$ 208	\$ 267
Selling, general and administrative expenses	454	420	867	860
Total Share-based compensation	<u>\$ 546</u>	<u>\$ 547</u>	<u>\$ 1,075</u>	<u>\$ 1,127</u>

At August 3, 2019, there was \$4.4 million of total unrecognized share-based compensation expense related to unvested stock options and restricted stock. This cost has a weighted average remaining recognition period of 2.7 years.

Note 8: Income Per Share

Income per share is computed under the provisions of ASC 260, *Earnings Per Share*. Basic income per share is computed based on the weighted average number of common shares outstanding during the period. Diluted income per share is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method, whereby proceeds from such exercise, unamortized compensation and hypothetical excess tax benefits, if any, on share-based awards are assumed to be used by us to purchase the common shares at the average market price during the period. Potentially dilutive shares of common stock represent outstanding stock options and RSAs.

The components of basic and diluted income per share were as follows (in thousands, except per share amounts):

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Net income	\$ 9,284	\$ 9,689	\$ 9,961	\$ 10,911
Weighted average basic shares outstanding	29,505	29,209	29,487	29,145
Dilutive effect of stock options and restricted stock	173	472	252	422
Weighted average shares for diluted income per share	29,678	29,681	29,739	29,567
Basic income per share of Class A and Class B common stock	\$ 0.31	\$ 0.33	\$ 0.34	\$ 0.37
Diluted income per share of Class A and Class B common stock	\$ 0.31	\$ 0.33	\$ 0.33	\$ 0.37

The following stock options have been excluded from the calculation of diluted income per share as the effect of including these stock options would have been anti-dilutive (in thousands):

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Stock options	1,381	600	1,367	600
Restricted stock	11	22	—	22
Total	1,392	622	1,367	622

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of the financial condition and results of our operations should be read together with the financial statements and related notes of Tilly’s, Inc. included in Part I Item 1 of this Quarterly Report on Form 10-Q and with our audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended February 2, 2019. As used in this Quarterly Report on Form 10-Q, except where the context otherwise requires or where otherwise indicated, the terms “the Company”, “World of Jeans & Tops”, “we”, “our”, “us”, “Tillys” and “Tilly’s” refer to Tilly’s, Inc. and its subsidiary.

Cautionary Statement Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Forward-looking statements are often identified by the use of words such as, but not limited to, “anticipate”, “believe”, “can”, “continue”, “could”, “estimate”, “expect”, “intend”, “may”, “plan”, “project”, “seek”, “should”, “target”, “will”, “would” and similar expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. These forward-looking statements are subject to numerous risks and uncertainties, including the risks and uncertainties described under the section titled “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended February 2, 2019, those identified in this “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this Quarterly Report on Form 10-Q, and in other filings we may make with the Securities and Exchange Commission from time to time. Moreover, we operate in an evolving environment. New risk factors and uncertainties emerge from time to time and it is not possible for our management to predict all risk factors and uncertainties, nor can we assess the impact of all factors 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 statement. We qualify all of our forward-looking statements by these cautionary statements.

Overview

Tillys is a destination specialty retailer of casual apparel, footwear and accessories for young men, young women, boys and girls. We offer an extensive assortment of iconic global, emerging, and proprietary brands rooted in an active and social lifestyle. Tillys started operations in 1982, when Hezy Shaked and Tilly Levine opened our first store in Orange County, California. As of August 3, 2019, we operated 229 stores in 33 states, comprised of 227 full-size stores averaging approximately 7,500 square feet and two RSQ-branded pop-up stores averaging approximately 3,000 square feet. We also sell our products through our e-commerce website, www.tillys.com.

Known or Anticipated Trends

The retail industry has experienced a general downward trend in customer traffic to physical stores for an extended period of time. Conversely, online shopping has generally increased and resulted in sustained online sales growth. We believe these market trends will continue. We will continue to focus our efforts on improving our existing stores, and expanding our online/digital capabilities through omni-channel initiatives designed to provide a seamless shopping experience for our customers, whether in-store or online.

