

Destination Maternity Corp  
Form 10-Q  
May 08, 2013  
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**United States**  
**Securities and Exchange Commission**  
Washington, D.C. 20549

**FORM 10-Q**

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended March 31, 2013

Or

.. **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-21196

**Destination Maternity Corporation**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**13-3045573**  
(IRS Employer

Identification No.)

**456 North 5th Street, Philadelphia, Pennsylvania**  
(Address of principal executive offices)

**19123**  
(Zip code)

**Registrant's telephone number, including area code (215) 873-2200**

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$.01 par value 13,536,429 shares outstanding as of May 3, 2013

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**DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES**

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts)

(unaudited)

|  | March 31, 2013    | September 30, 2012 |
|--|-------------------|--------------------|
| <b>ASSETS</b>  |                   |                    |
| Current assets:  |                   |                    |
| Cash and cash equivalents  | \$ 13,803         | \$ 22,376          |
| Restricted cash  | 2,082             |                    |
| Trade receivables, net   | 15,079            | 13,197             |
| Inventories  | 85,752            | 88,754             |
| Deferred income taxes  | 7,607             | 7,557              |
| Prepaid expenses and other current assets  | 6,072             | 4,220              |
| <b>Total current assets</b>  | <b>130,395</b>    | <b>136,104</b>     |
| Property, plant and equipment, net of accumulated depreciation and amortization of \$122,914 and \$120,371 | 50,694            | 51,078             |
| Other assets:  |                   |                    |
| Deferred financing costs, net of accumulated amortization of \$80 and \$751                                | 887               | 92                 |
| Other intangible assets, net of accumulated amortization of \$2,118 and \$2,123                            | 1,427             | 1,347              |
| Deferred income taxes  | 11,041            | 10,667             |
| Other non-current assets   | 314               | 356                |
| <b>Total other assets</b>  | <b>13,669</b>     | <b>12,462</b>      |
| <b>Total assets</b>  | <b>\$ 194,758</b> | <b>\$ 199,644</b>  |

**LIABILITIES AND STOCKHOLDERS EQUITY**

|   |               |               |
|---|---------------|---------------|
| Current liabilities:                            |               |               |
| Line of credit borrowings                       | \$            | \$            |
| Current portion of long-term debt               | 1,830         | 15,257        |
| Accounts payable                                | 21,295        | 21,987        |
| Accrued expenses and other current liabilities  | 38,069        | 35,544        |
| <b>Total current liabilities</b>                | <b>61,194</b> | <b>72,788</b> |
| Deferred rent and other non-current liabilities | 21,656        | 21,884        |
| <b>Total liabilities</b>                        | <b>82,850</b> | <b>94,672</b> |

Commitments and contingencies (Note 12)

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Stockholders' equity:

Preferred stock, 1,656,381 shares authorized:

Series B junior participating preferred stock, \$.01 par value; 300,000 shares authorized, none outstanding

Common stock, \$.01 par value; 20,000,000 shares authorized, 13,534,777 and 13,370,149 shares issued and outstanding, respectively

|                                      |        |        |
|--------------------------------------|--------|--------|
|                                      | 135    | 134    |
| Additional paid-in capital           | 97,034 | 95,086 |
| Retained earnings                    | 14,780 | 9,786  |
| Accumulated other comprehensive loss | (41)   | (34)   |

|                            |         |         |
|----------------------------|---------|---------|
| Total stockholders' equity | 111,908 | 104,972 |
|----------------------------|---------|---------|

|  |            |            |
|--|------------|------------|
| Total liabilities and stockholders' equity | \$ 194,758 | \$ 199,644 |
|--|------------|------------|

The accompanying notes are an integral part of these Consolidated Financial Statements.

