INTERNATIONAL BUSINESS MACHINES CORP
Form 8-K
January 19, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 8-K

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

Date of Report: January 18, 2007
(Date of earliest event reported)

INTERNATIONAL BUSINESS MACHINES CORPORATION
(Exact name of registrant as specified in its charter)

New York	**1-2360**	**13-0871985**
(State of Incorporation)	(Commission File Number)	(IRS employer Identification No.)

ARMONK, NEW YORK	**10504**
(Address of principal executive offices)	(Zip Code)

914-499-1900
(Registrant s telephone number)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.02. Results of Operations and Financial Condition.

Attachment I of this Form 8-K is the transcript of IBM s Chief Financial Officer Mark Loughridge s fourth quarter earnings presentation to securities analysts on January 18, 2007. Certain reconciliation and other information (Non-GAAP Supplementary Materials) for this presentation was included in Attachment II to the Form 8K that IBM submitted on January 18, 2007, which included IBM s press release dated January 18, 2007. All of the information in Attachment I is hereby filed except for the information set forth below, which is furnished but not filed.

The following statement on Page 6:

up 16 percent year-to-year without the divested PC business in last year s results.

The following statements on Page 7:

Total Expense and Other Income increased 16 percent in the quarter, excluding last year s pension charge.

Excluding currency impacts and the year-to-year impact from real estate transactions, total expense growth would have been 9 percent.

SG&A was up 13 percent.

The following statements on Page 8:

This is an increase of about $80 million year-to-year, excluding last year s pension curtailment charge.

up about $325 million over the prior year, excluding the 2005 non-recurring charges.

The following statements on Page 9:

Excluding the significant pension funding activity in the U.S. in 2005 and U.K in 2006, we generated $1.5 billion more cash from operations year-to-year.

We generated cash flow of $10.5 billion, up about $960 million compared to last year.

The following statement on Page 21:

In the emerging markets of China, India, Russia and Brazil we grew 16 percent in 2006.

The following statement on Page 22:

our Return on Invested Capital for the year was 34 percent for our core business .

IBM s web site (www.ibm.com) contains a significant amount of information about IBM, including financial and other information for investors (www.ibm.com/investor/). IBM encourages investors to visit its various web sites from time to time, as information is updated and new information is posted.

3

SIGNATURE

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, hereunto duly authorized.

Date: January 19, 2007

By:	/s/ Timothy S. Shaughnessy Timothy S. Shaughnessy Vice President and Controller

4

ATTACHMENT I

INTRODUCTION

Thank you. This is Patricia Murphy, Vice President of Investor Relations for IBM. I m here with Mark Loughridge, IBM s Senior Vice President and Chief Financial Officer. Thank you for joining our fourth quarter earnings presentation.

By now, the opening page of the presentation should have automatically loaded, and you should be on the title page.

The charts will automatically advance as we move through the presentation. If you prefer to manually control the charts, at any time you can un-check the synchronize button on the left of the presentation.

The prepared remarks will be available in roughly an hour, and a replay of this webcast will be posted to our Investor Relations website by this time tomorrow.

Our presentation includes certain non-GAAP financial measures, in an effort to provide additional information to investors.

All non-GAAP measures have been reconciled to their related GAAP measures in accordance with SEC rules. You will find reconciliation charts at the end, and in the Form 8-K submitted to the SEC.

For those of you who are manually controlling the charts, please click on the Next button for Chart 2.

Certain comments made in this presentation may be characterized as forward looking under the Private Securities Litigation Reform Act of 1995.

Those statements involve a number of factors that could cause actual results to differ materially.

Additional information concerning these factors is contained in the company s filings with the SEC. Copies are available from the SEC, from the IBM web site, or from us in Investor Relations.

Now, I ll turn the call over to Mark Loughridge.

IBM RESULTS FOURTH QUARTER

Thanks Patricia.

We had a very strong finish to the year.

We delivered $26.3 billion in revenue, which was up 7 percent as reported and 4 percent at constant currency.

Our pre-tax income was up 5 percent to $4.8 billion.

And we delivered $2.26 of earnings per share, including a six cent benefit from a lower tax rate. Our EPS was up 12 percent year-to-year.

Excluding the one-time pension curtailment charge from the 2005 results, EPS was up 7 percent.

This quarter

We had the best software revenue growth in over five years, with continued momentum in our strategic middleware, and additional benefit from our recent acquisitions. Our focus on building up our software capabilities is clearly paying off.

The profile of our services business continued to improve. Revenue growth accelerated in the quarter, and we had exceptional signings performance, closing almost $18 billion of new business.

From a geographic perspective, the Americas and Asia Pacific posted the strongest growth, with a solid recovery in Japan and good contribution from emerging countries.

We are driving productivity initiatives across the business. At the same time we re ramping investments to drive future growth.

And once again we had strong cash performance, with an increase in net cash from operations for the year of $2.2 billion, excluding Global Financing Receivables.

Let s move on to our full year performance with Chart 4.

-2-

IBM RESULTS FULL YEAR

Our full year performance was the result of a series of actions we ve taken over the last several years to improve our mix of businesses and globally integrate the company.

We delivered $91.4 billion of revenue, pretax earnings of $13.3 billion, and earnings per share of $6.06.

We expanded margins, had record cash performance, and provided record return to shareholders. In summary, we had a strong fourth quarter and 2006, and we feel good about the momentum of our business as we enter 2007.

But before moving on, I d like to add some perspective to our profit performance on the next chart.

-3-

IBM PROFIT RESULTS   FULL YEAR

There are a few items in our operating results that many other companies, especially in the tech sector, exclude from the discussion of their earnings. For example:

We absorbed over $300 million for the amortization of purchased intangibles   which is a non-cash item.

We absorbed $850 million of stock-based compensation. We have significantly reduced stock grants over the last few years, and since 2004 we ve reduced our stock based compensation by almost 50 percent.

We absorbed $300 million of charges for ongoing restructuring, primarily reflecting resource rebalancing activity.

In addition, we absorbed $2.4 billion of cost and expense for retirement-related plans. This reflects the benefit that we received from the pension plan changes we implemented in 2006, designed to reduce the expense level and reduce the volatility over the long term.

These items are part of any ongoing business, and we view them in the same way as any other element of cost or expense that impacts our financial statement.

Now before getting into the details of the fourth quarter results, I ll make a brief comment on the structure of our presentation.

This quarter we completed the acquisition of Integrated Security Systems, a business that protects a clients   IT infrastructure against intrusion through a combination of software and managed services. This is consistent with our strategy, which capitalizes on a trend toward the convergence of software and services.

The long term value of ISS is in managed services, and ISS is now an integrated business within Global Technology Services   and reported in the Global Technology Services segment. But because some of the value is being delivered through software licenses, this activity will be classified as software sales on the income statement.

Going forward, we will consistently focus our discussion on the segment view, as this is how we are managing our businesses, and the best reflection of our strategy.

Let s now turn to IBM s external segment revenue.

-4-

REVENUE BY SEGMENT

IBM s fourth quarter revenue was up 7 percent as reported, 4 percent at constant currency.

Performance was led by Software, reflecting strong demand for our industry-leading middleware portfolio. Revenue was up 14 percent as reported and up 11 percent at constant currency.

Global Technology Services revenue grew 7 percent as reported and 4 percent at constant currency. The acceleration in growth was driven by Integrated Technology Services, with progress in the implementation of our new offerings, and contribution from the newly-acquired ISS business.

Global Business Services grew 6 percent as reported and 3 percent at constant currency, led by solid performance in consulting.

Systems and Technology revenue was up 3 percent as reported, and flat at constant currency.

The best performance came from Storage, and Retail Store Systems. Our System z revenue improved year-to-year, and as anticipated, Microelectronics revenue declined as it wrapped around on a very strong fourth quarter of 2005.

Global Financing revenue was up 3 percent as reported, and flat at constant currency, with a modest improvement in financing revenue due to an increase in assets.

Overall, IBM s gross profit margin improved a half a point, led by services, and a mix toward our higher margin software business.

I ll address the margin dynamics in the discussion of the segments.

REVENUE BY GEOGRAPHY

Looking at our revenue by geography, as always, I ll focus my comments on the results at constant currency, to provide the best view of the underlying business performance.

The Americas revenue grew 5 percent.

From a product perspective, the Americas growth was again driven by software.

By region, the best performance came from Latin America, with double-digit revenue growth. The U.S. also grew, while Canada had a modest decline.

Europe s revenue was up 3 percent year-to-year, an improvement from the growth rate in the third quarter.

Of the major countries, Italy had the best performance, and the U.K. also improved year-to-year.

Asia Pacific also delivered strong results with revenue up 5 percent in the quarter.

The Asia Pacific economy remained strong, led by India and China.

Our business in Japan returned to growth in the second half of the year. This is an important market for us, as Japan represents over half of the Asia Pacific revenue base and is the second largest country globally in terms of revenue and profit.

The emerging countries of China, India, Brazil and Russia together grew 18 percent. India and Russia both posted growth of over 30 percent. China grew 18 percent, and Brazil grew 9 percent.

For the year, these four countries contributed $4.5 billion of revenue, up 16 percent year-to-year without the divested PC business in last year s results.

We continue to invest to build capabilities in these countries, to address the fast-growing domestic market opportunities, and to enhance IBM s globally integrated operations.

Finally, our OEM revenue was down 3 percent, after four consecutive quarters of very strong growth. Now we ll move on to expense.

EXPENSE SUMMARY

I m going to spend a little more time on expense this quarter, as it is important to understand the dynamics, and the investments that we are making.

Total Expense and Other Income increased 16 percent in the quarter, excluding last year s pension charge. Excluding currency impacts and the year-to-year impact from real estate transactions, total expense growth would have been 9 percent.

SG&A was up 13 percent.

Approximately four points of this growth is due to the impact of currency.

We estimate that our investments in acquisitions drove four points of the growth in SG&A. While it can take some time for these investments to be fully accretive, we are encouraged by the accelerated pace with which we have integrated acquisitions and the contribution from the acquired businesses within the fourth quarter.

The remaining five points of the SG&A growth was largely driven by investments we are making in our software and services business and emerging markets. Like the acquisitions, productivity of the sales resource improves over time. The returns on these investments are reflected in the momentum in our key middleware brands, growth in emerging markets, and strong signings performance.

RD&E was up 9 percent.

Acquisitions drove approximately half of this growth, with the remainder reflecting our ongoing commitments to maintain our technology leadership across our product portfolio.

We expect a similar level of expense growth during the first half of 2007, driven by investments in strategic areas with some moderation of the growth rate in the second half. To help mitigate some of the impact, we expect to continue to expand gross margins, globalize our support functions, and rapidly integrate new acquisitions.

I also want to highlight a couple of other items that significantly impacted our profit growth. We refer to these as our roadmap items.

The first is gains on real estate transactions, which are recorded in Other Income and Expense. In the fourth quarter of last year, we had unusually high gains in the quarter due to a few large transactions. While we did have some real estate activity in the fourth quarter of this year, the gains were down $140 million year-to-year.

And second,retirement-related plans generated about $600 million of cost and expense in the quarter. This is an increase of about $80 million year-to-year, excluding last year s pension curtailment charge.

The retirement-related plans cost over $2.4 billion for the full year, up about $325 million over the prior year, excluding the 2005 non-recurring charges.

For 2007, the interest rate environment together with other factors such as actuarial assumptions will result in retirement-related expense of about $2.5 billion, an increase of less than $100 million year-to-year.

I ll comment on two other items, tax rate and currency.

In the fourth quarter, we recorded an effective tax rate of 28 percent, down from the previous ongoing rate of 30 percent.

For the full year 2006, IBM s effective tax rate was 29.3 percent. Looking forward to 2007, we expect a rate in the range of 28 1/2 percent. The improved rate is the result of a more favorable mix of income in lower tax jurisdictions, and the ongoing benefit from the R&D credit passed by Congress in December.

On currency

IBM hedges its major cross-border cash flows and, as a result, mitigates the effect of currency volatility in the year-over-year results. The impact of these hedging programs is principally reflected in Other Income and Expense, as well as cost of goods sold.

I m not going to predict future currency moves, but at current spot rates we would expect revenue growth to benefit from currency translation in the first half of 2007.

Now let s turn to Cash Flow.

CASH FLOW

We had another outstanding year in cash generation.

As you know, this cash flow analysis chart has one primary difference from the FAS 95 format. It considers our Global Financing Receivables as an investment to generate profit, not as Working Capital that should be minimized for efficiency.

For 2006, Net Cash Provided from Operations, excluding the year-to-year change in Global Financing Receivables, was $15.3 billion, an increase of $2.2 billion from last year, and the highest on record. Excluding the significant pension funding activity in the U.S. in 2005 and the U.K. in 2006, we generated $1.5 billion more cash from operations year-to-year.

Our year-to-date cash performance was driven primarily by growth in Net Income, and continued focus on working capital.

Turning to our investing activities

Net Capital Expenditures were approximately $4.7 billion, an increase of approximately $1.2 billion year-to-year. The growth was driven by the unusually high level of real estate asset sales in 2005, and increased spending in support of strategic outsourcing contracts.

Let me make a subtotal here since many investors look at cash flow after Capital Expenditures. We generated cash flow of $10.5 billion, up about $960 million compared to last year. We have increased cash flow in each of the past four years.

Spending on Acquisitions was $3.8 billion, up $2.3 billion year-to-year. This activity increased in the fourth quarter as we completed acquisitions announced in the third quarter, including FileNet, MRO and ISS.

We returned a record $9.8 billion to investors this year, an increase of almost $800 million year-to-year.

Eight-point-one billion dollars of this shareholder return was through share repurchase, an increase of about $350 million from our spending last year.

We spent a record amount on share repurchase in 2006, buying back over 97 million shares. Average fully diluted shares were at 1.6 billion, down 4.6 percent from a year ago.