We opened two new full-size stores and closed two RSQ-branded pop-up stores during the first half of fiscal 2019, ending the quarter with 227 full-size stores and two RSQ-branded pop-up stores. We will continue to leverage existing stores and target new markets where we believe our brand recognition can be enhanced with new stores that are planned to drive additional improvement to our operating income. In fiscal 2019, we expect to open up to 13 new full-size stores. We expect total capital expenditures for fiscal 2019 not to exceed \$20 million, comprised of new store costs supplemented by continuing technology investments.

During fiscal 2019, we expect the impact of legislated minimum wage increases, merit increases, new systems costs, and the adoption of the new lease accounting standard to result in an aggregate increase of approximately \$6 million in our annualized operating costs before consideration of any comparable store net sales assumptions, of which approximately \$2 million will be in occupancy expense within cost of goods sold and approximately \$4 million will be in selling, general and administrative costs. In the absence of any mitigating efforts we may undertake, we estimate that our fiscal 2019 comparable store net sales would need to increase by approximately 3% in order to absorb these anticipated cost increases without creating deleverage of operating expenses as a percentage of net sales.

As of September 4, 2019, all unredeemed legal settlement coupons originally issued in early September 2018 expired. Approximately 2.2% of all coupons originally issued were redeemed, resulting in no material impact on our business.

How We Assess the Performance of Our Business

In assessing the performance of our business, we consider a variety of performance and financial measures. The key indicators of the financial condition and operating performance of our business are net sales, comparable store sales, gross profit, selling, general and administrative expenses and operating income.

Net Sales

Net sales reflect revenue from the sale of our merchandise at store locations, as well as sales of merchandise through our e-commerce platform, which is reflected in sales when the merchandise is shipped to the customer. Net sales also include shipping and handling fees for e-commerce shipments that have been shipped to the customer. Net sales are net of returns on sales during the period as well as an estimate of returns expected in the future stemming from current period sales. Net sales are adjusted for the unredeemed awards and accumulated partial points on our customer loyalty program. Revenue from the sale of gift cards is deferred and not included in net sales until the gift cards are used to purchase merchandise. However, based upon historical patterns, some gift cards will never be redeemed (referred to as gift card "breakage"). Based on our historical gift card breakage rate, gift card breakage revenue is recognized over the redemption period in proportion to actual gift card redemptions and is also included in net sales.

Our business is seasonal and as a result our revenues fluctuate from quarter to quarter. In addition, our revenues in any given quarter can be affected by a number of factors including the timing of holidays and weather patterns. The third and fourth quarters of the fiscal year, which include the back-to-school and holiday sales seasons, have historically produced stronger sales and disproportionately stronger operating results than have the first two quarters of the fiscal year.

Comparable Store Sales

Comparable store sales is a measure that indicates the change in year-over-year comparable store sales which allows us to evaluate how our store base is performing. Numerous factors affect our comparable store sales, including:

- overall economic trends;
- our ability to attract traffic to our stores and e-commerce platform;
- our ability to identify and respond effectively to consumer preferences and fashion trends;
- competition;
- the timing of our releases of new and seasonal styles;
- changes in our product mix;
- pricing;
- the level of customer service that we provide in stores and through our e-commerce platform;
- our ability to source and distribute products efficiently;
- calendar shifts of holiday or seasonal periods;
- the number and timing of store openings and the relative proportion of new stores to mature stores; and
- the timing and success of promotional and advertising efforts.

Comparable store sales are sales from our e-commerce platform and stores open at least 12 full fiscal months as of the end of the current reporting period. A remodeled, relocated or refreshed store is included in comparable store sales, both during and after construction, if the square footage of the store used to sell merchandise was not changed by more than 20% and the store was not closed for more than five days in any fiscal month. We include sales from our e-commerce platform as part of comparable store sales as we manage and analyze our business on a single omni-channel and have substantially integrated our investments and operations for our stores and e-commerce platform to give our customers seamless access and increased ease of shopping. Comparable store sales exclude gift card breakage income and e-commerce shipping and handling fee revenue. Some of our competitors and other retailers may calculate comparable or "same store" sales differently than we do. As a result, data in this report regarding our comparable store sales may not be comparable to similar data made available by other retailers.