**Table of Contents****DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share amounts)

(unaudited)

|   | <b>Three Months Ended March 31,</b> |             | <b>Six Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|-----------------------------------|-------------|
|   | <b>2013</b>                         | <b>2012</b> | <b>2013</b>                       | <b>2012</b> |
| Net sales   | \$ 134,859                          | \$ 137,792  | \$ 270,123                        | \$ 274,142  |
| Cost of goods sold  | 61,879                              | 64,031      | 125,975                           | 130,775     |
| Gross profit  | 72,980                              | 73,761      | 144,148                           | 143,367     |
| Selling, general and administrative expenses                | 63,026                              | 64,636      | 127,275                           | 129,715     |
| Store closing, asset impairment and asset disposal expenses | 272                                 | 560         | 734                               | 997         |
| Operating income  | 9,682                               | 8,565       | 16,139                            | 12,655      |
| Interest expense, net                                       | 127                                 | 344         | 327                               | 744         |
| Loss on extinguishment of debt                              |                                     |             | 9                                 | 10          |
| Income before income taxes                                  | 9,555                               | 8,221       | 15,803                            | 11,901      |
| Income tax provision  | 3,678                               | 3,242       | 6,084                             | 4,659       |
| Net income  | \$ 5,877                            | \$ 4,979    | \$ 9,719                          | \$ 7,242    |
| Net income per share Basic                                  | \$ 0.44                             | \$ 0.38     | \$ 0.73                           | \$ 0.55     |
| Average shares outstanding Basic                            | 13,273                              | 13,074      | 13,231                            | 13,049      |
| Net income per share Diluted                                | \$ 0.44                             | \$ 0.38     | \$ 0.73                           | \$ 0.55     |
| Average shares outstanding Diluted                          | 13,402                              | 13,248      | 13,373                            | 13,221      |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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**DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(in thousands)

(unaudited)

|  | <b>Three Months Ended March 31,</b> |             | <b>Six Months Ended March 31,</b> |             |
|--|-------------------------------------|-------------|-----------------------------------|-------------|
|  | <b>2013</b>                         | <b>2012</b> | <b>2013</b>                       | <b>2012</b> |
| Net income   | \$ 5,877                            | \$ 4,979    | \$ 9,719                          | \$ 7,242    |
| Foreign currency translation adjustments               |                                     | 8           | (7)                               | (8)         |
| Change in fair value of interest rate swap, net of tax |                                     | 35          |                                   | 83          |
| Comprehensive income                                   | \$ 5,877                            | \$ 5,022    | \$ 9,712                          | \$ 7,317    |

The accompanying notes are an integral part of these Consolidated Financial Statements.

**Table of Contents****DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

(in thousands)

(unaudited)

|  | Common Stock           |        | Additional<br>Paid-in<br>Capital | Retained<br>Earnings<br>(Accumulated<br>Deficit) | Accumulated<br>Other<br>Comprehensive<br>Loss | Total      |
|--|------------------------|--------|----------------------------------|--|---|------------|
|  | Number<br>of<br>Shares | Amount |                                  |  |   |            |
| Balance as of September 30, 2012   | 13,370                 | \$ 134 | \$ 95,086                        | \$ 9,786   | \$ (34)                                       | \$ 104,972 |
| Net income   |                        |        |                                  | 9,719  |   | 9,719      |
| Foreign currency translation adjustments                                       |                        |        |                                  |  | (7)   | (7)        |
| Cash dividends   |                        |        |                                  | (4,725)  |   | (4,725)    |
| Stock-based compensation   | 102                    | 1      | 1,495                            |  |   | 1,496      |
| Exercise of stock options, net   | 93                     | 1      | 491                              |  |   | 492        |
| Excess tax benefit from stock option exercises and restricted stock vesting    |                        |        | 576                              |  |   | 576        |
| Repurchase and retirement of common stock                                      | (30)                   | (1)    | (614)                            |  |   | (615)      |
| Balance as of March 31, 2013   | 13,535                 | \$ 135 | \$ 97,034                        | \$ 14,780  | \$ (41)                                       | \$ 111,908 |
| Balance as of September 30, 2011   | 13,226                 | \$ 132 | \$ 92,932                        | \$ (261)   | \$ (108)                                      | \$ 92,695  |
| Net income   |                        |        |                                  | 7,242  |   | 7,242      |
| Change in fair value of interest rate swap, net of tax                         |                        |        |                                  |  | 83  | 83         |
| Foreign currency translation adjustments                                       |                        |        |                                  |  | (8)   | (8)        |
| Cash dividends   |                        |        |                                  | (4,648)  |   | (4,648)    |
| Stock-based compensation   | 91                     | 1      | 1,179                            |  |   | 1,180      |
| Exercise of stock options, net   | 2                      |        | 13                               |  |   | 13         |
| Tax benefit shortfall from stock option exercises and restricted stock vesting |                        |        | (80)                             |  |   | (80)       |
| Repurchase and retirement of common stock                                      | (3)                    |        | (55)                             |  |   | (55)       |
| Balance as of March 31, 2012   | 13,316                 | \$ 133 | \$ 93,989                        | \$ 2,333   | \$ (33)                                       | \$ 96,422  |