We had approximately $5 billion remaining from our Board authorizations at the end of December.

IBM has bought back over 1.2 billion shares on a split-adjusted basis, at an average price of about $62 per share since the inception of our share repurchase program in 1995.

Turning to dividends, this year we paid out about $1.7 billion, which is an increase of about $430 million year-to-year, driven by a 50 percent dividend increase.

We continued our long history of high returns to our shareholders. This year, between share repurchase and dividends we were able to pay out over 100 percent of our net earnings to our shareholders, even after investing over $14 billion in R&D, capital expenditures, and acquisitions.

BALANCE SHEET

Turning to the Balance Sheet our cash on hand was $10.7 billion.

Ninety-eight percent of our total debt of $22.7 billion was driven by our Global Financing business, and Global Financing was leveraged at an appropriate 6.9 to 1.

The remaining non-financing debt level was $395 million and debt-to-capital was 1.5 percent.

As anticipated, Stockholder s Equity was down $4.6 billion year-to-year, driven by a non-cash accounting charge of about $9.5 billion for FAS 158 pension accounting, implemented in the fourth quarter. We ended the year with almost $29 billion of stockholders equity.

Our Balance Sheet remains very strong.

Now, let me turn to the businesses, starting with Services.

-11-

GLOBAL SERVICES

Our two services segments, Global Technology Services and Global Business Services together delivered external revenue of $12.8 billion, up 7 percent as reported and 3 percent at constant currency.

Signings for services this quarter were $17.8 billion at constant currency, up 55 percent over last year. At spot rates, we signed $20.3 billion. Our shorter-term signings were $6.2 billion, up 16 percent year-to-year. Our longer-term signings were $11.6 billion, up 89 percent year-to-year. This quarter we signed 14 deals larger than $100 million, and our backlog has increased to an estimated $116 billion. This strong finish to the quarter allowed us to grow signings for the full year, for both short term and long term.

Turning to the segments

Global Technology Services delivered revenue of $8.6 billion, up 7 percent as reported and 4 percent at constant currency.

Strategic Outsourcing revenue was up 7 percent as reported and up 4 percent at constant currency. Signings doubled year-to-year, with strong growth in all geographies.

Business Transformation Outsourcing revenue was up 8 percent as reported, and up

5 percent at constant currency. BTO signings were down 57 percent year-to-year. We continue to see opportunity within the BTO business, particularly in Finance and Accounting, Human Resources and Procurement.

Integrated Technology Services revenue was up 8 percent as reported and up

6 percent at constant currency.

We continue to see progress from the changes we ve implemented to improve the Integrated Technology Services business, including streamlining our offerings and aligning skills, to address higher growth and higher value areas. The acquisition of Internet Security Systems added to our capabilities in security and intrusion protection, and contributed to the ITS growth.

ITS signings were up 20 percent this quarter, with growth in all geographies. As in the third quarter, the strongest growth came from the regions where our transformational actions were implemented first. We re encouraged by our progress in ITS.

Turning to margin, Global Technology Servicespre-tax margin was 9.3 percent, down year-to-year as compared to a particularly strong fourth quarter of 2005, but in line with full year margins adjusted for the impact of the ISS acquisition.

We continue to make investments in sales, delivery and business development skills across our entire set of offerings, as well as invest in strategic outsourcing infrastructure and BTO capabilities. Looking forward, we will continue to optimize resources and processes to increase productivity, and improve flexibility and scalability. This activity may be skewed a bit more towards the first half of 2007. The goal of these actions is to drive labor cost savings and increased customer satisfaction within service delivery.

Global Business Services delivered revenue of $4.2 billion, up 6 percent as reported and up 3 percent at constant currency. The constant currency growth represents a 7 point improvement since the growth rate at the end of the first half, as we ve expanded our focus from Operational Transformation to a focus on Profitable Growth.

Our signings this quarter reflect the strong demand for both our shorter-term and longer-term offerings. Shorter-term signings were up 14 percent year-to-year, where we saw strength in the larger higher value add engagements. Longer-term signings were up over 200 percent year-to-year, driven by our global delivery capabilities in the Application Management business. Longer-term signings were up 17 percent for the year.

Global Business Services pre-tax profit was up over 30 percent year-to-year, and the fourth quarter pre-tax margin improved 2.3 points to 11.8 percent.

Margin improvement was driven by improved utilization, strong contract management and delivery, and stable to improved pricing.

Finally, I would like to talk about our signings this quarter, not the quantity or dollar value, but the quality of the deals we signed this quarter, and what they represent.

The key to our success in Services will come from first, our ability to integrate our businesses globally, and to take advantage of our local and global skills; and second, from the use of the technology and industry skills required to create solutions that drive value and savings for our customers.

We were successful on both fronts this quarter, we signed large Application Management deals at Vodafone and CMA CGM. The key differentiator for both of these is the ability to provide strong local expertise and industry skills coupled with the benefits of global delivery.

We also signed large long term deals with the State of Indiana, the State of Texas, and the German Army. The value in these contracts came from our strong industry knowledge, and from the use of technology needed to drive cost savings and improve performance for our customers.

These wins were driven by a strategy that puts technology at the forefront, and uses our scale and global capabilities to meet our customer s diverse sets of requirements.

We ve done a lot to improve the profile of our Services business in 2006, and we are entering the year with a stronger services base.

Now I ll move on to Systems and Technology Group.

-14-

SYSTEMS AND TECHNOLOGY

Systems and Technology Group revenue of $7.1 billion grew 3 percent year-to-year, or flat at constant currency. For the full year, Systems and Technology grew 5 percent.

System z revenue grew 5 percent year-to-year, 1 percent at constant currency. MIPS grew 6 percent against, what was, the quarter with the largest MIPS shipment on record. This was the sixth consecutive quarter of MIPS growth.

System z performance reflected continued good sales execution and we believe we grew market share.

The mainframe s unique ability to deliver attractive economics, advanced security, and industry leading energy conservation, cooling and virtualization, play to the strength of the platform.

System i revenue declined 10 percent year-to-year, 14 percent at constant currency.

Sales of upgrades improved sequentially, however they remain down year-to-year as customers continue to leverage their existing capacity. We expect the upgrade activity to ramp during the year.

System p revenue grew 4 percent, flat at constant currency. We believe we grew share in the quarter.

System p had strong high-end sales extending our price/performance leadership position and raising margins. Customers are leveraging System p s native virtualization to consolidate multiple smaller servers into high-end System p.

System x servers grew 7 percent year-to-year, and 3 percent at constant currency.

Blades were essentially flat year-to-year. We had good growth in both Europe and Asia Pacific, offset by a decline in the Americas.

We expect we held share in System x in the quarter.

Storage grew 9 percent year-to-year, 6 percent at constant currency.

Disk rose 12 percent, with double-digit growth in both mid-range disk and SAN. DS8000 unit shipments grew over 14 percent year-to-year.

We believe we gained share in Disk in the fourth quarter, and we extended our market leadership in tape.

Tape was up 4 percent year-to-year on the continued strength of our new tape security offering. Together with IBM software and services, this solution provides for cost effective encryption and management of large volumes of digital information.

When results are published, we believe we will retain our number one market share position in overall storage hardware.

Microelectronics revenue declined 6 percent compared to a very strong fourth quarter last year. In this quarter, we met all customer demand for games processor volumes to support the launch of both Sony Playstation/3 and Nintendo Wii, while continuing to also supply Microsoft with its Xbox 360 processors.

Our **Retail Store Systems** had double-digit growth rate every quarter this year, and grew about 20 percent for the year. Customers are replacing older technology in favor of integrated retail solutions. IBM is the market leader in this segment.

Now, I ll move on to Software.

-16-

SOFTWARE

Software segment revenue was $5.6 billion in the quarter, up 14 percent year-to-year as reported, and 11 percent at constant currency. For the full year, software grew 8 percent as reported and 7 percent at constant currency.

Customers are responding to the breadth of our software portfolio coupled with IBM s unique ability to apply these technologies to their business needs. As a result, in the fourth quarter, key branded middleware delivered 25 percent growth as reported and 21 percent at constant currency, which is roughly double the market growth rate.

This growth came from both organic sources and strategic acquisitions. In the fourth quarter all brands grew faster than the market with all of the five brands delivering double-digit growth as reported. Our major acquisitions for the year include Filenet, MRO and Micromuse which enhanced growth in the Information Management and Tivoli brands.

The **WebSphere** family of software grew 22 percent as reported, and 18 percent at constant currency.

WebSphere provides the foundation for web-enabled applications and is a key product set in deploying Services Oriented Architecture. We are continuing to invest in SOA technologies, which allow us to bring advanced industry-specific solutions to the market. As a result we are extending our leadership in SOA.

Information Management software helps companies integrate, manage and gain value from their business information. For the quarter, revenue was up 28 percent year-to-year and 24 percent at constant currency.

Our distributed relational database was particularly strong, growing 32 percent, far outpacing our next two competitors.

Our Information on Demand portfolio was marked by the launch of the IBM Information Server on October 16th. This product is an industry-first, unified software platform that helps clients extract more value from complex information. Our IoD offerings were up 42 percent in the quarter.

This quarter we concluded the acquisition of FileNet Corporation, an industry leader in enterprise content management.

In Information Management, we grew faster than the market organically, and a strong performance from Filenet added to this growth.

Tivoli software grew 25 percent, and 21 percent at constant currency.

As in the third quarter, we again saw double-digit growth in each of our three key segments - Systems Management, Security and Storage.

Systems Management grew as a result of major service providers choosing our Micromuse solutions over other competitors in the market.

In the quarter we completed the acquisition of MRO software which added to our capabilities in enterprise and IT asset management.

Lotus software grew 30 percent, and 24 percent at constant currency.

Lotus benefited from strong momentum in its Notes/Domino family of collaboration products and broad adoption of its enhanced version of Sametime, which shipped in the third quarter of this year.

Customer loyalty to our Lotus products remains strong as evidenced by nine consecutive quarters of growth.

Rational software, which provides customers with tools that manage the business process of software and systems development, was up 12 percent, and 8 percent at constant currency. In a slower growing market, Rational gained share in the fourth quarter and full year 2006.

Other Middleware was up 3 percent, and flat at constant currency.

This segment includes more mature products which provide a stable flow of revenue and profit.

Operating Systems were down, due to improved price performance in System z operating systems.

-18-

Overall, our software business had another strong quarter with revenue growth of 14 percent. The pre-tax profit of over $2 billion is up 4 percent year-to-year, but the pre-tax margin declined as we integrated our new acquisitions. The full year pre-tax income of $5.5 billion is up nearly 15 percent year-to-year.

We have been investing heavily in our Software business for some time, both internally and through our targeted acquisitions. This quarter s strong results reflect those investments.

Now, I ll wrap up in the next four charts with a discussion on the full year performance.

-19-

2006 SUMMARY BUSINESS MIX

Over the last few years we have been steadily transforming the company. We ve taken a series of actions divesting of businesses that are commoditizing, while investing in targeted acquisitions to build capabilities in higher value areas. We ve had a sharp focus on productivity, to expand margins and drive more efficiency in our business. And we have accelerated our move to a globally-integrated company. The actions we have taken have resulted in a more balanced mix of businesses, and a stronger, more competitive and sustainable global business. Our 2006 performance reflects this improved business model.

In wrapping up 2006, I d like to address the year from three perspectives our business mix, our global reach, and our business model.

First, our businesses.

The largest profit contributor was our software business, with about 40 percent of segment pre-tax profit. This year, our leadership in technology and innovation has allowed us to continue to capitalize on industry trends, such as SOA and Information on Demand.

Our Services revenue growth improved over the course of the year. We are getting traction in our short term businesses. Integrated Technology Services is recovering after rebalancing its offerings and resources. Global Business Services significantly improved profitability. With a great finish to the year in signings, we ended the year with a backlog of $116 billion, while maintaining our focus on strong profitability.

In hardware, we are the leader in servers. Through continued investment in R&D, we introduced Power5+, extended virtualization capabilities, and provided leading technology for all three major game platforms. Our System z servers had a great year, and provide good profit generation across the business over time.

We re continuing to add to our capabilities. Over the years, we have built a targeted acquisition strategy, and we ve developed the capability to rapidly acquire, integrate, and accelerate new product offerings. This year we spent almost $4 billion on 13 acquisitions, including nine in the software segment. And we are also continuously evaluating underperforming and less strategic areas of our portfolio.

Our businesses are enabled by the global reach of IBM.

2006 SUMMARY GLOBAL REACH

IBM has tremendous global reach. We operate in 170 countries, with about 60 percent of our revenue generated outside the US. And about 65 percent of our employees are outside of the U.S., including 30 percent in Asia Pacific.

This gives us access to markets, with local management teams who understand our clients and their business challenges.

In the major countries, we are well-established. This year, we had continued solid contribution from the U.S., and improved performance in France and Italy. In the second half, our business in Japan recovered.

In the emerging markets of China, India, Russia and Brazil we grew 16 percent in 2006. These are among the fastest growing IT markets in the world. Over the next four years, we expect them to grow at more than two times the worldwide rate, with an opportunity of over $150 billion by 2010. We re investing to extend our leadership in emerging markets.

At the same time, our global scale provides a base that enables us to leverage investments and infrastructure, and drive productivity and efficiency.

From a sales perspective, ibm.com was our fastest growing channel in every geography. We delivered $10 billion of sales through the ibm.com telesales and web channels.

In support of our clients, we expanded our global delivery centers, which is a more efficient model for services delivery. In 2006 we added capabilities to our centers in India, Brazil and Argentina, to provide the ability to seamlessly transfer workload. This year we added over 20,000 employees to our service delivery centers in low cost countries.

And we have continued the global integration of our internal support functions, such as supply chain, finance, and HR. We look for 10 precent to 15 percent productivity from the global support functions, and this year we achieved our goal.

As a globally integrated company, we will continue to leverage the skills and capabilities of our global infrastructure and workforce.