Gross Profit

Gross profit is equal to our net sales less our cost of goods sold. Cost of goods sold reflects the direct cost of purchased merchandise as well as buying, distribution and occupancy costs. Buying costs include compensation and benefit expense for our internal buying organization. Distribution costs include costs for receiving, processing and warehousing our store merchandise, and shipping of merchandise to or from our distribution and e-commerce fulfillment centers and to our e-commerce customers and between store locations. Occupancy costs include the rent, common area maintenance, utilities, property taxes, security and depreciation costs of all store locations. These costs are significant and can be expected to continue to increase as our company grows. The components of our reported cost of goods sold may not be comparable to those of other retail companies.

We regularly analyze the components of gross profit as well as gross profit as a percentage of net sales. Specifically we look at the initial markup on purchases, markdowns and reserves, shrinkage, buying costs, distribution costs and occupancy costs. Any inability to obtain acceptable levels of initial markups, a significant increase in our use of markdowns or a significant increase in inventory shrinkage or inability to generate sufficient sales leverage on the buying, distribution and occupancy components of cost of goods sold could have an adverse impact on our gross profit and results of operations.

Gross profit is also impacted by shifts in the proportion of sales of proprietary branded products compared to third-party branded products, as well as by sales mix shifts within and between brands and between major product departments such as mens apparel, womens apparel, footwear or accessories. A substantial shift in the mix of products could have a material impact on our results of operations. In addition, gross profit and gross profit as a percentage of net sales have historically been higher in the third and fourth quarters of the fiscal year, as these periods include the back-to-school and winter holiday selling seasons. In those periods, various costs, such as occupancy costs, generally do not increase in proportion to the seasonal sales increase.

Selling, General and Administrative Expenses

Our selling, general and administrative, or SG&A, expenses are composed of store selling expenses and corporate-level general and administrative expenses. Store selling expenses include store and regional support costs, including personnel, advertising and debit and credit card processing costs, e-commerce receiving and processing costs and store supplies costs. General and administrative expenses include the payroll and support costs of corporate functions such as executive management, legal, accounting, information systems, human resources, impairment charges and other centralized services. Store selling expenses generally vary proportionately with net sales and store growth. In contrast, general and administrative expenses are generally not directly proportional to net sales and store growth, but will be expected to increase over time to support the needs of our growing company. SG&A expenses as a percentage of net sales are usually higher in lower volume periods and lower in higher volume periods.

Operating Income

Operating income equals gross profit less SG&A expenses. Operating income excludes interest income, interest expense and income taxes. Operating income percentage measures operating income as a percentage of our net sales.

Results of Operations

The following tables summarize key components of our unaudited results of operations for the periods indicated, both in dollars (in thousands) and as a percentage of our net sales.

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Statements of Operations Data:				
Net sales	\$ 161,738	\$ 157,406	\$ 292,041	\$ 281,040
Cost of goods sold	110,019	107,301	204,638	195,957
Gross profit	51,719	50,105	87,403	85,083
Selling, general and administrative expenses	39,609	37,627	75,147	71,275
Operating income	12,110	12,478	12,256	13,808
Other income, net	572	490	1,401	873
Income before income taxes	12,682	12,968	13,657	14,681
Income tax expense	3,398	3,279	3,696	3,770
Net income	\$ 9,284	\$ 9,689	\$ 9,961	\$ 10,911

Percentage of Net Sales:

Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	68.0%	68.2%	70.1%	69.7%
Gross profit	32.0%	31.8%	29.9%	30.3%
Selling, general and administrative expenses	24.5%	23.9%	25.7%	25.4%
Operating income	7.5%	7.9%	4.2%	4.9%
Other income, net	0.4%	0.3%	0.5%	0.3%
Income before income taxes	7.8%	8.2%	4.7%	5.2%
Income tax expense	2.1%	2.1%	1.3%	1.3%
Net income	5.7%	6.2%	3.4%	3.9%

The following table presents store operating data for the periods indicated:

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018	August 3, 2019	August 4, 2018
Operating Data:				
Stores operating at end of period	229	226	229	226
Comparable store sales change (1)	0.6%	4.4%	1.4%	2.4%
Total square feet at end of period (in thousands)	1,710	1,698	1,710	1,698
Average net sales per retail store (in thousands) (2)	\$ 606	\$ 616	\$ 1,102	\$ 1,109
Average net sales per square foot (2)	\$ 81	\$ 82	\$ 147	\$ 147
E-commerce revenues (in thousands) (3)	\$ 22,820	\$ 19,672	\$ 42,487	\$ 34,805
E-commerce revenues as a percentage of net sales	14.1%	12.5%	14.5%	12.4%

(1) Comparable store sales are net sales from stores that have been open at least 12 full fiscal months as of the end of the current reporting period. A remodeled or relocated store is included in comparable store sales, both during and after construction, if the square footage of the store used to sell merchandise was not changed by more than 20% and the store was not closed for more than five days in any fiscal month. Comparable store sales include sales through our e-commerce platform but exclude gift card breakage income, deferred revenue on loyalty program and e-commerce shipping and handling fee revenue.

(2) E-commerce sales, e-commerce shipping and handling fee revenue and gift card breakage are excluded from net sales in deriving average net sales per retail store.

(3) E-commerce revenues include e-commerce sales and e-commerce shipping fee revenue.

Second Quarter (13 Weeks) Ended August 3, 2019 Compared to Second Quarter (13 Weeks) Ended August 4, 2018
Net Sales

Net sales were \$161.7 million, an increase of \$4.3 million or 2.8%, compared to \$157.4 million last year. Comparable store net sales, which includes e-commerce net sales, increased 0.6% compared to an increase of 4.4% last year. E-commerce net sales increased 15.7% and represented approximately 14.1% of total net sales compared to an increase of 8.1% and a 12.5% share of total net sales last year. Comparable store net sales in physical stores decreased 1.5% and represented approximately 85.9% of total net sales compared to an increase of 3.8% and an 87.5% share of total net sales last year.

Gross Profit

Gross profit was \$51.7 million, an increase of \$1.6 million or 3.2%, compared to \$50.1 million last year. Gross margin, or gross profit as a percentage of net sales, was 32.0% compared to 31.8% last year. Product margins were approximately flat as a percentage of net sales. Buying, distribution and occupancy costs improved by approximately 10 basis points in total. Improved leverage of buying and occupancy costs as a percentage of net sales offset by higher e-commerce shipping costs associated with e-commerce net sales growth.

Selling, General and Administrative Expenses

SG&A expenses were \$39.6 million, or 24.5% of net sales, compared to \$37.6 million, or 23.9% of net sales, last year. The components of the SG&A increase, both in terms of percentage of net sales and total dollars, were as follows:

%	\$ millions	Primarily Attributable to
0.9%	\$1.5	Favorable resolution of the previously disclosed <i>Minniti</i> legal matter, resulting in a \$1.5 million reduction in legal reserves recorded in the second quarter of fiscal 2018.
0.6%	1.0	Increase in e-commerce marketing and fulfillment costs associated with e-commerce net sales growth.
0.2%	0.9	Increase in store payroll due to minimum wage and annual merit increases.
(0.8)%	(1.2)	Decrease in corporate bonus expense.
(0.4)%	(0.6)	Decrease in store impairment charges.
0.1%	0.4	Net increase in other SG&A expenses.
0.6%	\$2.0	Total

Operating Income

Operating income was \$12.1 million, or 7.5% of net sales, compared to \$12.5 million, or 7.9% of net sales, last year. The slight decline in operating income was primarily attributable to last year's \$1.5 million legal matter credit noted above.