The accompanying notes are an integral part of these Consolidated Financial Statements.



**Table of Contents****DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

|  | <b>Six Months Ended<br/>March 31,</b> |               |
|--|---------------------------------------|---------------|
|  | <b>2013</b>                           | <b>2012</b>   |
| <b>Operating Activities</b>  |                                       |               |
| Net income   | \$ 9,719                              | \$ 7,242      |
| Adjustments to reconcile net income to net cash provided by operating activities:                |                                       |               |
| Depreciation and amortization  | 6,170                                 | 6,319         |
| Stock-based compensation expense   | 1,496                                 | 1,180         |
| Loss on impairment of long-lived assets  | 688                                   | 973           |
| (Gain) loss on disposal of assets  | (4)                                   | 104           |
| Loss on extinguishment of debt   | 9                                     | 10            |
| Deferred income tax (benefit) provision  | (1,061)                               | 305           |
| Amortization of deferred financing costs   | 102                                   | 56            |
| Changes in assets and liabilities:   |                                       |               |
| Decrease (increase) in:  |                                       |               |
| Trade receivables  | (1,882)                               | (3,891)       |
| Inventories  | 3,001                                 | 8,529         |
| Prepaid expenses and other current assets  | (1,852)                               | 1,996         |
| Other non-current assets   | 42                                    | (41)          |
| Increase (decrease) in:  |                                       |               |
| Accounts payable, accrued expenses and other current liabilities                                 | 1,475                                 | 3,676         |
| Deferred rent and other non-current liabilities  | 125                                   | (339)         |
| Net cash provided by operating activities  | 18,028                                | 26,119        |
| <b>Investing Activities</b>  |                                       |               |
| Capital expenditures   | (5,951)                               | (3,894)       |
| Additions to intangible assets   | (188)                                 | (105)         |
| Net cash used in investing activities  | (6,139)                               | (3,999)       |
| <b>Financing Activities</b>  |                                       |               |
| Decrease in cash overdraft   | 232                                   | 876           |
| Increase in restricted cash  | (2,082)                               |               |
| Repayment of long-term debt  | (13,427)                              | (5,450)       |
| Deferred financing costs paid  | (906)                                 |               |
| Withholding taxes on stock-based compensation paid in connection with repurchase of common stock | (615)                                 | (55)          |
| Cash dividends paid  | (4,725)                               | (4,648)       |
| Proceeds from exercise of stock options  | 492                                   | 13            |
| Excess tax benefit from exercise of stock options and restricted stock vesting                   | 576                                   |               |
| Net cash used in financing activities  | (20,455)                              | (9,264)       |
| Effect of exchange rate changes on cash and cash equivalents                                     | (7)                                   | (9)           |
| <b>Net (Decrease) Increase in Cash and Cash Equivalents</b>                                      | <b>(8,573)</b>                        | <b>12,847</b> |

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|   |           |           |
|---|-----------|-----------|
| <b>Cash and Cash Equivalents, Beginning of Period</b>     | 22,376    | 15,285    |
| <b>Cash and Cash Equivalents, End of Period</b>           | \$ 13,803 | \$ 28,132 |
| <b>Supplemental Disclosures of Cash Flow Information:</b> |           |           |
| Cash paid for interest                                    | \$ 253    | \$ 813    |
| Cash paid for income taxes                                | \$ 6,891  | \$ 391    |

The accompanying notes are an integral part of these Consolidated Financial Statements.