2006 SUMMARY   BUSINESS MODEL

Finally, let s look at IBM s 2006 business model performance.

In 2006, we had record profit, earnings per share, and cash performance. In the year, we grew pre-tax profit about $1 billion, and grew earnings per share by 14 percent, excluding last year s non-recurring activity.

Gross margins expanded for the third consecutive year. Our productivity actions and high profit levels allow us to reallocate resources and increase investment in more strategic areas of the business.

Looking at the measures of capital efficiency, our Return on Invested Capital for the year was 34 percent for our core business, with a 30 percent Return on Equity for our financing business.

And we had record return to shareholders of $9.8 billion, including $8 billion for share repurchase.

-22-

SUSTAINED PERFORMANCE

Our business model success will be measured over the long term, not any individual period. The strategies we have put in place, the investments we make, and the individual actions we take, are all with an objective of optimizing our long term performance.

2007 should be no different. We ll continue to take actions to transform and improve our business. This means that any particular period may reflect the impact of those actions, as we buy and sell businesses, have gains and charges, and invest resource in some areas while moving resource out of others. So, while the timing of various activities can impact the individual quarters, at this point, it would be reasonable to assume an earnings per share distribution in 2007 similar to 2006. We do all of this in the context of managing the business for sustainability and with our long term objective in mind, to deliver 10 percent to 12 percent earnings per share growth over the long term.

Taking all of this into consideration, and a steady economic environment, we would expect earnings per share for 2007 to again be in line with our long term model. This is also consistent with the growth in the current average estimate for earnings per share.

Now, Patricia and I will take your questions.

CLOSING

Thanks, Mark.

Before we begin the Q&A let me comment on two items.

First, we have supplemental charts at the end of the deck that complement Mark s prepared remarks. We have a few new charts this quarter, including a chart that bridges the software and services segment revenue to the income statement, and an estimate of retirement-related expenses based on year end 2006 assumptions.

Also, as always, I d ask you to refrain from multi-part questions to allow us to take questions from more callers.

Operator, please open it up for questions.

-24-

---

eft:auto;margin-right:auto;width:98.2421875%;border-collapse:collapse;text-align:left;">

Thirteen Weeks
Ended

Thirteen Weeks
Ended

Thirty-nine Weeks Ended

Thirty-nine Weeks Ended

October 27, 2012

October 29, 2011

October 27, 2012

October 29, 2011
Net sales
$
139,501

$
120,125

$
354,043

$
329,501

Cost of goods sold
81,306

77,054

210,475

203,752

Gross profit
58,195

43,071

143,568

125,749

Operating expenses:

Selling, general and administrative expenses
57,473

39,936

154,754

118,056

Share-based compensation expense
(151
)

—

4,268

—

Merger related expenses
53

—

4,628

—

Depreciation and amortization
3,702

2,084

10,349

5,839

Total operating expenses
61,077

42,020

173,999

123,895

(Loss) income from operations
(2,882
)

1,051

(30,431
)

1,854

Interest expense
(2,509
)

(1,883
)

(6,597
)

(5,920
)
Net loss
$
(5,391
)

$
(832
)

$
(37,028
)

$
(4,066
)
Net loss per common share:

Basic and diluted
$
(0.35
)

$

(0.09
)

$
(2.75
)

$
(0.45
)

Weighted average number of common shares outstanding:

Basic and diluted
15,303,800

8,967,963

13,442,162

8,967,162

See accompanying notes to condensed consolidated financial statements.

Table of Contents

PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(Unaudited)
(in thousands, except per share amounts)

	Common Stock		Additional Paid-In	Accumulated	Treasury Stock		
	Shares	Amount	Capital	Deficit	Shares	Amount	Total
Balance at January 28, 2012	9,868,267	$99	$125,344	$(52,069)	898,249	$(8,577)	$64,797
Share-based compensation expense	—	—	4,268	—	—	—	4,268
Exercise of stock options	39,904	—	83	—	—	—	83
Issuance of common stock for April 18, 2012 acquisition of Parlux	6,314,128	63	59,162	—	—	—	59,225
Issuance of stock options and warrants for April 18, 2012 acquisition of Parlux	—	—	30,338	—	—	—	30,338
Net loss	—	—	—	(37,028)	—	—	(37,028)
Balance at October 27, 2012	16,222,299	$162	$219,195	$(89,097)	898,249	$(8,577)	$121,683

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Thirty-nine Weeks Ended October 27, 2012	Thirty-nine Weeks Ended October 29, 2011
Cash flows from operating activities:		
Net loss	$(37,028)	$(4,066)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Amortization of deferred financing costs	666	732
Depreciation and amortization	10,349	5,839
(Recovery) provision for losses on accounts receivable	(51)	136
Share-based compensation	4,268	20
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable	(22,192)	(15,241)
Inventories	(42,920)	(30,978)
Prepaid expenses and other assets	2,320	(2,411)
Accounts payable	25,173	33,836
Accounts payable-affiliates	1,957	3,763
Accrued expenses and other liabilities, and other long-term liabilities	7,358	11,676
Net cash (used in) provided by operating activities	(50,100)	3,306
Cash flows from investing activities:		
Additions to property and equipment	(5,575)	(2,658)
Payment to acquire Parlux, net of Parlux cash on hand of $17,114	(44,949)	—
Net cash used in investing activities	(50,524)	(2,658)
Cash flows from financing activities:		
Net borrowings under bank line of credit	71,191	410
Payments on affiliated notes payable	—	(373)
Borrowings under affiliated notes payable to fund Parlux acquisition	30,000	—
Principal payments under capital lease obligations	(809)	(688)
Proceeds from exercise of stock options	83	10
Net cash provided by (used in) financing activities	100,465	(641)
Net (decrease) increase in cash and cash equivalents	(159)	7
Cash and cash equivalents at beginning of period	1,682	1,236
Cash and cash equivalents at end of period	$1,523	$1,243
Supplemental Information:		
Cash paid during the period for:		
Interest	$1,462	$1,412
Income taxes	$327	$853
Non-cash investing and financing activities:		
Fair value of equity consideration given to acquire Parlux	$89,563	$—

See accompanying notes to condensed consolidated financial statements.

Table of Contents

PERFUMANIA HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - BASIS OF PRESENTATION AND OPERATIONS

The condensed consolidated balance sheet of Perfumania Holdings, Inc. and subsidiaries (the "Company") as of January 28, 2012, which has been derived from our audited financial statements as of and for the year ended January 28, 2012, and the accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and note disclosures normally included in annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”), have been condensed or omitted pursuant to those rules and regulations. The financial information presented herein, which is not necessarily indicative of results to be expected for the full current fiscal year, reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the interim unaudited condensed consolidated financial statements. Such adjustments are of a normal, recurring nature. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 28, 2012.

Due to the seasonality of the Company’s business, with the most significant activity occurring from September through December each year, the results of operations for the thirteen and thirty-nine weeks ended October 27, 2012 are not necessarily indicative of results to be expected for the full fiscal year.

See Note 2 for information on the April 18, 2012 acquisition of Parlux Fragrances, Inc. ("Parlux Inc."), formerly a publicly-traded company that is in the business of creating, designing, manufacturing, distributing and selling prestige fragrances and beauty-related products marketed primarily through specialty stores, national department stores and perfumeries on a worldwide basis.

The Company is an independent, national, vertically integrated wholesale distributor and specialty retailer of perfumes and fragrances that does business through six primary operating subsidiaries; Perfumania, Inc. (“Perfumania”), Quality King Fragrance, Inc. (“QFG”), Scents of Worth, Inc. ("SOW"), Perfumania.com, Inc. (“Perfumania.com”), Five Star Fragrance Company, Inc. (“Five Star”) and Parlux (see Note 2). We operate in two industry segments, wholesale distribution and specialty retail sales of designer fragrances and related products.

Our wholesale businesses include QFG, Five Star and Parlux. QFG distributes designer fragrances to mass market retailers, drug and other chain stores, retail wholesale clubs, traditional wholesalers, and other distributors throughout the United States. The Company’s manufacturing divisions, Parlux and Five Star, own and license designer and other fragrance brands that are sold to national department stores, through the Company’s wholesale business, SOW’s consignment business and Perfumania’s retail stores, paying royalties to the licensors based on a percentage of sales. All manufacturing operations are outsourced to third-party manufacturers. Five Star’s sales and results of operations have historically not been significant to the Company’s results on a consolidated basis.

Our retail business is conducted through three subsidiaries:

- Perfumania, a specialty retailer of fragrances and related products,
- SOW, which sells fragrances in retail stores on a consignment basis, and
- Perfumania.com, an Internet retailer of fragrances and other specialty items.

As of October 27, 2012, Perfumania operated a chain of 347 retail stores specializing in the sale of fragrances and related products at discounted prices up to 75% below the manufacturers’ suggested retail prices. Perfumania.com offers a selection of our more popular products for sale over the Internet and serves as an alternative shopping experience to the Perfumania retail stores. SOW operates the largest national designer fragrance consignment program, with contractual relationships to sell products on a consignment basis in approximately 2,400 stores, including more than 1,200 Kmart locations nationwide. Its other retail customers include Burlington Coat Factory, Loehmann’s, Steinmart and K & G.

NOTE 2 - ACQUISITION OF PARLUX

On April 18, 2012, pursuant to the Agreement and Plan of Merger, dated as of December 23, 2011 (the “Merger Agreement”), by and among Perfumania, Parlux Inc., a Delaware corporation, and PFI Merger Corp., a Delaware corporation and wholly owned subsidiary of Perfumania (“Merger Sub”), Perfumania acquired all of the outstanding shares of Parlux Inc. common stock via a merger of Parlux Inc. with Merger Sub, with Parlux Inc. surviving the merger. Parlux Inc. was then merged into PFI Merger Sub I, LLC, which survived this second merger as a wholly owned subsidiary of Perfumania and changed its name to Parlux Fragrances, LLC. ("Parlux") We refer to these two transactions as the “merger.” The merger was consummated following the approval and adoption of the Merger Agreement by Parlux Inc.'s shareholders and the approval by Perfumania shareholders of the issuance of shares of Perfumania common stock to the Parlux Inc.'s shareholders pursuant to the Merger Agreement. Trading in Parlux Inc.'s common stock on the NASDAQ stock market terminated after market close on April 18, 2012.

The accompanying unaudited condensed consolidated financial statements include the results of operations and cash flows for Parlux beginning on April 18, 2012. Parlux has been integrated into the Company's operations and is not considered a separate segment for financial reporting purposes. Total net sales of $35.9 million and a net loss of $20.6 million are attributable to Parlux and are included in the Company's unaudited condensed consolidated statement of operations for the thirty-nine weeks ended October 27, 2012. These amounts include $2.1 million in certain acquisition-related expenses incurred by Parlux, which are included in merger related expenses on the accompanying condensed consolidated statements of operations.

Under the terms of the Merger Agreement, each share of Parlux Inc.'s common stock issued and outstanding immediately before the merger was cancelled and converted into the right to receive either (i) 0.533333 shares of Perfumania common stock or (ii) 0.20 shares of Perfumania common stock plus $4.00 in cash, depending on the elections made by Parlux Inc.'s shareholders, without proration or other adjustments. Parlux Inc.'s shareholders received cash for any fractional shares of Perfumania common stock which they might otherwise have received in the merger. As a result, Perfumania issued approximately 6.014 million shares of its common stock and paid approximately $62.1 million in cash to the former Parlux Inc. shareholders in the merger. The Perfumania shares issued to Parlux Inc.'s shareholders represent approximately 40% of Perfumania's issued and outstanding common stock after the merger.

The cash portion of the merger consideration was financed through a combination of $32.1 million that Perfumania borrowed under Perfumania's Senior Credit Facility and $30 million that a Perfumania subsidiary borrowed from family trusts of the Nussdorf family, its principal shareholders, each on April 18, 2012. These borrowings, the Senior Credit Facility and the Nussdorf Trusts are described in greater detail in Note 6.

Each outstanding and unexercised option to purchase shares of Parlux Inc.'s common stock under Parlux Inc.'s equity-based compensation plans was assumed by Perfumania and converted into an option to purchase a number of shares of Perfumania common stock, at an exercise price, determined by applying the merger exchange ratio. In addition, subject in some cases to the terms of existing executive employment agreements, (a) the vesting schedule of each assumed option was accelerated by one year, (b) an assumed stock option will vest immediately if the holder's employment by Perfumania is terminated before the first anniversary of the merger closing either (i) by Perfumania other than for cause or (ii) by the holder with good reason, and (c) the period for exercising each assumed stock option following termination of employment is extended to 90 days. Perfumania also assumed an outstanding warrant held by one of Parlux Inc.'s directors, which is exercisable for 5,333 shares of Perfumania common stock at $3.38 per share.

Pursuant to various licensing arrangements entered into by Parlux Inc., in connection with the closing of the merger, Perfumania issued 300,000 shares of common stock and warrants for the purchase of an aggregate of 4,799,971 shares of Perfumania common stock at $8.00 per share.

The merger was structured to qualify as a reorganization for U.S. Federal income tax purposes; accordingly, each Parlux Inc. shareholder generally should recognize taxable gain (but not loss) for U.S. Federal income tax purposes as a result of the merger only to the extent of the lesser of (x) the sum of the amount of cash and the fair market value of the Perfumania stock received, minus the adjusted tax basis of the Parlux Inc. common stock surrendered in exchange therefore, and (y) the amount of cash received (other than cash received in lieu of a fractional share).

Glenn Nussdorf, a principal shareholder of Perfumania, owned approximately 9.9% of the outstanding common stock of Parlux Inc. before the merger. In addition, Perfumania has purchased merchandise from Parlux Inc. for about 20 years and was one of Parlux's largest customers. See further discussion at Note 11.