Income Tax Expense

Income tax expense was \$3.4 million, or 26.8% of income before taxes, compared to \$3.3 million, or 25.3% of income before taxes, last year. Income tax expense for both periods includes certain discrete items associated with employee stock-based award activity.

Net Income and Income Per Share

Net income was \$9.3 million, or \$0.31 per diluted share, compared to \$9.7 million, or \$0.33 per diluted share last year. Last year's results include \$1.1 million net of tax, or \$0.04 per diluted share, related to the favorable resolution of the previously disclosed legal matter noted above.

First Half (26 Weeks) Ended August 3, 2019 Compared to First Half (26 Weeks) Ended August 4, 2018
Net Sales

Net sales were \$292.0 million, an increase of \$11.0 million or 3.9%, compared to \$281.0 million last year. E-commerce net sales increased 21.7% and represented approximately 14.5% of total net sales compared to an increase of 0.9% and a 12.4% share of total net sales last year. Comparable store net sales in physical stores decreased 1.5% and represented approximately 85.5% of total net sales, compared to an increase of 2.7% and a 87.6% share of total net sales last year.

Gross Profit

Gross profit was \$87.4 million, an increase of \$2.3 million or 2.7%, compared to \$85.1 million last year. Gross margin was 29.9% compared to 30.3% last year. This 40 basis point decrease in gross margin was primarily attributable to a 30 basis point decline in product margins primarily due to higher total markdowns. Buying, distribution and occupancy costs deleveraged 10 basis points in total as a percentage of net sales. Higher e-commerce shipping costs associated with e-commerce net sales growth more than offset improved leverage of buying and occupancy costs as a percentage of net sales.

Selling, General and Administrative Expenses

SG&A expenses were \$75.1 million, or 25.7% of net sales, compared to \$71.3 million, or 25.4% of net sales, last year. The components of the SG&A increase, both in terms of percentage of net sales and total dollars, were as follows:

%	\$ millions	Primarily Attributable to
0.2%	\$1.9	Increase in store payroll due to minimum wage increases and annual merit increases.
0.6%	1.9	Increase in e-commerce marketing and fulfillment costs associated with e-commerce net sales growth.
0.5%	1.5	Favorable resolution of the previously disclosed <i>Minniti</i> legal matter, resulting in a \$1.5 million reduction in legal reserves recorded in the second quarter of fiscal 2018.
(0.4)%	(1.3)	Decrease in corporate bonus expense.
(0.3)%	(0.8)	Decrease in store impairment charges.
(0.3)%	0.7	Net change in all other SG&A expenses.
0.3%	\$3.9	Total

Operating Income

Operating income was \$12.3 million, or 4.2% of net sales, compared to \$13.8 million, or 4.9% of net sales, last year. The decrease in year-over-year operating income was attributable to the favorable resolution of a legal matter during last year's second quarter of approximately \$1.5 million, as noted above.

Income Tax Expense

Income tax expense was \$3.7 million, or 27.1% of income before taxes, compared to \$3.8 million, or 25.7% of income before taxes, last year. Income tax expense for both periods includes certain discrete items associated with employee stock-based award activity.

Net Income and Income Per Share

Net income was \$10.0 million, or \$0.33 per diluted share, compared to \$10.9 million, or \$0.37 per diluted share, last year. Last year's results include \$1.1 million net of tax, or \$0.04 per diluted share, related to the favorable resolution of the previously disclosed legal matter noted above.

Liquidity and Capital Resources

Our primary cash needs are for merchandise inventories, payroll, store rent and capital expenditures. We have historically provided for these needs through internally generated cash flows. In addition, we have access to additional liquidity through a \$25.0 million revolving credit facility with Wells Fargo Bank, NA. We expect to continue to finance our operations from cash and marketable securities on hand as well as cash flows from operations without borrowing under our revolving credit facility over the next twelve months.