**Table of Contents****DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

**1. BASIS OF FINANCIAL STATEMENT PRESENTATION**

The accompanying unaudited consolidated financial statements have been prepared in accordance with the requirements for Form 10-Q and Article 10 of Regulation S-X, and accordingly, certain information and footnote disclosures have been condensed or omitted. Reference is made to the Annual Report on Form 10-K as of and for the year ended September 30, 2012 for Destination Maternity Corporation and subsidiaries (the Company or Destination Maternity), as filed with the Securities and Exchange Commission (SEC), for additional disclosures including a summary of the Company's accounting policies.

In the opinion of management, the consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the consolidated financial position, results of operations and cash flows of the Company for the periods presented. Since the Company's operations are seasonal, the interim operating results of the Company may not be indicative of operating results for the full year.

The Company operates on a fiscal year ending September 30 of each year. All references to fiscal years of the Company refer to fiscal years, or periods within such fiscal years, ended on September 30 in those years. For example, the Company's fiscal 2013 will end on September 30, 2013.

**2. EARNINGS PER SHARE (EPS) AND CASH DIVIDENDS**

Basic net income (or earnings) per share (Basic EPS) is computed by dividing net income by the weighted average number of common shares outstanding, excluding restricted stock awards for which the restrictions have not lapsed. Diluted net income (or earnings) per share (Diluted EPS) is computed by dividing net income by the weighted average number of common shares outstanding, after giving effect to the potential dilution, if applicable, from the assumed exercise of outstanding stock options and from the assumed lapse of restrictions on restricted stock awards. Common shares issuable in connection with the award of performance-based restricted stock units (RSUs) are excluded from the calculation of EPS until the RSUs' performance conditions are achieved and the shares in respect of the RSUs become issuable (see Note 9).

The following table summarizes the Basic EPS and Diluted EPS calculations (in thousands, except per share amounts):

|  | Three Months Ended March 31, |        |         |               |        |         |
|--|------------------------------|--------|---------|---------------|--------|---------|
|  | 2013                         |        |         | 2012          |        |         |
|  | Net<br>Income                | Shares | EPS     | Net<br>Income | Shares | EPS     |
| Basic EPS  | \$ 5,877                     | 13,273 | \$ 0.44 | \$ 4,979      | 13,074 | \$ 0.38 |
| Incremental shares from the assumed exercise of outstanding stock options            |                              | 92     |         |               | 133    |         |
| Incremental shares from the assumed lapse of restrictions on restricted stock awards |                              | 37     |         |               | 41     |         |
| Diluted EPS  | \$ 5,877                     | 13,402 | \$ 0.44 | \$ 4,979      | 13,248 | \$ 0.38 |

|           | Six Months Ended March 31, |        |         |               |        |         |
|-----------|----------------------------|--------|---------|---------------|--------|---------|
|           | 2013                       |        |         | 2012          |        |         |
|           | Net<br>Income              | Shares | EPS     | Net<br>Income | Shares | EPS     |
| Basic EPS | \$ 9,719                   | 13,231 | \$ 0.73 | \$ 7,242      | 13,049 | \$ 0.55 |

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|  |          |        |         |          |        |         |
|--|----------|--------|---------|----------|--------|---------|
| Incremental shares from the assumed exercise of outstanding stock options            | 96       | 124    |         |          |        |         |
| Incremental shares from the assumed lapse of restrictions on restricted stock awards | 46       | 48     |         |          |        |         |
| Diluted EPS  | \$ 9,719 | 13,373 | \$ 0.73 | \$ 7,242 | 13,221 | \$ 0.55 |