The merger has been accounted for using the acquisition method of accounting (“purchase accounting”), which requires, among other things, that the assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. No material assets or liabilities arose from contingencies recognized at the acquisition date. Certain estimated values are not yet finalized and are subject to change. The Company will finalize the amounts recognized as it obtains the information necessary to complete the analyses. In accordance with US GAAP, the Company expects to finalize these amounts prior to the end of its current fiscal year, February 2, 2013. The following tables summarize the purchase price and the assets acquired and liabilities assumed as of the acquisition date at estimated fair value:

Table of Contents

(in thousands except price per share)		
Proceeds from Senior Credit Facility		$32,062
Proceeds from notes payable to affiliates		30,000
Total cash consideration		62,062
Total shares of Perfumania common stock issued (1)	6,314	
Perfumania price per share, April 18, 2012	$9.38	59,225
Fair value of Perfumania stock options and warrants issued		30,338
Total purchase price		$151,625

(1) Includes 300 shares issued pursuant to various licensing agreements

(in thousands)	
Cash	$17,114
Accounts receivable	21,242
Inventories	62,934
Other current assets	9,793
Property and equipment	1,107
Other non-current assets	178
Identified intangible assets	24,676
Goodwill	49,642
Accounts payable	(16,032)
Deferred tax liabilities	(15,043)
Other liabilities assumed	(3,986)
Net assets acquired	$151,625

Identifiable intangibles were acquired as a result of the acquisition of Parlux Inc., which will be amortized as follows:

- Customer relationships: amortized on a straight-line basis based on the expected period of benefit.
- License agreements: amortized on a straight-line basis over their useful lives based on the terms of the respective license agreements.

Amortization expense for these identified intangible assets was $1.7 million and $4.4 million for the thirteen and thirty-nine weeks ended October 27, 2012, and is included in depreciation and amortization expense on the accompanying condensed consolidated statements of operations.

Estimated aggregate amortization expense for the remainder of fiscal 2012 and the five succeeding years and thereafter for identified intangible assets created as a result of the acquisition is as follows (in thousands):

Fiscal Year	Amortization Expense
Remainder of 2012	$1,888
2013	6,664
2014	4,562
2015	3,475
2016	1,010
2017	517
Thereafter	2,155
	$20,271

9

Table of Contents

The following table is a summary of the fair value estimates of the acquired identifiable intangible assets and weighted-average useful lives as of the acquisition date.

	Estimated fair value of asset (in thousands)	Weighted-average useful life (in years)
Customer relationships	$5,171	10.0
License agreements	19,505	3.2
Total	$24,676	4.0

Goodwill in the amount of $49.6 million was recorded as a result of the acquisition of Parlux Inc. Goodwill is calculated as the excess of the consideration transferred over the net assets recognized and represents the estimated future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. Goodwill will not be amortized, but will be tested for impairment at least annually. None of the goodwill is deductible for tax purposes.

The recorded amounts for assets and liabilities are provisional and subject to change. The following items are subject to change:

- Amounts for inventory, intangibles and deferred income taxes and liabilities, pending finalization of valuations; and
- The purchase price allocable to goodwill, as a result of changes to the aforementioned items.

A single estimate of fair value results from a complex series of judgments about future events and uncertainties and relies heavily on estimates and assumptions. The Company's judgments used to determine the estimated fair value assigned to each class of assets acquired and liabilities assumed, as well as asset lives, can materially impact its results of operations.

The unaudited pro forma results presented below include the effects of the Parlux Inc. acquisition as if it had been consummated as of January 30, 2011. The pro forma results include the amortization associated with estimates (certain of which are preliminary) for the acquired intangible assets. In addition, the pro forma results do not include any anticipated synergies, operating efficiencies or cost savings or other expected benefits of the acquisition or any integration costs. Accordingly, the unaudited pro forma financial information below is not necessarily indicative of either future results of operations or results that might have been achieved had the acquisition been consummated as of January 30, 2011.

	Thirteen Weeks Ended October 27, 2012	Thirteen Weeks Ended October 29, 2011	Thirty-nine Weeks Ended October 27, 2012	Thirty-nine Weeks Ended October 29, 2011
	(in thousands, except per share data)			
Net sales	$139,501	$149,341	$373,248	$394,040
Net loss	(5,391)	(5,098)	(38,922)	(34,766)
Net loss per share - basic	$(0.35)	$(0.33)	$(2.90)	$(2.28)
Net loss per share - diluted	(0.35)	(0.33)	(2.90)	(2.28)

NOTE 3 - RECENT ACCOUNTING PRONOUNCEMENTS

There are no recently issued accounting standards that are expected to have a material effect on our financial condition, results of operations or cash flows.

NOTE 4 - GOODWILL AND INTANGIBLE ASSETS

Goodwill in the amount of $49.6 million at October 27, 2012 resulted from the April 18, 2012 acquisition of Parlux Inc. See Note 2. There was no recorded goodwill as of January 28, 2012.

The following table provides information related to intangible assets (in thousands), which are included in other assets, net on the accompanying condensed consolidated balance sheets as of October 27, 2012 and January 28, 2012:

10

Table of Contents

		October 27, 2012			January 28, 2012		
	Useful Life (years)	Original Cost	Accumulated Amortization	Net Book Value	Original Cost	Accumulated Amortization	Net Book Value
Tradenames	7-20	$9,408	$6,667	$2,741	$9,408	$6,381	$3,027
Customer relationships	10	5,171	302	4,869	—	—	—
Favorable leases	7	886	453	433	886	359	527
License agreements	1-4	19,505	4,103	15,402	—	—	—
Tradename (non-amortizing)	N/A	8,500	—	8,500	8,500	—	8,500
		$43,470	$11,525	$31,945	$18,794	$6,740	$12,054

In accordance with accounting standards, intangible assets with indefinite lives are not amortized, but rather tested for impairment at least annually by comparing the estimated fair values to their carrying values.

Trademarks, including tradenames and owned licenses having finite lives, are amortized over their respective lives to their estimated residual values and are also reviewed for impairment in accordance with accounting standards when changes in circumstances indicate the assets' values may be impaired. Customer relationships will be amortized over the expected period of benefit and license agreements will be amortized over the remaining contractual term.

Impairment testing is based on a review of forecasted operating cash flows and the profitability of the related brand. There were no triggering events during the thirteen and thirty-nine weeks ended October 27, 2012 that would indicate potential impairment and the requirement to review the carrying value of intangible assets.

Amortization expense associated with intangible assets subject to amortization is included in depreciation and amortization on the accompanying condensed consolidated statements of operations. Amortization expense for intangible assets subject to amortization was $1.8 million and $0.1 million for the thirteen weeks ended October 27, 2012 and October 29, 2011, and $4.7 million and $0.3 million for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively. As of October 27, 2012, future amortization expense associated with intangible assets subject to amortization is as follows (in thousands):

Fiscal Year	Amortization Expense
Remainder of 2012	$2,007
2013	7,140
2014	5,038
2015	3,951
2016	1,381
2017	818
Thereafter	3,110
	$23,445

NOTE 5 - ACCOUNTING FOR SHARE-BASED PAYMENTS

The 2010 Equity Incentive Plan (the "2010 Plan") provides for equity-based awards to the Company's employees, directors and consultants. Under the 2010 Plan, the Company initially reserved 1,000,000 shares of common stock for issuance. This number automatically increases on the first trading day of each fiscal year beginning with fiscal 2011, by an amount equal to 1 1/2% of the shares of common stock outstanding as of the last trading day of the immediately preceding fiscal year; accordingly, 1,269,050 shares of common stock were reserved for issuance as of October 27, 2012. The Company previously had two stock option plans which expired on October 31, 2010. No further awards will be granted under these plans, although all options previously granted and outstanding will remain outstanding until they are either exercised or forfeited. As of October 27, 2012, 720,000 stock options have been granted pursuant to the 2010 Plan.

The following is a summary of the stock option activity during the thirty-nine weeks ended October 27, 2012:

11

Table of Contents

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Outstanding as of January 28, 2012	216,737	$9.93		
Granted (1)	1,238,505	7.84		
Exercised	(39,904)	3.80		
Forfeited	(170,124)	8.62		
Outstanding as of October 27, 2012	1,245,214	$8.22	6.8	$439
Vested as of October 27, 2012	1,035,210	$8.03	6.4	$439
Exercisable as of October 27, 2012	1,035,210	$8.03	6.4	$439

(1) Includes 548,505 stock options issued to holders of options to purchase shares of Parlux Inc. common stock under Parlux Inc.'s equity-based compensation plans as of April 18, 2012, which are not counted against the number of shares reserved for issuance under the 2010 Plan. See further discussion at Note 2.

The following is a summary of stock warrants activity during the thirty-nine weeks ended October 27, 2012:

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Outstanding as of January 28, 2012	1,500,000	$23.94		
Granted (2)	4,805,304	8.00		
Exercised	—	—		
Forfeited	—	—		
Outstanding as of October 27, 2012	6,305,304	$11.79	5.7	$12
Vested as of October 27, 2012	6,305,304	$11.79	5.7	$12
Exercisable as of October 27, 2012	6,305,304	$11.79	5.7	$12

(2) Represents warrants issued in connection with the acquisition of Parlux on April 18, 2012. See further discussion at Note 2.

Share-based compensation expense was ($0.2) million and $4.3 million during the thirteen and thirty-nine weeks ended October 27, 2012, respectively. During the thirteen and thirty-nine weeks ended October 29, 2011, share-based compensation was less than $0.1 million.

The fair value for stock options issued during the thirty-nine weeks ended October 27, 2012 was estimated at the date of grant, using the Black-Scholes option pricing model with the following weighted average assumptions:

	Thirty-nine Weeks Ended October 27, 2012
Expected life (years)	1-5
Expected stock price volatility	100% - 118%
Risk-free interest rates	0.2% - 1.0%
Expected dividend yield	0

The expected life of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. The expected stock price volatility is estimated using the historical volatility of the Company's stock. The risk-free interest rate is based on the implied yield available on U.S. Treasury zero coupon issues with a term equal to the option's expected life. The Company has not paid dividends in the past and does not intend to in the foreseeable future.

The weighted average estimated fair value of options granted during the thirty-nine weeks ended October 27, 2012 was $7.82.

Table of Contents

NOTE 6 - REVOLVING CREDIT FACILITY AND NOTES PAYABLE TO AFFILIATES

The Company’s revolving credit facility and notes payable to affiliates consist of the following:

	October 27, 2012 (in thousands)	January 28, 2012
Revolving credit facility interest payable monthly, secured by a pledge of substantially all of the Company’s assets	$101,248	$30,057
Subordinated notes payable-affiliates	125,366	95,366
	226,614	125,423
Less current portion	—	—
Total long-term debt	$226,614	$125,423

The Company has a $225 million revolving Senior Credit Facility with a syndicate of banks that is used for the Company’s general corporate purposes and those of its subsidiaries, including working capital. This facility does not require amortization of principal and is scheduled to expire in January 2015, when all amounts will be due and payable in full. Under this facility, revolving loans may be drawn, repaid and reborrowed up to the amount available under a borrowing base calculated with reference to specified percentages of the Company’s credit card and trade receivables and inventory, which may be reduced by the lender in its reasonable discretion. The Company must maintain availability under the facility of at least $10 million. As of October 27, 2012, the Company had $39.0 million of availability.

On April 18, 2012, pursuant to Amendment No. 1 to the Senior Credit Facility dated December 23, 2011, Perfumania borrowed $32.1 million to fund a portion of the Parlux cash merger consideration and approximately $3.5 million to fund costs of the merger and related transactions. At the closing of the merger, Perfumania applied the cash and cash equivalents held by Parlux to repayment of the Senior Credit Facility and terminated Parlux's existing bank credit facility.

Interest under the Senior Credit Facility is at variable rates plus specified margins that are determined based upon the Company’s excess availability from time to time. The Company is also required to pay monthly commitment fees based on the unused amount of the Senior Credit Facility and a monthly fee with respect to outstanding letters of credit. As of October 27, 2012, the interest rate on LIBOR Rate borrowings was 3.00% and the interest rate on base borrowings was 4.75%.

All obligations of the Company related to the Senior Credit Facility are secured by first priority perfected security interests in all personal and real property owned by the Company, including without limitation 100% (or, in the case of excluded foreign subsidiaries, 66%) of the outstanding equity interests in the subsidiaries. The Company is subject to customary limitations on its ability to, among other things, pay dividends and make distributions, make investments and enter into joint ventures, and dispose of assets. The Company was in compliance with all financial and operating covenants as of October 27, 2012.

In addition, the Company has outstanding unsecured debt obligations as follows:

(i)a promissory note in the principal amount of $35 million, (the “QKD Note”) held by Quality King Distributors, Inc. ("Quality King"), which provides for payment of principal in quarterly installments between April 30, 2015 and July 31, 2018 and payment of interest in quarterly installments commencing on January 31, 2011 at the then current senior debt rate, as defined in the Senior Credit Facility, plus 1% per annum;

(ii)promissory notes in the aggregate principal amount of approximately $85.4 million held by six estate trusts established by Glenn, Stephen and Arlene Nussdorf (the “Nussdorf Trust Notes”), which provide for payment of the principal in full on April 30, 2015 and payments of interest in quarterly installments commencing on July 31, 2012 at the then current senior debt rate plus 2% per annum. These notes were in the original principal amount of $55.4 million, but were replaced by amended and restated notes reflecting the additional $30 million loaned by the trusts on April 18, 2012, the date of the Parlux merger; and (iii)a promissory note in the principal amount of $5 million held by Glenn and Stephen Nussdorf (the "2004 Note"), which provided for payment in January 2009 and is currently in default because of the restrictions on payment described below, resulting in an increase of 2% in the nominal interest rate, which is the prime rate plus 1%.