Working capital at August 3, 2019, was \$83.2 million compared to \$119.9 million at February 2, 2019, a decrease of \$36.7 million. The changes in our working capital during the first half of fiscal 2019 were as follows:

\$ millions	Description
\$119.9	Working capital at February 2, 2019
(53.8)	Decrease in working capital primarily due to the balance sheet implementation impacts of the adoption of ASC 842, <i>Leases</i>
17.1	Net increase from changes in all other current assets and liabilities
\$83.2	Working capital at August 3, 2019

Cash Flow Analysis

A summary of operating, investing and financing activities for the first half of fiscal 2019 compared to the first half of fiscal 2018 is shown in the following table (in thousands):

	Twenty-Six Weeks Ended	
	August 3, 2019	August 4, 2018
Net cash provided by operating activities	\$ 14,085	\$ 21,950
Net cash provided by (used in) investing activities	9,530	(1,812)
Net cash used in financing activities	(29,387)	(27,702)
Net decrease in cash and cash equivalents	\$ (5,772)	\$ (7,564)

Net Cash Provided By Operating Activities

Operating activities consist primarily of net income adjusted for non-cash items, plus the effect on cash of changes during the period in our assets and liabilities.

Net cash flows provided by operating activities were \$14.1 million this year compared to \$22.0 million last year. The \$7.9 million decrease in cash provided by operating activities was primarily due to the timing of payments to vendors and an increase in bonuses paid in the first half of fiscal 2019.

Net Cash Provided By (Used In) Investing Activities

Cash flows from investing activities consist primarily of capital expenditures and maturities and purchases of marketable securities.

Net cash provided by investing activities was \$9.5 million this year compared to net cash used in investing activities of \$1.8 million last year. Net cash provided by investing activities in the first half of fiscal 2019 consisted of proceeds from the maturities of marketable securities of \$76.5 million, partially offset by purchases of marketable securities of \$62.1 million and capital expenditures totaling \$4.8 million. Net cash used in investing activities during the first half of fiscal 2018 consisted of purchases of marketable securities of \$79.8 million, and capital expenditures totaling \$6.7 million, partially offset by proceeds from the maturities of marketable securities of \$84.7 million.

Net Cash Used in Financing Activities

Financing activities primarily consist of cash dividend payments, taxes paid in lieu of shares issued for share based compensation and proceeds from employee exercises of stock options.

Net cash used in financing activities was \$29.4 million this year compared to \$27.7 million last year. Financing activities in the first half of fiscal 2019 consisted of dividends paid of \$29.5 million and taxes paid in lieu of shares issued for share-based compensation of \$0.1 million, partially offset by \$0.2 million in proceeds from stock option exercises. Financing activities in the first half of fiscal 2018 consisted of dividends paid of \$29.1 million and taxes paid in lieu of shares issued for share-based compensation of \$0.1 million, partially offset by \$1.5 million in proceeds from stock option exercises.

Line of Credit

Our amended and restated credit agreement with Wells Fargo Bank, N.A. (the "Bank") provides for a \$25.0 million revolving line of credit with a maturity date of June 26, 2020. The interest rate charged on borrowings is selected at our discretion at the time of draw between the London Interbank Offered Rate, plus 0.75%, or at the Bank's prime rate. The agreement allows for the declaration and payment of dividends or distributions to stockholders, subject to certain limitations. On February 27, 2019 and February 20, 2018, we paid a special cash dividend of \$1.00 per share to all holders of record of issued and outstanding shares of both our Class A and Class B common stock. The line of credit is secured by substantially all of our assets. As a sub-feature under the credit agreement, the Bank may also issue stand-by and/or commercial letters of credit up to \$15.0 million.