**Table of Contents****2. EARNINGS PER SHARE ( EPS ) AND CASH DIVIDENDS (Continued)**

In addition to performance-based RSUs, for the three and six months ended March 31, 2013, stock options and unvested restricted stock totaling 255,527 and 278,066 shares, respectively, were excluded from the calculation of Diluted EPS as their effect would have been antidilutive. For the three and six months ended March 31, 2012, stock options and unvested restricted stock totaling 304,169 and 350,592 shares, respectively, were excluded from the calculation of Diluted EPS as their effect would have been antidilutive.

During the six months ended March 31, 2013 and 2012 the Company paid cash dividends totaling \$4,725,000 (or \$0.35 per share) and \$4,648,000 (or \$0.35 per share), respectively. On April 22, 2013 the Company declared a quarterly cash dividend of \$0.1875 per share payable on June 28, 2013, which will total approximately \$2,500,000.

**3. TRADE RECEIVABLES**

Trade receivables are recorded based on revenue recognized for sales of the Company's merchandise and for other revenue earned by the Company through its marketing partnership programs and international franchise agreements, and are non-interest bearing. The Company evaluates the collectability of trade receivables based on a combination of factors, including aging of trade receivables, write-off experience, analysis of historical trends and expectations of future performance. An allowance for doubtful accounts is recorded for the amount of trade receivables that are considered unlikely to be collected. When the Company's collection efforts are unsuccessful, uncollectible trade receivables are charged against the allowance for doubtful accounts. As of March 31, 2013 and September 30, 2012, the Company's trade receivables were net of allowance for doubtful accounts of \$147,000 and \$201,000, respectively.

**4. INVENTORIES**

Inventories were comprised of the following (in thousands):

|                  | March 31, 2013 | September 30, 2012 |
|------------------|----------------|--------------------|
| Finished goods   | \$ 78,670      | \$ 82,795          |
| Work-in-progress | 2,529          | 2,804              |
| Raw materials    | 4,553          | 3,155              |
|                  | \$ 85,752      | \$ 88,754          |

**5. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities were comprised of the following (in thousands):

|  | March 31, 2013 | September 30, 2012 |
|--|----------------|--------------------|
| Employee compensation and benefits           | \$ 6,881       | \$ 5,918           |
| Insurance, primarily self-insurance reserves | 5,214          | 5,341              |
| Gift certificates and store credits          | 4,210          | 4,194              |
| Deferred rent                                | 3,782          | 3,599              |
| Sales and use taxes                          | 3,105          | 3,097              |
| Product return reserve                       | 2,559          | 2,225              |
| Accounting and legal                         | 1,399          | 1,215              |
| Income taxes payable                         | 893            | 1,350              |
| Other  | 10,026         | 8,605              |

|    |        |    |        |
|----|--------|----|--------|
| \$ | 38,069 | \$ | 35,544 |
|----|--------|----|--------|

**6. LINE OF CREDIT AND LONG-TERM DEBT**

On November 1, 2012, the Company entered into a five-year \$61,000,000 senior secured revolving credit facility (the Credit Facility), which replaced the Company's former \$55,000,000 senior secured revolving credit facility (the Prior Credit Facility). The Credit Facility consists of two tranches: (i) a senior secured revolving credit and letter of credit facility of up to \$55,000,000 (Tranche A) and (ii) a senior secured first-in, last-out revolving credit facility of up to \$6,000,000 (Tranche A-1). The Credit Facility will mature on November 1, 2017. Upon the Company's request and with the consent of the lender, permitted borrowings under Tranche A may be increased up to an additional \$15,000,000, in increments of \$2,500,000, up to a Tranche A maximum limit of \$70,000,000. Proceeds from advances under the Credit Facility, with certain restrictions, may be used to repay existing debt, and to provide financing for working capital, letters of credit, capital expenditures, dividends, share repurchases and other general corporate purposes.