Table of Contents

These notes are subordinated to the Senior Credit Facility. No principal may be paid on any of them until three months after the Senior Credit Facility terminates and is paid in full, and payment of interest is subject to satisfaction of certain conditions, including the Company's maintaining excess availability under the Senior Credit Facility of the greater of $17.5 million or 17.5% of the borrowing base certificate after giving effect to the payment, and a fixed charge coverage ratio, as defined in the credit agreement, of 1.1:1.0. Interest expense on these notes was approximately $1.5 million and $1.1 million for the thirteen weeks ended October 27, 2012 and October 29, 2011, respectively, and $4.4 million and $3.7 million for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively, and is included in interest expense on the accompanying condensed consolidated statements of operations. No payments of principal or interest have been made on the QKD Note or the Nussdorf Trust Notes. On the 2004 Note, no payments of principal have been made and no interest payments have been made since October 2008. Accrued interest payable due at October 27, 2012 and January 28, 2012 on the Nussdorf Trust Notes, the Quality King Note, and the 2004 Note was approximately $25.6 million and $21.4 million, respectively, and is included in other long-term liabilities on the accompanying condensed consolidated balance sheets as of October 27, 2012 and January 28, 2012, respectively.

NOTE 7 - ACCOUNTING FOR INCOME TAXES

The Company conducts business throughout the United States, Puerto Rico and beginning in 2012, the United States Virgin Islands and, as a result, files income tax returns in the U.S. Federal and various state jurisdictions, Puerto Rico and the United States Virgin Islands. In the normal course of business the Company is subject to examinations in these jurisdictions. With few exceptions, the Company is no longer subject to U.S. Federal, state, local or Puerto Rico income tax examinations for fiscal years prior to 2008. State and foreign income tax returns are generally subject to examination for a period of three to five years after filing of the respective return. The state impact of any Federal changes remains subject to examination by various states for a period of up to one year after formal notification to the states. In the most recently filed consolidated Federal tax return, the Company was able to carryback a portion of its net operating loss to the previously filed 2007 Federal tax return. The carryback resulted in a claim for refund of Federal income taxes of approximately $2.5 million. The amount of the claim was determined based on information which became available and which was recorded as an income tax benefit during both the thirteen and thirty-nine weeks ended October 30, 2010. During the year ended January 28, 2012, the amount of the claim was reduced to approximately $2.4 million as a result of an IRS examination. The claim for refund is included in prepaid expenses and other current assets on the condensed consolidated balance sheets as of October 27, 2012 and January 28, 2012. Management does not expect any material adjustment to the amount of the claim for refund as a result of these examinations.

On April 18, 2012, the Company completed a non-taxable acquisition of Parlux. As part of the acquisition, the Company recorded various deferred tax liabilities related to the acquisition accounting resulting in an increase in goodwill. The Company has provided a full valuation allowance against all deferred tax assets acquired from Parlux due to the uncertainty as to when business conditions will improve sufficiently to enable it to utilize its deferred tax assets. Due to the change in control of Parlux, there may be limitations on the future utilization of Parlux's net operating losses. The limitation, if any, is not anticipated to be significant.

The Company continues to provide a full valuation allowance against all deferred tax assets due to the uncertainty as to when business conditions will improve sufficiently to enable it to utilize its deferred tax assets. As a result, the Company did not record a Federal or state tax benefit on its operating loss for the thirty-nine weeks ended October 27, 2012.

During the thirteen and thirty-nine weeks ended October 27, 2012, there were no changes to the liability for income tax associated with uncertain tax positions. The Company accrues interest related to unrecognized tax benefits as well as any related penalties in operating expenses in its condensed consolidated statements of operations, which is consistent with the recognition of these items in prior reporting periods. The accrual for interest and penalties related to uncertain tax positions as of October 27, 2012 and January 28, 2012 was not significant.

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

NOTE 8 - BASIC AND DILUTED NET LOSS PER COMMON SHARE

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

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

Table of Contents

During the thirteen weeks ended October 27, 2012 and October 29, 2011, there were 7,550,518 and 1,703,004, respectively, potential shares of common stock which were excluded from the diluted loss per share calculation because the effect of including these potential shares was antidilutive. During the thirty-nine weeks ended October 27, 2012 and October 29, 2011, there were 7,550,518 and 1,703,004, respectively, potential shares of common stock which were excluded from the diluted loss per share calculation because the effect of including those potential shares was antidilutive.

NOTE 9 - FAIR VALUE MEASUREMENTS

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

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

Level 1 inputs);

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

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

As of October 27, 2012, the Company had no material financial assets or liabilities measured on a recurring basis that required adjustments or write-downs and the carrying values of current assets and liabilities approximate their fair value. The Company measures certain assets at fair value on a non-recurring basis, specifically long-lived assets evaluated for impairment. No such impairments were recorded during the thirteen and thirty-nine weeks ended October 27, 2012.

NOTE 10 - CONTINGENCIES

Following the announcement of the Company's merger agreement with Parlux Inc. on December 23, 2011, several putative class action complaints were filed against the Company, Parlux Inc., the Parlux Inc. directors, and certain other related parties in state courts in Florida and Delaware. With the exception of the following, all such cases were dismissed or abandoned before the end of the quarter ended October 27, 2012.

As previously disclosed on January 31, 2012, a putative class action, captioned as Jose Dias v. Fredrick E. Purches, et al., (Case Number 7199 VCG) was filed in the Court of Chancery for the State of Delaware on behalf of a purported stockholder of Parlux. The plaintiff sought to enjoin the merger based on alleged breaches of fiduciary duty by the Parlux board in negotiating and approving the merger agreement, the alleged inadequacy of the merger consideration and Parlux Inc.'s alleged failure to make material disclosures relating to the merger, and sought damages, costs and attorneys' fees. The Court ordered Parlux Inc. and the Company to file with the SEC certain additional information about the process followed by the financial advisors to Parlux Inc.'s board of directors, which both companies did on April 6, 2012. The Court did not enjoin the Parlux Inc. stockholder meeting, did not enjoin the consummation of the merger, and did not grant any other relief. The defendants moved to dismiss the action, which the plaintiff did not oppose. Parlux Inc. and its former directors then sought sanctions and attorneys' fees against the plaintiff, and the plaintiff sought an award of $500,000 in attorneys' fees. On October 1, 2012 the Court issued a memorandum opinion in which it (i) denied the Parlux Inc. defendants' request for sanctions and attorneys' fees, (ii) granted attorney's fees to the plaintiff in the amount of $266,667 and (iii) granted the defendants' motions to dismiss. On November 5, 2012, the Court entered an order consistent with its memorandum opinion and dismissed the action with prejudice as to plaintiff Dias and without prejudice as to the alleged class of plaintiffs.

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

NOTE 11 - RELATED-PARTY TRANSACTIONS

Glenn, Stephen and Arlene Nussdorf owned an aggregate 7,742,282 shares or approximately 50.5%, of the total number of shares of the Company’s common stock as of October 27, 2012, excluding shares issuable upon conversion of certain warrants and not assuming the exercise of any outstanding options. Stephen Nussdorf has served as the Chairman of the Company’s Board of Directors since February 2004 and Executive Chairman of the Board since April 2011.

Table of Contents

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

See Note 6 for a discussion of notes payable to affiliates.

Transactions With Affiliated Companies

Prior to the acquisition of Parlux Inc., Glenn Nussdorf beneficially owned approximately 9.9% of the outstanding common stock of Parlux Inc. Perfumania had purchased merchandise from Parlux Inc. for about 20 years and was one of Parlux Inc.'s largest customers. Perfumania primarily purchased certain brands, for which Parlux Inc. is the exclusive licensee, for distribution through the Company's wholesale and retail segments.

Glenn Nussdorf has an ownership interest in Lighthouse Beauty Marketing, LLC, Lighthouse Beauty, LLC and Lighthouse Beauty KLO, LLC (collectively "Lighthouse Companies"), all of which are manufacturers and distributors of prestige fragrances. In fiscal 2010, the Company began purchasing merchandise from the Lighthouse Companies.

Glenn Nussdorf also has an ownership interest in Ricky's, a retailer specializing in fashion accessories, cosmetics and beauty supplies. During the last two quarters of fiscal 2011, the Company purchased various beauty accessories from Ricky's. In fiscal 2009 and fiscal 2010, the Company also purchased merchandise from Quality King.

Our wholly owned subsidiary, Parlux, sold a number of its products to Jacavi Beauty Supply, LLC ("Jacavi"), a fragrance distributor. Jacavi's managing member is Rene Garcia. Rene Garcia, his family trusts and related entities are members of a group that owned an aggregate 2,211,269 shares, or approximately 14.4%, of the total number of shares of the Company's common stock as of October 27, 2012, excluding shares issuable upon conversion of certain warrants. There were no sales to Jacavi from April 18, 2012, the date Parlux was acquired, through October 27, 2012. There was no accounts receivable balance from Jacavi as of October 27, 2012. During the thirty-nine weeks ended October 27, 2012, Perfumania purchased merchandise from Jacavi. See disclosure of merchandise purchases in the table below.

The amounts due to these related companies are non-interest bearing and are included in accounts payable-affiliates in the accompanying condensed consolidated balance sheets. Transactions for merchandise purchases with these related companies during the thirteen and thirty-nine weeks ended October 27, 2012 and October 29, 2011 were as follows:

	Total Purchases Thirteen Weeks Ended October 27, 2012	Total Purchases Thirteen Weeks Ended October 29, 2011	Total Purchases Thirty-nine Weeks Ended October 27, 2012	Total Purchases Thirty-nine Weeks Ended October 29, 2011	Balance Due October 27, 2012	Balance Due January 28, 2012
			(in thousands)			
Parlux	$—	$ 18,523	$ 6,771 (1)	$ 35,024	$ — (2)	$ 10,476
Lighthouse Companies	6,545	6,884	9,733	8,950	4,064	128
Jacavi Beauty Supply, LLC	901	—	3,658	—	—	—
Ricky's	—	—	—	—	—	11
	$ 7,446	$ 25,407	$ 20,162	$ 43,974	$ 4,064	$ 10,615

(1) Represents purchases from Parlux prior to April 18, 2012, when the Company acquired Parlux.

(2) Since the Company acquired Parlux on April 18, 2012, the balance due to Parlux was eliminated in consolidation as of October 27, 2012.

Glenn, Stephen and Arlene Nussdorf own GSN Trucking, Inc. ("GSN") which provides general transportation and freight services. The Company periodically utilizes GSN to transport both inbound purchases of merchandise and outbound shipments to wholesale customers. During the thirty-nine weeks ended October 27, 2012 and October 29, 2011, total payments to GSN for transportation services provided were less than $0.1 million. There was no balance due to GSN at October 27, 2012 or January 28, 2012.

Quality King occupies a leased 560,000 square foot facility in Bellport, NY. The Company began occupying approximately half of this facility in December 2007 under a sublease that terminates on September 30, 2027 and this location serves as the Company's principal offices. As of October 27, 2012, the monthly current sublease payments are approximately \$222,000 and increase by 3% annually. Total payments by the Company to Quality King were approximately \$0.7 million and \$0.6 million during the thirteen weeks ended October 27, 2012 and October 29, 2011, respectively, and \$2.1 million and \$1.9 million during the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively, for this sublease.

The Company and Quality King are parties to a Services Agreement providing for the Company's participation in certain third party arrangements at the Company's respective share of Quality King's cost, including allocated overhead, plus a 2%

Table of Contents

administrative fee, and the provision of legal services. The Company also shares with Quality King the economic benefit of the bulk rate contract that the Company has with UPS to ship Quality King's merchandise and related items. The Services Agreement will terminate on thirty days' written notice from either party. The expenses charged under these arrangements to the Company were less than $0.1 million during the thirteen weeks ended October 27, 2012 and $0.1 million during the thirteen weeks ended October 29, 2011, respectively, and $0.5 million and $0.4 million during the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively. The balance due to Quality King for expenses charged under the Services Agreement was less than $0.1 million and $0.3 million at October 27, 2012 and January 28, 2012, respectively.

On December 23, 2011, the Company, Parlux Inc., Artistic Brands Development LLC ("Artistic Brands") (a company controlled by Rene Garcia) and Rene Garcia entered into a Letter Agreement (the "Proposal Agreement") providing for, among other things, the issuance to Artistic Brands or its designee of 300,000 shares of the Company's common stock at the effective time of the Parlux merger as consideration for certain licensing transactions contemplated in the Proposal Agreement. Perfumania issued the shares to Artistic Brands' designee, Shawn Carter, on April 18, 2012.

In connection with the Parlux merger, on April 18, 2012, Parlux, Artistic Brands, Shawn Carter and S. Carter Enterprises, LLC entered into a sublicense agreement and Artistic Brands, Shawn Carter and S. Carter Enterprises, LLC entered into a license agreement pursuant to the Proposal Agreement. In connection with these agreements, the Company issued to Artistic Brands and its designees, including Shawn Carter, warrants for the purchase of an aggregate of 1,599,999 shares of the Company's common stock at an exercise price of $8.00 per share. Pursuant to the license agreement, Artistic Brands obtained the exclusive right and license to manufacture, promote, distribute, and sell prestige fragrances and related products under the Jay-Z trademark. The initial term of the license agreement expires at the earlier of (i) five years following the first date on which licensed products are shipped and (ii) December 31, 2018. Artistic Brands has the right to renew the license agreement, so long as certain financial conditions are met and it has not otherwise breached the agreement. Pursuant to the license agreement, Artistic Brands agreed to make certain royalty payments, including certain guaranteed minimum royalties, none of which have yet been paid. Pursuant to the sublicense agreement, Artistic Brands sublicensed all rights granted under the license agreement to the Company, and in return the Company assumed all of the Artistic Brands' obligations under the license agreement, including making all royalty payments and certain guaranteed minimum royalties owed to S. Carter Enterprises, LLC. Also, in connection with the Parlux merger, the Company issued warrants to purchase 3,199,972 shares of the Company's common stock to the Garcia Group and Artistic Brands, and warrants to purchase 5,333 shares of common stock to Glenn H. Gopman, in exchange for warrants to purchase Parlux Inc. stock previously held by those parties.