We are required to maintain certain financial and non-financial covenants in accordance with the line of credit. The financial covenants require certain levels of leverage and profitability, such as (i) income before income taxes not to be less than \$1.0 million (calculated at the end of each fiscal quarter on a trailing 12-month basis), (ii) a maximum ratio of 4.00 to 1.00 as of each quarter end for “Funded Debt to EBITDAR”, defined as the sum of total debt, capital leases and annual rent expense multiplied by six divided by the sum of net income, interest expense, taxes, depreciation, amortization and annual rent expense on a trailing 12-month basis, and (iii) requires minimum eligible inventory, cash, cash equivalents and marketable securities totaling \$50.0 million as of the end of each quarter. In addition, maximum investment in fixed assets in any fiscal year of \$50.0 million.

Our standby letter of credit of \$1.1 million was established for security against insurance claims, as required by our workers' compensation insurance policy. There has been no activity or borrowings under this letter of credit since its inception.

As of August 3, 2019, we were in compliance with all of our covenants and had no outstanding borrowings under the revolving credit facility.

Contractual Obligations

As of August 3, 2019, there were no material changes to our contractual obligations as described in the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section of our Annual Report on Form 10-K for the fiscal year ended February 2, 2019.

Off-Balance Sheet Arrangements

We are not a party to any off-balance sheet arrangements, except for purchase obligations and our revolving credit facility.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires the appropriate application of certain accounting policies, some of which require us to make estimates and assumptions about future events and their impact on amounts reported in our consolidated financial statements. Since future events and their impact cannot be determined with absolute certainty, the actual results will inevitably differ from our estimates. A summary of our significant accounting policies is included in Note 2 to the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended February 2, 2019.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of August 3, 2019, there were no material changes in the market risks described in the “Quantitative and Qualitative Disclosure of Market Risks” section of our Annual Report on Form 10-K for the fiscal year ended February 2, 2019.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Disclosure Committee, including our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of August 3, 2019. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to our management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of August 3, 2019, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at the reasonable assurance level. However, our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Part II. Other Information

Item 1. Legal Proceedings

From time to time, we may become involved in lawsuits and other claims arising from our ordinary course of business. We are currently unable to predict the ultimate outcome, determine whether a liability has been incurred or make an estimate of the reasonably possible liability that could result from an unfavorable outcome because of the uncertainties related to the incurrence, amount and range of loss on any pending litigation or claim. Because of the unpredictable nature of these matters, we cannot provide any assurances regarding the outcome of any litigation or claim to which we are a party or that the ultimate outcome of any of the matters threatened or pending against us, including those disclosed below, will not have a material adverse effect on our financial condition, results of operations or cash flows.

Juan Carlos Gonzales, on behalf of himself and all others similarly situated, v. Tilly's Inc. et al, Superior Court of California, County of Orange, Case No. 30-2017-00948710-CU-OE-CXC. In October 2017, the plaintiff filed a putative class action against us, alleging various violations of California's wage and hour laws. The complaint seeks class certification, unspecified damages, unpaid wages, penalties, restitution, interest, and attorneys' fees and costs. In December 2017, we filed an answer to the complaint, denying all of the claims and asserting various defenses. In April 2018, the plaintiff filed a separate action under the Private Attorneys General Act against us seeking penalties on behalf of himself and other similarly situated employees for the same alleged violations of California's wage and hour laws. We requested the plaintiff to dismiss the class action claims based on an existing class action waiver in an arbitration agreement which plaintiff signed with our co-defendant, BaronHR, the staffing company that employed plaintiff to work at the Company. In June 2018, the plaintiff's class action complaint was dismissed. The court set a deadline of October 31, 2019 for the parties to participate in a mediation. The court has not yet issued a trial date. We have defended this case vigorously, and will continue to do so.