**Table of Contents****6. LINE OF CREDIT AND LONG-TERM DEBT (Continued)**

The Credit Facility contains various affirmative and negative covenants and representations and warranties. Under the Credit Facility, the Company is required to maintain minimum Excess Availability (as defined in the related Credit Facility agreement) equal to 10% of the Borrowing Base (as defined in the related Credit Facility agreement). The Credit Facility is secured by a security interest in the Company's trade receivables, inventory, real estate interests, letter of credit rights, cash, intangibles and certain other assets. The interest rate on outstanding borrowings is equal to, at the Company's election, either (i) the lender's base rate plus the applicable margin, or (ii) a LIBOR rate plus the applicable margin. The applicable margin for base rate borrowings is 0.50% for Tranche A borrowings and 2.00% for Tranche A-1 borrowings. The applicable margin for LIBOR rate borrowings is 1.50% for Tranche A borrowings and 3.00% for Tranche A-1 borrowings. Tranche A-1 borrowings are deemed to be the first loans made and the last loans repaid. The Company also pays an unused line fee under the Credit Facility of 0.25% per annum. In connection with the execution of the Credit Facility, the Company incurred deferred financing costs of \$967,000, of which \$61,000 were paid in fiscal 2012.

The Prior Credit Facility had a maturity date of January 13, 2013. Proceeds from advances under the Prior Credit Facility, subject to certain restrictions, could be used to provide financing for working capital, letters of credit, capital expenditures, debt prepayments, dividends, share repurchases and other general corporate purposes. The Prior Credit Facility contained customary provisions, including affirmative and negative covenants, representations and warranties, and an unused line fee. There were no financial covenant requirements under the Prior Credit Facility unless Excess Availability (as defined in the related Prior Credit Facility agreement) fell below 10% of the Borrowing Base (as defined in the related Prior Credit Facility agreement). Throughout the period of the Prior Credit Facility, the Company exceeded the applicable excess availability requirements under the Prior Credit Facility and was not subject to any financial covenants.

The Prior Credit Facility was secured by a security interest in the Company's trade receivables, inventory, real estate interests, letter of credit rights, cash, intangibles and certain other assets. The security interest granted to the Prior Credit Facility lender was, in certain respects, subordinate to the security interest granted to the Company's Term Loan lenders. The interest rate on outstanding borrowings was equal to, at the Company's election, either (i) the lender's prime rate plus the applicable margin, or (ii) a LIBOR rate plus the applicable margin. During the first quarter of fiscal 2013 and during fiscal 2012, the applicable margins were 0.75% for prime rate borrowings and 1.75% for LIBOR rate borrowings, the lowest available margins based upon the availability calculation made in accordance with the Prior Credit Facility.

As of March 31, 2013, the Company had no outstanding borrowings under the Credit Facility and \$5,060,000 in letters of credit, with \$55,940,000 of availability under the Credit Facility. As of March 31, 2013, a letter of credit for \$1,874,000 related to the Company's outstanding obligation under an Industrial Revenue Bond (IRB), which was issued under the Prior Credit Facility, was outstanding. As of March 31, 2013, the Company had \$2,082,000 on deposit with the agent bank for the Prior Credit Facility as cash collateral for the letter of credit, which is classified as restricted cash in the accompanying consolidated balance sheet. On April 3, 2013, the IRB trustee drew down \$1,830,000 plus accrued interest under the letter of credit in connection with the Company's redemption of the remaining bonds (see below). Funds for the draw were provided from the cash collateral on deposit with the agent bank for the Prior Credit Facility. The remaining \$251,000 of cash collateral was returned to the Company after the original letter of credit was cancelled. As of March 31, 2013, Tranche A borrowings under the Credit Facility would have resulted in interest at a rate between approximately 1.70% and 3.75% per annum, and Tranche A-1 borrowings under the Credit Facility would have resulted in interest at a rate between approximately 3.20% and 5.25% per annum. During the first six months of fiscal 2013, the Company's average level of direct borrowings (all of which were under the Credit Facility) was \$412,000, and the Company's maximum borrowings at any time were \$6,200,000. During the first six months of fiscal 2012, the Company did not have any direct borrowings under the Prior Credit Facility.