NOTE 12 - SEGMENT INFORMATION

The Company operates in two industry segments, wholesale distribution and specialty retail sales of designer fragrance and related products. Management reviews segment information by segment and on a consolidated basis each month. Retail sales include sales through Perfumania retail stores, the Scents of Worth consignment business and the Company's internet site, perfumania.com. Transactions between Parlux and Five Star, and unrelated customers are included in our wholesale segment information. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in the Annual Report on Form 10-K for the fiscal year ended January 28, 2012. The Company's chief operating decision maker, who is its Chief Executive Officer, assesses segment performance by reference to gross profit. Each of the segments has its own assets, liabilities, revenues and cost of goods sold. While each segment has certain unallocated operating expenses, these expenses are not reviewed by the chief operating decision maker on a segment basis, but rather on a consolidated basis. Financial information for these segments is summarized in the following table:

Table of Contents

	Thirteen Weeks Ended October 27, 2012	Thirteen Weeks Ended October 29, 2011	Thirty-nine Weeks Ended October 27, 2012	Thirty-nine Weeks Ended October 29. 2011
	(in thousands)			
Net sales:				
Retail	$73,529	$72,888	$225,920	$ 224,121
Wholesale	65,972	47,237	128,123	105,380
	$139,501	$120,125	$354,043	$ 329,501
Gross profit:				
Retail	$32,910	$33,350	$99,326	$ 101,484
Wholesale	25,285	9,721	44,242	24,265
	$58,195	$43,071	$143,568	$ 125,749

	October 27, 2012	January 28, 2012
Total assets:		
Wholesale	$585,789	$312,855
Retail	359,877	238,844
	945,666	551,699
Eliminations (a)	(444,070)	(264,944)
Consolidated assets	$501,596	$286,755

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

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

As discussed in Note 2 to the unaudited condensed consolidated financial statements, on April 18, 2012, the Company consummated its acquisition of Parlux Inc. For US GAAP reporting, the accompanying results of operations and cash flows for the thirty-nine weeks ended October 27, 2012 contain Parlux's results beginning as of the date of acquisition, while the prior year only includes the results of the Company.

The Company's board of directors and management believes that the acquisition of Parlux Inc. will provide substantial benefits to the Company's stockholders since it has created a larger, independent, national, vertically integrated manufacturer, wholesale distributor and specialty retailer of perfumes and fragrances that is well-positioned to compete in the marketplace and drive growth, as well as to benefit from increased operating scale and licensing opportunities.

The operations and results of the historical Parlux Inc. business are significant to the Company's consolidated financial statements. At the end of the last reported fiscal year of the respective companies immediately preceding the merger (January 28, 2012 for the Company and March 31, 2011 for Parlux Inc.), the total assets were approximately $287 million for Perfumania, compared to approximately $113 million for Parlux Inc., and total net sales were approximately $494 million for Perfumania compared to approximately $123 million for Parlux Inc. Management is currently working with Parlux personnel to integrate the Parlux business, to maximize operating efficiencies and cost savings, and to update operating and capital forecasts. Management believes that the merger will have a significant effect on the Company's future sales, expenses and operating results as compared to its historical results.

Subsequent to the end our fiscal third quarter, some of our Perfumania stores and SOW retail consignment stores were impacted by Hurricane Sandy and were closed for several days. Our two distribution centers were also closed for several days. However, none of our stores or our distribution centers sustained material damage. While we cannot yet fully assess the impact of Hurricane Sandy and its aftermath, at this time we do not anticipate that it will have a material negative impact on our results of operations or cash flows for the fourth quarter ending February 2, 2013.

18

Table of Contents

Comparison of the Thirteen Weeks Ended October 27, 2012 with the Thirteen Weeks Ended October 29, 2011.

Net Sales

	Thirteen Weeks Ended October 27, 2012	Percentage of Net Sales	Thirteen Weeks Ended October 29, 2011	Percentage of Net Sales	Dollar Change	Dollar Change due to Parlux Acquisition	Dollar Change Excluding Parlux Acquisition	Percent Change Excluding Parlux Acquisition
	($ in thousands)							
Retail	$73,529	52.7%	$72,888	60.7%	$641	$—	$641	0.9 %
Wholesale	65,972	47.3%	47,237	39.3%	18,735	26,202	(7,467)	(15.8)%
Total net sales	$139,501	100.0%	$120,125	100.0%	$19,376	$26,202	$(6,826)	(5.7)%

Net sales increased 16.1% from $120.1 million in the thirteen weeks ended October 29, 2011 to $139.5 million in the thirteen weeks ended October 27, 2012. The increase in sales included a $18.8 million increase in wholesale sales and a $0.6 million increase in retail sales. Excluding the results of Parlux, net sales decreased by $6.8 million or 5.7%.
Retail sales increased by 0.9% from $72.9 million in the thirteen weeks ended October 29, 2011 to $73.5 million in the thirteen weeks ended October 27, 2012. The increase included an increase in SOW's consignment sales of $0.8 million offset by a decrease in Perfumania's retail sales of $0.2 million.
Perfumania's retail sales decreased from $59.6 million in the thirteen weeks ended October 29, 2011 to $59.4 million in the thirteen weeks ended October 27, 2012. The average number of stores operated was 345 in the thirteen weeks ended October 27, 2012 compared with 344 in the comparable period last year. Perfumania's comparable store sales decreased by 2.0% during the thirteen weeks ended October 27, 2012 from the same period in 2011. Comparable store sales measure sales from stores that have been open for one year or more. We exclude stores that are closed for renovation from comparable store sales from the month during which renovation commences until the first full month after reopening. The average retail price per unit sold during the thirteen weeks ended October 27, 2012 increased by 2.2% from the prior year's comparable period while the total number of units sold decreased by 2.4%. The reduction in demand is attributed to lower mall traffic.
SOW's consignment sales increased from $13.3 million in the thirteen weeks ended October 29, 2011 to $14.1 million in the thirteen weeks ended October 27, 2012. The increase in SOW's net sales is due generally to sales increases for multiple consignment accounts offset by the termination of several consignment relationships.
Excluding the results of Parlux, the decrease in wholesale sales of $7.5 million is the result of less product availability for the wholesale division due to a tightening of supplier inventory, and lower customer demand during the thirteen weeks ended October 27, 2012 compared to the thirteen weeks ended October 29, 2011.
Gross Profit

	Thirteen Weeks Ended October 27, 2012	Thirteen Weeks Ended October 29, 2011	Dollar Change	Dollar Change due to Parlux Acquisition	Dollar Change Excluding Parlux Acquisition	Percent Change Excluding Parlux Acquisition
	($ in thousands)					
Retail	$32,910	$33,350	$(440)	$—	$(440)	(1.3)%
Wholesale	25,285	9,721	15,564	13,989	1,575	16.2 %
Total gross profit	$58,195	$43,071	$15,124	$13,989	$1,135	2.6 %

19

Table of Contents

Gross Profit Percentages

	Thirteen Weeks Ended October 27, 2012	Thirteen Weeks Ended October 29, 2011
Retail	44.8%	45.8%
Wholesale	38.3%	20.6%
Total gross profit percentage	41.7%	35.9%

Gross profit increased 35.1% from $43.1 million in the thirteen weeks ended October 29, 2011 to $58.2 million in the thirteen weeks ended October 27, 2012. The increase in gross profit was due to the acquisition of Parlux on April 18, 2012. Excluding the results of Parlux, gross profit increased by $1.1 million or 2.6%.

Perfumania's retail gross profit dollars for the thirteen weeks ended October 27, 2012 decreased by 0.1% to $27.2 million compared with the comparable period in 2011. For these same periods, Perfumania's retail gross margins were 45.8%.

Wholesale gross profit percentage increased from 20.6% during the thirteen weeks ended October 29, 2011 to 38.3% during the thirteen weeks ended October 27, 2012. Excluding the results of Parlux, gross profit percentage during the thirteen weeks ended October 27, 2012 was 28.4%. During the thirteen weeks ended October 27, 2012, Parlux's gross profit was reduced by approximately $1.3 million to expense a portion of the purchase accounting adjustment to record Parlux's acquired inventory at fair market value at the acquisition date. This will impact future quarters until the remaining fair market value purchase accounting adjustment of approximately $13.5 million is expensed.

Expenses

Selling, general and administrative expenses include payroll and related benefits for our distribution center, sales, store operations, field management, purchasing and other corporate office and administrative personnel; rent, common area maintenance, real estate taxes and utilities for our stores, distribution centers and corporate office; advertising, consignment fees, sales promotion, insurance, supplies, freight out, and other administrative expenses. Selling, general and administrative expenses were $57.5 million in the thirteen weeks ended October 27, 2012, compared to $39.9 million in the thirteen weeks ended October 29, 2011. Excluding the results of Parlux, selling, general and administrative expenses increased by $0.7 million. Included in selling, general and administrative expenses are expenses in connection with the Services Agreement with Quality King, which was less than $0.1 million during the thirteen weeks ended October 27, 2012 and $0.1 million for the thirteen weeks ended October 29, 2011.

Depreciation and amortization was approximately $3.7 million and $2.1 million in the thirteen weeks ended October 27, 2012 and October 29, 2011, respectively. Approximately $1.7 million of amortization expense during the thirteen weeks ended October 27, 2012 relates to amortization on identifiable intangibles acquired as a result of the acquisition of Parlux.

Merger related expenses of approximately $0.1 million during the thirteen weeks ended October 27, 2012 represents costs incurred by the Company for the acquisition of Parlux.

Interest expense was approximately $2.5 million for the thirteen weeks ended October 27, 2012 compared with approximately $1.9 million for the thirteen weeks ended October 29, 2011. The increase in interest expense is due primarily to a higher average outstanding balance on the Company's revolving credit facility, as well as a higher outstanding balance on the Company's outstanding notes payable to affiliates during the thirteen weeks ended October 27, 2012 compared with the thirteen weeks ended October 29, 2011.

The Company continues to record a full valuation allowance against all deferred tax assets, thus no income tax benefit was recorded on operating losses during the thirteen weeks ended October 27, 2012 and October 29, 2011.

As a result of the foregoing, we realized a net loss of approximately $5.4 million in the thirteen weeks ended October 27, 2012 compared to a net loss of $0.8 million in the thirteen weeks ended October 29, 2011. Excluding the results of Parlux, our net loss would have been $0.9 million for the thirteen weeks ended October 27, 2012.

20

Table of Contents

Comparison of the Thirty-nine Weeks Ended October 27, 2012 with the Thirty-nine Weeks Ended October 29, 2011.

Net Sales

	Thirty-nine Weeks Ended October 27, 2012	Percentage of Net Sales	Thirty-nine Weeks Ended October 29, 2011	Percentage of Net Sales	Dollar Change	Dollar Change due to Parlux Acquisition	Dollar Change Excluding Parlux Acquisition	Percent Change Excluding Parlux Acquisition
	($ in thousands)							
Retail	$225,920	63.8%	$224,121	68.0%	$1,799	$—	$1,799	0.8 %
Wholesale	128,123	36.2%	105,380	32.0%	22,743	35,874	(13,131)	(12.5)%
Total net sales	$354,043	100.0%	$329,501	100.0%	$24,542	$35,874	$(11,332)	(3.4)%

Net sales increased 7.4% from $329.5 million in the thirty-nine weeks ended October 29, 2011 to $354.0 million in the thirty-nine weeks ended October 27, 2012. The increase in sales included an increase in retail sales of $1.8 million and an increase in wholesale sales of $22.7 million. Excluding the results of Parlux, net sales decreased by $11.3 million.

Retail sales increased by 0.8% from $224.1 million in the thirty-nine weeks ended October 29, 2011 to $225.9 million in the thirty-nine weeks ended October 27, 2012. The increase included an increase in Perfumania's retail sales of $0.7 million and an increase in SOW's consignment sales of $1.1 million.

Perfumania's retail sales increased from $180.2 million in the thirty-nine weeks ended October 29, 2011 to $180.9 million in the thirty-nine weeks ended October 27, 2012. Perfumania's comparable store sales decreased by 0.4% during the thirty-nine weeks ended October 27, 2012. The average retail price per unit sold during the thirty-nine weeks ended October 27, 2012 decreased 4.2% from the prior year's comparable period while the total number of units sold increased by 0.3%. We attribute the decrease in the average retail price per unit sold to various store level pricing promotions. The average number of stores operated was 342 in the thirty-nine weeks ended October 27, 2012, versus 349 in the prior year's comparable period.

SOW's consignment sales increased from $43.9 million in the thirty-nine weeks ended October 29, 2011 to $45.0 million in the thirty-nine weeks ended October 27, 2012. The increase in SOW's net sales is due to an increase in sales to multiple existing accounts offset by the termination of several consignment relationships.

Excluding the results of Parlux, the decrease in wholesale sales of $13.1 million or 12.5% is the result of less product availability for the wholesale division and less customer demand during the thirty-nine weeks ended October 27, 2012 compared to the thirty-nine weeks ended October 29, 2011.

Gross Profit

	Thirty-nine Weeks Ended October 27, 2012	Thirty-nine Weeks Ended October 29, 2011	Dollar Change	Dollar Change due to Parlux Acquisition	Dollar Change Excluding Parlux Acquisition	Percent Change Excluding Parlux Acquisition
	($ in thousands)					
Retail	$99,326	$101,484	$(2,158)	$—	$(2,158)	(2.1)%
Wholesale	44,242	24,265	19,977	18,932	1,045	4.3 %
Total gross profit	$143,568	$125,749	$17,819	$18,932	$(1,113)	(0.9)%

21

Table of Contents

Gross Profit Percentages

	Thirty-nine Weeks Ended October 27, 2012	Thirty-nine Weeks Ended October 29, 2011
Retail	44.0%	45.3%
Wholesale	34.5%	23.0%
Total gross profit percentage	40.6%	38.2%

Gross profit increased 14.2% from $125.7 million in the thirty-nine weeks ended October 29, 2011 to $143.6 million in the thirty-nine weeks ended October 27, 2012. Excluding the results of Parlux, gross profit decreased by $1.1 million or 0.9%.