Skylar Ward, on behalf of herself and all others similarly situated, v. Tilly's, Inc., Superior Court of California, County of Los Angeles, Case No. BC595405. In September 2015, the plaintiff filed a putative class action lawsuit against us alleging, among other things, various violations of California's wage and hour laws. The complaint sought class certification, unspecified damages, unpaid wages, penalties, restitution, and attorneys' fees. In June 2016, the court granted our demurrer to the plaintiff's complaint on the grounds that the plaintiff failed to state a cause of action against Tilly's and dismissed the complaint. Specifically, the court agreed with us that the plaintiff's cause of action for reporting-time pay fails as a matter of law as the plaintiff and other putative class members did not "report for work" with respect to certain shifts on which the plaintiff's claims are based. In November 2016, the court entered a written order sustaining our demurrer to the plaintiff's complaint and dismissing all of plaintiff's causes of action with prejudice. In January 2017, the plaintiff filed an appeal of the order to the California Court of Appeal. In October 2017, the plaintiff filed her opening appellate brief, and our responding appellate brief was filed in December 2017. In May 2018, the plaintiff filed her reply appellate brief. Later in May 2018, an amicus brief was filed by Abercrombie & Fitch Stores, Inc., in support of Tilly's position in this appeal. Oral argument was heard by the California Court of Appeal in November 2018. On February 4, 2019, the Court of Appeal issued an opinion overturning the trial court's decision, holding that the plaintiff's allegations stated a claim. In March 2019, we filed a petition for review with the California Supreme Court seeking its discretionary review of the Court of Appeal's decision. In May 2019, the California Supreme Court denied the petition for review and remanded the case to the trial court for further proceedings. In July 2019, we filed an answer to the first amended complaint, denying all claims and asserting various defenses. The parties are currently engaged in the initial round of discovery. We have defended this case vigorously, and will continue to do so.

Item 1A. Risk Factors

We operate in a rapidly changing environment that involves a number of risks that could materially and adversely affect our business, financial condition, prospects, operating results or cash flows. For a detailed discussion of the risks that affect our business, please refer to the section entitled "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended February 2, 2019. There have been no material changes to our risk factors as previously disclosed in our Annual Report on Form 10-K.

Item 6. Exhibits

Exhibit No.	Description of Exhibit
31.1*	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2*	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1**	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive data files from Tilly's, Inc.'s Quarterly Report on Form 10-Q for the quarter ended August 3, 2019, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Income; (iii) the Consolidated Statements of Comprehensive Income; (iv) the Consolidated Statement of Stockholders' Equity; (v) the Consolidated Statements of Cash Flows and (vi) Notes to the Consolidated Financial Statements.
*	Filed herewith
**	Furnished herewith and not "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

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.

Date: September 10, 2019

Tilly's, Inc.

/s/ Edmond Thomas

Edmond Thomas

*President, Chief Executive Officer and Director
(Principal Executive Officer)*

Date: September 10, 2019

/s/ Michael Henry

Michael Henry

*Chief Financial Officer
(Principal Financial Officer)*

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO RULE 13a-14(a)
OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED**

I, Edmond Thomas, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Tilly's, Inc. for the quarter ended August 3, 2019;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 10, 2019

/s/ Edmond Thomas

Edmond Thomas

President, Chief Executive Officer and Director

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO RULE 13a-14(a)
OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED**

I, Michael Henry, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Tilly's, Inc. for the quarter ended August 3, 2019;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 10, 2019

/s/ Michael Henry

Michael Henry

Chief Financial Officer

**CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q for the fiscal quarter ended August 3, 2019 of Tilly's, Inc. (the "Company") as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Edmond Thomas, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (i) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: September 10, 2019

/s/ Edmond Thomas

Edmond Thomas

President, Chief Executive Officer and Director

In connection with the Quarterly Report on Form 10-Q for the fiscal quarter ended August 3, 2019 of Tilly's, Inc. (the "Company") as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael Henry, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (i) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: September 10, 2019

/s/ Michael Henry

Michael Henry

Chief Financial Officer

The foregoing certifications are being furnished solely to accompany the Report pursuant to 18 U.S.C. Section 1350 and in accordance with SEC Release No. 33-8238. These certifications shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, nor shall they be incorporated by reference in any filing of the Company under the Securities Act of 1933, as amended, whether made before or after the date hereof, regardless of any general incorporation language in such filing.