Prior to November 1, 2012, the Company had a Term Loan and Security Agreement (the Term Loan Agreement) for a senior secured Term Loan B due March 13, 2013 (the Term Loan), the \$90,000,000 proceeds of which were received on April 18, 2007. On November 1, 2012, the Company prepaid the remaining Term Loan balance of \$13,427,000 in connection with the execution of its new Credit Facility. The interest rate on the Term Loan was equal to, at the Company's election, either (i) the prime rate plus 1.00%, or (ii) a LIBOR rate plus the applicable margin. During the first quarter of fiscal 2013 and during fiscal 2012, the applicable margin for LIBOR rate borrowings was 2.25%, the lowest available margin based on the Company's applicable quarterly Consolidated Leverage Ratios (as defined in the Term Loan Agreement). Prior to its repayment, the Term Loan required minimum principal repayments in quarterly installments of \$225,000 each, in addition to an annual principal repayment equal to 25% of Excess Cash Flow (as defined in the Term Loan Agreement) in excess of \$5,000,000 for each fiscal year, based on the Company's Consolidated Leverage Ratio. There was no required

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**6. LINE OF CREDIT AND LONG-TERM DEBT (Continued)**

principal repayment related to fiscal 2011 results. The Term Loan was permitted to be prepaid at the Company's option, in part or in whole, at any time without any prepayment premium or penalty. During the first six months of fiscal 2013 and 2012 the Company made optional prepayments of \$13,427,000 and \$5,000,000, respectively, on the outstanding Term Loan.

The Term Loan was secured by a security interest in the Company's trade receivables, inventory, real estate interests, letter of credit rights, cash, intangibles and certain other assets. The security interest granted to the Term Loan lenders was, in certain respects, subordinate to the security interest granted to the lender under the Prior Credit Facility. The Term Loan Agreement imposed certain restrictions on the Company's ability to, among other things, incur additional indebtedness, pay dividends, repurchase stock, and enter into other various types of transactions. The Term Loan Agreement also contained quarterly financial covenants that required the Company to maintain a specified maximum permitted Consolidated Leverage Ratio and a specified minimum permitted Consolidated Interest Coverage Ratio (as defined in the Term Loan Agreement). Throughout the period of the Term Loan, the Company was in compliance with all covenants of the Term Loan Agreement.

In order to mitigate the Company's floating rate interest risk on the variable rate Term Loan, the Company entered into an interest rate swap agreement with the agent bank for the Term Loan for a five-year term commencing on April 18, 2007, the date the \$90,000,000 Term Loan proceeds were received. The interest rate swap agreement enabled the Company to effectively convert an amount of the Term Loan (equal to the notional amount of the interest rate swap) from a floating interest rate (LIBOR plus 2.25% during the first six months of fiscal 2012, based on the Company's specified leverage ratios), to a fixed interest rate (7.25% during the first six months of fiscal 2012, based on the Company's specified leverage ratios). The notional amount of the interest rate swap was \$75,000,000 at the inception of the swap agreement and decreased over time to a notional amount of \$5,000,000 at the expiration date of April 18, 2012.

The Company had \$1,830,000 outstanding under an IRB at March 31, 2013 and September 30, 2012, which is classified as a current liability in the accompanying consolidated balance sheets pursuant to a put option that was available to the bondholders. On February 11, 2013, the Company notified the IRB trustee of its intention to redeem all remaining outstanding bonds effective April 3, 2013. As provided under the indenture of trust for the bonds, on April 3, 2013 the IRB trustee drew down \$1,830,000 plus accrued interest under the letter of credit issued as security for the bonds (see above), at which time the Company had no further obligations, and the bonds had no further rights, under the indenture.