Perfumania's retail gross profit for the thirty-nine weeks ended October 27, 2012 decreased by 2.7% to $82.5 million compared with the comparable period in 2011. For these same periods, Perfumania's retail gross margins were 45.6% and 47.0%, respectively.

Wholesale gross profit percentage increased from 23.0% during the thirty-nine weeks ended October 29, 2011 to 34.5% during the thirty-nine weeks ended October 27, 2012. Excluding the results of Parlux, gross profit percentage during the thirty-nine weeks ended October 27, 2012 was 27.4%. During the thirty-nine weeks ended October 27, 2012, Parlux's gross profit was reduced by approximately $3.0 million to expense a portion of the purchase accounting adjustment to record Parlux's acquired inventory at fair market value at the acquisition date. This will impact future quarters until the remaining fair market value purchase accounting adjustment of approximately $13.5 million is expensed.

Expenses

Selling, general and administrative expenses were $154.8 million in the thirty-nine weeks ended October 27, 2012, compared to $118.1 million in the thirty-nine weeks ended October 29, 2011. Excluding the results of Parlux, selling, general and administrative expenses increased by $1.6 million. Also included in selling, general and administrative expenses are expenses in connection with the Services Agreement with Quality King, which were $0.5 million and $0.4 million for the thirty-nine weeks ended October 27, 2012 and October 29, 2011, respectively.

Depreciation and amortization was approximately $10.3 million in the thirty-nine weeks ended October 27, 2012, compared to $5.8 million for the thirty-nine weeks ended October 29, 2011. Approximately $4.4 million of amortization expense during the thirty-nine weeks ended October 27, 2012 relates to amortization on identifiable intangibles acquired as a result of the acquisition of Parlux.

Share-based compensation expense of approximately $4.3 million during the thirty-nine weeks ended October 27, 2012 represents the expense incurred on stock options granted during the current period.

Merger related expenses of approximately $4.6 million during the thirty-nine weeks ended October 29, 2012 represents costs incurred by the Company for the acquisition of Parlux.

Interest expense was approximately $6.6 million for the thirty-nine weeks ended October 27, 2012 compared with approximately $5.9 million for the thirty-nine weeks ended October 29, 2011. The increase in interest expense is due primarily to a higher average outstanding balance on the Company's revolving credit facility, as well as a higher overall average outstanding balance on the Company's outstanding notes payable to affiliates during the thirty-nine weeks ended October 27, 2012 compared with the thirty-nine weeks ended October 29, 2011.

Since the Company continues to record a full valuation allowance against all deferred tax assets, no income tax benefit was recorded during either of the thirty-nine week periods ended October 27, 2012 and October 29, 2011.

As a result of the foregoing, we realized a net loss of approximately $37.0 million in the thirty-nine weeks ended October 27, 2012, compared to a net loss of $4.1 million in the thirty-nine weeks ended October 29, 2011. Excluding the results of Parlux, our net loss was $16.4 million for the thirty-nine weeks ended October 27, 2012.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities during the thirty-nine weeks ended October 27, 2012 was approximately $50.1 million, compared with approximately $3.3 million provided by operating activities during the thirty-nine weeks ended October 29, 2011. The $53.4 million decrease in cash flows from operating activities during the thirty-nine weeks ended October 27, 2012 compared with the prior year’s comparable period resulted primarily from an increase in our net loss and an increase in our inventory levels. The seasonality of our operations may lead to significant fluctuations in certain asset and liability accounts between fiscal year-end and subsequent interim periods.

Table of Contents

Net cash used in investing activities was approximately $50.5 million in the thirty-nine weeks ended October 27, 2012 compared to $2.7 million in the thirty-nine weeks ended October 29, 2011. The current period's investing activities primarily related to the payment of $62.1 million to acquire Parlux, net of Parlux's $17.1 million cash on hand. During the thirty-nine weeks ended October 27, 2012, Perfumania opened 15 new stores and closed 11 stores, including 1 seasonal location. We plan to open a minimum of 5 stores and close 1 store for the remainder of fiscal 2012. We continuously evaluate the appropriate new store growth rate in light of economic conditions and may adjust the growth rate as conditions change. Furthermore, we continue to evaluate the need to close, remodel or relocate existing stores.

Net cash provided by financing activities during the thirty-nine weeks ended October 27, 2012 was approximately $100.5 million, primarily because of the $32.1 million borrowed under our Senior Credit Facility, net of cash and cash equivalents acquired from Parlux, the $30 million borrowed from affiliates to fund the cash paid for Parlux and the $35.7 million net loss, compared with approximately $0.6 million used in financing activities for the thirty-nine weeks ended October 29, 2011. See further discussion at Note 2 of the condensed consolidated financial statements.

The Company has a $225 million revolving credit facility with a syndicate of banks (the "Senior Credit Facility"), which is used for the Company's general corporate purposes and those of its subsidiaries, including working capital. The Company and certain of its subsidiaries are co-borrowers under the Senior Credit Facility, and the Company's other subsidiaries have guaranteed all of their obligations thereunder. The Company was in compliance with all financial and operating covenants under the Senior Credit facility as of October 27, 2012. As of October 27, 2012, the Company had $39.0 million available to borrow under the Senior Credit Facility based on the borrowing base at that date. Further information about the Senior Credit Facility is included in Note 6 of our condensed consolidated financial statements included in this Form 10-Q.

The Company has various unsecured notes payable outstanding to affiliates which in aggregate total $125.4 million of principal. No payments of principal may be made on any of these notes payable to affiliates before the maturity of the Senior Credit Facility although interest payments are permitted under certain conditions. See further discussion of our notes payable to affiliates and our Senior Credit Facility in Note 6 of our condensed consolidated financial statements included in this Form 10-Q.

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our condensed consolidated financial statements have been prepared in accordance with US GAAP. Preparation of these statements requires management to make judgments and estimates that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, management evaluates its estimates, including those related to bad debts, inventories, asset impairments, sales returns and allowances, and other contingent assets and liabilities. As such, some accounting policies have a significant impact on amounts reported in these financial statements. The judgments and estimates made can significantly affect results. Materially different amounts might be reported under different conditions or by using different assumptions. We consider an accounting policy to be critical if it is both important to the portrayal of our financial condition and results of operations, and requires significant judgment and estimates by management in its application. We have identified certain critical accounting policies that affect the significant estimates and judgments used in the preparation of its financial statements. There have been no significant changes to our critical accounting policies and estimates as discussed in our Annual Report on Form 10-K for the year ended January 28, 2012.

ITEM 3.QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
Not applicable

ITEM 4. CONTROLS AND PROCEDURES
As of the end of the period covered by this report (October 27, 2012), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our

Table of Contents

disclosure controls and procedures were effective. This evaluation excluded those disclosure controls and procedures that are subsumed by the internal control over financial reporting of the business operations of the former Parlux Fragrances, Inc., which we acquired on April 18, 2012, ten days before the end of our first fiscal quarter, since their evaluation was not feasible. However, we note that Parlux had consistently reported effective disclosure controls and procedures based on its managements' evaluations over the fiscal year preceding the acquisition. The significance of the Parlux business to our condensed consolidated financial statements is discussed in Item 2 above and in Note 2 to our condensed consolidated financial statements in Item 1.

During the third quarter of fiscal 2012 there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information in Note 10 of the condensed consolidated financial statements included in Part 1, Item 1 is incorporated herein by reference.

ITEM 1A. RISK FACTORS

You should consider the following risk factors, in addition to the other information presented in this Form 10-Q and in our other filings with the SEC, in evaluating us, our business and an investment in our common stock. Any of the following risks, as well as other risks and uncertainties not presently known to us or that we currently deem immaterial, could seriously harm our business and financial results and cause the value of our common stock to decline, which in turn could cause you to lose all or part of your investment.

We may not realize the benefits of integrating our Parlux acquisition

To be successful after our recent merger with Parlux, we will need to complete the integration of the operations of Perfumania and Parlux into one company. Integration requires substantial management attention and could detract attention from day-to-day business. We could encounter difficulties in the integration process, such as the need to revisit assumptions about reserves, future production, revenues, capital expenditures and operating costs, including synergies, the loss of key employees or commercial relationships or the need to address unanticipated liabilities. If we cannot complete the integration of the Perfumania and Parlux businesses successfully, we may fail to realize the expected benefits of the merger.

We are more leveraged following the Parlux merger than we have been historically

In order to complete our acquisition of Parlux, we incurred an additional $62.1 million of debt. Borrowings under the amended credit facility and our subordinated debt now total approximately $226.6 million. We and our subsidiaries must comply with various restrictive covenants in our credit facility. Among other things, these covenants limit our ability to:

- pay dividends;
- make distributions; and
- take other actions, such as making advances to suppliers.

Our substantial debt could have important consequences such as:

- increasing our vulnerability to general adverse economic and industry conditions;
- limit our ability to fund future working capital and capital expenditures, engage in future acquisitions or development activities, or otherwise fully realize the value of our assets and opportunities because of the need to dedicate a substantial portion of our cash flow from operations to payments on the debt or to comply with any restrictive terms of the debt;
- limit our flexibility in planning for, or reacting to, changes in our industry; or
- place us at a competitive disadvantage as compared to competitors that have less debt.

Realization of any of these factors could adversely affect Perfumania's financial condition.

We may experience impairment of the goodwill or value of long-lived assets that resulted from the Parlux merger

In connection with the Parlux merger, we recorded a substantial amount of goodwill in our financial statements and also acquired long-lived assets resulting from the acquisition or development of license brands and sublicensing opportunities. Both goodwill and the value of these long-lived assets can become impaired, as indicated by factors such as changes in our stock price, book value or market capitalization, and the past and anticipated operating performance and cash flows of our retail and wholesale segments. We test for impairment annually, but the fair value estimates involved require a significant amount of difficult judgment and assumptions by management. Our actual results may differ materially from our projections, which may result in the need to recognize impairment of some or all of the goodwill we recorded and/or to write down the value of our long-lived assets, including brand licenses and trademarks.

We could face liquidity and working capital constraints if we are unable to generate sufficient cash flows from operations

If we are unable to generate sufficient cash flows from operations to service our obligations, we could face liquidity and working capital constraints, which could adversely impact our future operations and growth. If we need to raise additional funds to support our operations, we may not be able to do so on favorable terms, or at all. Without such funding, we may need to modify or abandon our growth strategy or eliminate product offerings, any of which could negatively impact our financial position.

We may have problems raising money needed in the future, which could adversely impact operations or existing stockholders

Our growth strategy includes selectively opening and operating new Perfumania retail locations and increasing the average retail sales per store. We may need to obtain funding to achieve our growth strategy. In part due to our existing debt, additional financing may not be available on acceptable terms, if at all, which would adversely affect our operations. In order to obtain additional liquidity, we might issue additional common stock which could dilute our existing shareholders' ownership interest or we may be required to issue securities with greater rights than those currently possessed by holders of our common stock. We may also be required to take other actions which may lessen the value of our common stock, including borrowing money on terms that are not favorable.

The beauty industry is highly competitive and if we cannot effectively compete our business and results of operations will suffer

The beauty industry is highly competitive and can change rapidly due to consumer preferences and industry trends. Some of our competitors sell fragrances at discount prices and some are part of large national or regional chains that have substantially greater resources and name recognition than Perfumania. Perfumania's stores compete on the basis of selling price, customer service, merchandise variety and store location. Many of our current and potential competitors have greater financial, technical, operational, and marketing resources. We may not be able to compete successfully against these competitors in developing our products and services. These factors, as well as demographic trends, economic conditions and discount pricing strategies by competitors, could result in increased competition and could have a material adverse effect on our profitability, operating cash flow, and many other aspects of our business, prospects, results of operations and financial condition.

If we are unable to acquire or license additional brands, our business may not grow as we expect

Our business strategy contemplates growing our portfolio of licensed brands. We may be unsuccessful in identifying, negotiating, financing and consummating desirable licensing arrangements on commercially acceptable terms, or at all, which could hinder our ability to increase revenues. Additionally, even if we are able to consummate such licensing arrangements, we may not be able to successfully integrate them with our existing operations and portfolio of licenses or generate the expected levels of increased revenue as a result.

Any new product we develop may not generate sufficient consumer interest and sales to become a profitable brand or even to cover the costs of its development and subsequent promotions

Our success with new fragrance products depends on our products' appeal to a broad range of consumers, whose preferences are subject to change, and on our ability to anticipate and respond to market trends through product innovation. In addition, a number of the new launches are with celebrities (either entertainers or athletes) who require substantial royalty commitments and whose careers and/or public appeal could change dramatically, either positively or negatively with no warning. If any of our new product introductions is unsuccessful, or if the appeal of the celebrity related to a product diminishes, it could materially hurt our results of operations.

Our retail business is sensitive to and may be adversely affected by general economic conditions and overall consumer confidence

Our business is sensitive to a number of factors that influence the levels of consumer spending, including political and economic conditions such as recessionary environments, the levels of disposable consumer income, consumer debt, interest rates, fuel and energy prices, the level of unemployment and consumer confidence. During periods of economic uncertainty where consumer confidence is affected, consumer spending levels and customer traffic could decline, which would have an adverse effect on our business and our results of operations.

Adverse U.S. and global economic conditions could affect our wholesale business

A U.S. or global economic downturn could reduce the availability of credit for businesses. Some of our customers could experience a decline in financial performance. These conditions affect their ability to pay amounts owed to us on a timely basis or at all. There can be no assurance that government responses to potential economic disruptions would increase liquidity and the availability of credit, and as a result, our wholesale customers may be unable to borrow funds on acceptable terms. Any economic decline affecting our customers would adversely affect our business and results of operations.

If Perfumania cannot successfully manage its growth, our business will be adversely affected

We may not be able to sustain growth in revenues. Perfumania's growth has been somewhat dependent upon opening and operating new retail stores on a profitable basis, which in turn is subject to, among other things, securing suitable store sites on satisfactory terms, hiring, training and retaining qualified management and other personnel, having adequate capital resources and successfully integrating new stores into existing operations. Circumstances outside our control could negatively affect these anticipated store openings. Perfumania's new stores may take up to three years to reach planned operating levels. It is possible that Perfumania's new stores might not achieve sales and profitability comparable to existing stores, and it is possible that the opening of new locations might adversely affect sales at existing locations. The failure to expand by successfully opening new stores as planned, or the failure of a significant number of these stores to perform as planned, could have a material adverse effect on our business and our results of operations.

The market for real estate is competitive, which could adversely impact our results

Our ability to effectively obtain real estate to open new stores depends upon the availability of real estate that meets our criteria, including traffic, square footage, co-tenancies, lease economics, demographics, and other factors, and our ability to negotiate terms that meet our financial targets. In addition, we must be able to effectively renew our existing store leases. Failure to secure real estate locations adequate to meet annual targets, as well as effectively managing the profitability of our existing stores, could have a material adverse effect on our business and our results of operations.

If we are unable to effectively manage our inventory, we will not achieve our expected results

We are exposed to inventory risks that may adversely affect our operating results as a result of seasonality, new product launches, changes in customer preferences or demand, and consumer spending patterns. We must carry a significant amount of inventory, especially before the holiday season selling period. Demand for product can change between the time inventory is ordered and the date of sale, especially with new products. In particular, our business includes a significant portion of consigned sales, and our revenue recognition policy defers recognition of revenue for this type of sales. Consignment sales remain in inventory until the products are sold to end users and, if not sold, the inventory may be returned to us upon termination of the consignment relationships. The turnover frequency of our inventory on consignment is critical to generating regular cash flow in amounts necessary to keep financing costs to targeted levels and to purchase additional inventory. If this turnover is not sufficiently frequent, our financing costs may exceed targeted levels and we may be unable to generate regular cash flow in amounts necessary to purchase additional inventory to meet the demand for other products. In addition, slow inventory turnover may force us to reduce prices and accept lower margins to sell consigned products. Any of these situations may hurt our results of operations.

Parlux's business has historically depended on department store sales, which present special risks

Parlux historically launched its new fragrances through U.S. department stores. Department stores tend to lose sales to the mass market as a product matures. To counter this effect, Parlux needed to introduce new products quickly, which requires additional spending for development, advertising and promotional expenses. In addition, U.S. department stores have experienced a significant amount of consolidation in recent years. This has resulted in Parlux's increasing dependence on a smaller number of key retailers, enhancing their bargaining strength and resulting in increased risk. Continued department store consolidation could have a material adverse effect on our financial condition and results of operations.

Our business is subject to seasonal fluctuations, which could lead to fluctuations in our stock price

We have historically experienced and expect to continue experiencing higher sales in the fourth fiscal quarter than in any of the first three fiscal quarters. Purchases of fragrances as gift items increase during the holiday season, which results in significantly higher fourth fiscal quarter retail sales. Sales levels of new and existing stores are affected by a variety of factors, including the retail sales environment, the level of competition, the effect of marketing and promotional programs, acceptance of new product introductions, adverse weather conditions, general economic conditions and other factors beyond our control.

Our quarterly results may also vary as a result of the timing of new store openings and store closings, net sales contributed by new stores and fluctuations in comparable sales of existing stores. If our quarterly operating results are below expectations, our stock price might decline.

We may experience shortages of the merchandise we need because we do not rely on long-term agreements with suppliers

Our success depends to a large degree on our ability to provide an extensive assortment of brand name and designer fragrances. We do not rely on long-term purchase contracts or other contractual assurance of continued supply, pricing or access to new products. Suppliers of distributed brands generally may choose to reduce or eliminate the volume of their products we distribute, including supplying products to our wholesale customers directly or through another distributor. Our wholesale customers are generally able to cancel orders or delay the delivery of products on short notice. If we are unable to obtain merchandise from one or more key suppliers on a timely basis or acceptable terms, or if there is a material change in our ability to obtain necessary merchandise, our results of operations could be adversely affected.

We could be subject to litigation because of the merchandising aspect of our business

Some of the merchandise we purchase from suppliers might be manufactured by entities that are not the owners of the trademarks or copyrights for the merchandise. The owner of a particular trademark or copyright may challenge us to

Table of Contents

demonstrate that the specific merchandise was produced and sold with the proper authority, and if we are unable to demonstrate this, we could, among other things, be restricted from reselling the particular merchandise or be subjected to other liabilities. This type of restriction could adversely affect our business and results of operations.

Our stock price volatility could result in litigation, substantial cost, and diversion of management's attention

The price of our common stock has been and likely will continue to be subject to wide fluctuations in response to a number of events, such as:

- quarterly variations in operating results;
- acquisitions, capital commitments or strategic alliances by us or our competitors;
- legal and regulatory matters that are applicable to our business;
- the operating and stock price performances of other companies that investors may deem comparable to us;
- news reports relating to trends in our markets; and
- the amount of shares constituting our public float.

In addition, the stock market in general has experienced significant price and volume fluctuations that often have been unrelated to the performance of specific companies. The broad market fluctuations may adversely affect the market price of our common stock, regardless of our operating performance. Our stock price volatility could result in litigation, including class action lawsuits, which would require substantial monetary cost to defend, as well as the diversion of management attention from day-to-day activities which could negatively affect operating performance. Such litigation could also have a negative impact on the price of our common stock due to the uncertainty and negative publicity associated with litigation.

Future growth may place strains on our managerial, operational and financial resources

If we grow as we anticipate, a significant strain on our managerial, operational and financial resources may occur. Future growth or increase in the number of our strategic relationships could strain our managerial, operational and financial resources, inhibiting our ability to achieve the execution necessary to successfully implement our business plan.

The loss of or disruption in our distribution facilities could have a material adverse effect on our business

We currently have two distribution facilities located in Bellport, New York and Keasbey, New Jersey. In addition we use third-party fulfillment centers in New York and New Jersey. The loss of, or damage to any of these facilities, as well as the inventory stored therein, could adversely affect our business, prospects, results of operations, financial condition or cash flows.

Expanding our business through acquisitions of and investments in other businesses and technologies presents special risks that may disrupt our business

We have in the past and may in the future continue to expand through the acquisition of and investment in other businesses. Acquisitions involve a number of special problems, including:

- difficulty integrating acquired technologies, operations, and personnel with our existing business;
- diversion of management's attention in connection with both negotiating the acquisitions and integrating the assets;
- the need for additional financing;
- strain on managerial, operational and financial resources as management tries to oversee larger operations; and
- exposure to unforeseen liabilities of acquired companies.

We may not be able to successfully address these problems. Moreover, our future operating results will depend to a significant degree on our ability to successfully manage growth or integrate acquisitions.

Any weakness in internal control over financial reporting or disclosure controls and procedures could result in a loss of investor confidence in our financial reports and lead to a stock price decline

We are required to maintain effective internal control over financial reporting, as well as effective disclosure controls and procedures, complying with SEC rules and covering all our business operations. Any failure to have effective internal control over financial reporting or disclosure controls and procedures covering our business could cause investors to lose confidence in the accuracy and completeness of our financial reports, limit our ability to raise financing or lead to regulatory sanctions, any of which could result in a material adverse effect on our business or a decline in the market price of our common stock.

If we fail to protect the security of personal information about our retail customers, our reputation could suffer and we could suffer financial harm

Table of Contents

We receive and store personal information about the customers of our retail businesses. The regulatory environment for information security is increasingly demanding, and our customers have a high expectation that we will protect their personal information. If we experience a data security breach, we could be exposed to costly government enforcement actions and private litigation. In addition, this could damage our reputation and our customers could lose confidence in us, which could cause them to stop using credit cards to purchase our products or stop shopping at our stores altogether. Such events could lead to lost future sales, fines or lawsuits, which would adversely affect our results of operations.

The risks of e-commerce retailing could hurt our results of operations

Business risks related to our Perfumania.com e-commerce business include our ability to keep pace with rapid technological change, any failure in our – or any third-party processor's – security procedures and operational controls, failure or inadequacy in our – or any third-party processor's – systems or ability to process customer orders, and the imposition of sales or other taxes by states or foreign jurisdictions. If any of these risks materializes, it could have an adverse effect on our results of operations.

If we are unable to protect our intellectual property rights, specifically trademarks and trade names, our ability to compete would be negatively affected

The market for our products depends to a significant extent upon the value associated with our trademarks and trade names. We own, or have licenses or other rights to use, the material trademark and trade name rights used in connection with the packaging, marketing and distribution of our major products both in the United States and in other countries where such products are principally sold; therefore, trademark and trade name protection is very important to our business. Although most of our brand names are registered in the United States and in certain foreign countries in which we operate, we may not be successful in asserting trademark or trade name protection. In addition, the laws of certain foreign countries may not protect our intellectual property rights to the same extent as the laws of the United States, especially in the product class that includes fragrance products. The costs required to protect our trademarks and trade names may be substantial.

If other parties infringe on our intellectual property rights or the intellectual property rights that we license, the value of our brands in the marketplace may be diluted. Any infringement of our intellectual property rights would also likely result in a commitment of our time and resources to protect these rights through litigation or otherwise. Additionally, we may infringe or be accused of infringing on others' intellectual property rights and one or more adverse judgments with respect to these intellectual property rights could negatively impact our ability to compete and could materially adversely affect our business, prospects, results of operations, financial condition or cash flows.

Our success depends, in part, on the quality and safety of our fragrance and related products

Our success depends, in part, on the quality and safety of our fragrance and related products. If our products are found to be unsafe or defective, or if they otherwise fail to meet customers or consumers' standards and expectations, our reputation could be adversely affected, our relationships with customers or consumers could suffer, the appeal of one or more of our brands could be diminished, our sales could be adversely affected and/or we may become subject to liability claims, any of which could result in a material adverse effect on our business, results of operations and financial condition.

We are subject to risks related to our international operations

We operate on a global basis, with sales in approximately 80 countries. Our international operations could be adversely affected by:

- import and export license requirements;
- trade restrictions;
- changes in tariffs and taxes;
- product registration, permitting and regulatory compliance;
- restrictions on repatriating foreign profits back to the United States;
- the imposition of foreign and domestic governmental controls;
- changes in, or our unfamiliarity with, foreign laws and regulations;
- difficulties in staffing and managing international operations;

- changes in economic, social, legal and other conditions, including, without limitation, the continuing turmoil in the Eurozone;
- the volatility of the U.S. dollar against other currencies;
- greater difficulty enforcing intellectual property rights and weaker laws protecting such rights; and

Table of Contents

- geo-political conditions, such as terrorist attacks, war or other military action, public health problems and natural disasters.

Reductions in worldwide travel could hurt sales volumes in our duty-free related business

We depend on consumer travel for sales to our "duty free" customers in airports and other locations throughout the world. Any reductions in travel, including as a result of general economic downturns, natural disasters, or acts of war or terrorism, or disease epidemics, could result in a material decline in sales and profitability for this channel of distribution, which could negatively affect our operating results, financial condition, and operating cash flow.

Control of our management and policies is with our principal shareholders, who could take actions that are not in the best interest of the other shareholders

Members of the Nussdorf family beneficially own an aggregate of approximately 57% of our outstanding common stock, assuming exercise of warrants they hold. As a result, if they acted together, they would be able to direct our corporate policies and could act unilaterally to approve most actions requiring shareholder approval under law or our governing documents. The Nussdorfs' collective stock ownership may have the effect of delaying or preventing policies or actions deemed desirable by our Board of Directors, such as a business combination that might be in the interests of our other shareholders, which in turn could materially and adversely affect the market price of our common stock. Conversely, such ownership may cause us to implement policies that are not in the best interests of our other shareholders.

We also have a material amount of indebtedness to the Nussdorfs and their affiliates. As significant creditors, the Nussdorfs may refuse consent to actions our Board may consider necessary.

Furthermore, we have agreed that, in certain circumstances, we will register with the SEC the resale of certain shares of our common stock held by the Nussdorfs. They may require that, in the event of any marketing limitation on the number of shares included in an applicable registration statement, their shares be registered on a pro rata basis with shares being registered for parties that have obtained registration rights in connection with providing financing to us. This may limit our ability to obtain financing in the future.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

Among the factors that could cause actual results, performance or achievement to differ materially from those described or implied in the forward-looking statements are the integration of the Parlux acquisition, our ability to service our obligations, our ability to comply with the covenants in our Senior Credit Facility, any failure of general economic conditions to improve, including any weaker than anticipated recovery in discretionary spending by consumers, competition, the ability to raise additional capital to finance our expansion and other factors included in our filings with the SEC. Copies of our SEC filings are available from the SEC or may be obtained upon request from us.

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

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

Table of Contents

ITEM 5. OTHER INFORMATION
None.

ITEM 6. EXHIBITS
The exhibits listed in the following Exhibit Index are filed herewith.

3.1	Amended and Restated Articles of Incorporation, as amended through August 8, 2008 (Incorporated by reference to Exhibit 3.1 to the Company's Form 10-K filed July 2, 2009).
3.2	Bylaws (Incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (No 33-46833)).
31.1	Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

PERFUMANIA HOLDINGS, INC.
SIGNATURES
Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

		PERFUMANIA HOLDINGS, INC. (Registrant)
Date: December 11, 2012	By:	By: /S/ Michael W. Katz Michael W. Katz President and Chief Executive Officer (Principal Executive Officer)
	By:	By: /S/ Donna L. Dellomo Donna L. Dellomo Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)