**7. FAIR VALUE MEASUREMENTS**

The accounting standard for fair value measurements defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The standard establishes a framework for measuring fair value focused on exit price and creates a fair value hierarchy in order to increase the consistency and comparability of fair value measurements as follows:

Level 1 Quoted market prices in active markets for identical assets or liabilities

Level 2 Observable market-based inputs or inputs that are corroborated by observable market data

Level 3 Unobservable inputs that are not corroborated by market data

At March 31, 2013 and September 30, 2012, the Company had cash equivalents of \$8,267,000 and \$19,462,000, respectively. The Company's cash equivalents consist of investments in money market funds for which the carrying value approximates fair value (based on Level 1 inputs) due to the short-term nature of those instruments.

The carrying values of trade receivables and accounts payable approximate fair value due to the short-term nature of those instruments. The Company's long-term debt bears interest at a variable rate, which adjusts based on market conditions and the carrying value of the long-term debt approximates fair value. The fair value of the Company's debt was determined using a discounted cash flow analysis based on interest rates currently available to the Company, which the Company considers to be Level 2 inputs.





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**8. INCOME TAXES**

As of March 31, 2013, the Company had \$4,004,000 of unrecognized tax benefits related to uncertain income tax positions, including accrued interest and penalties of \$1,829,000. The Company records interest and penalties related to unrecognized tax benefits in its income tax provision. If recognized, the portion of the liabilities for unrecognized tax benefits that would impact the Company's effective tax rate was \$2,873,000, net of federal benefit.

During the twelve months subsequent to March 31, 2013, it is reasonably possible that the gross unrecognized tax benefits could potentially increase by approximately \$494,000 (of which approximately \$365,000 would affect the effective tax rate, net of federal benefit) for uncertain tax positions, including the continued effect of interest on unrecognized tax benefits and limitations on certain potential tax credits, partially offset by the effect of expiring statutes of limitations and settlements.

The Company's United States Federal income tax returns for years ended September 30, 2009 and thereafter remain subject to examination by the United States Internal Revenue Service. The Company also files tax returns in Canada, India, Kuwait and numerous United States state jurisdictions, which have varying statutes of limitations. Generally, Canadian tax returns for tax years ended September 30, 2007 and thereafter, Indian tax returns for tax years ended March 31, 2009, Kuwaiti tax returns for tax years ended September 30, 2009 and thereafter, and United States state tax returns for tax years ended September 30, 2008 and thereafter, depending upon the jurisdiction, remain subject to examination. However, the statutes of limitations on certain of the Company's United States state tax returns remain open for years prior to fiscal 2008.

**9. EQUITY AWARD PLANS**

In each of December 2012 and December 2011, the Compensation Committee of the Company's Board of Directors established performance goals for the award of performance-based RSUs for four executive officers, under the Amended and Restated Destination Maternity Corporation 2005 Equity Incentive Plan. The RSUs earned, if any, under the December 2012 awards (the 2012 Awards) will be based on the Company's cumulative operating income, as reflected in the Company's financial statements, from fiscal 2013 through fiscal 2015. The RSUs earned, if any, under the December 2011 awards (the 2011 Awards) will be based on the Company's cumulative operating income, as reflected in the Company's financial statements, from fiscal 2012 through fiscal 2014. The grant of any RSUs under these awards will generally be further contingent on the continued employment of the executive officers with the Company through the dates on which the shares in respect of these RSUs, if any, are issued following the end of the applicable performance periods, as well as the achievement of certain minimum levels of operating income in the final fiscal year of each applicable performance period. Any dividends declared on the shares of the Company's common stock underlying the RSUs will be credited as additional RSUs based on the fair market value of the Company's common stock on the dividend payment date. The additional RSUs, if any, will be earned on the same terms as the original RSUs. For the 2012 Awards, the executive officers will earn a cumulative total of 18,541 RSUs, excluding RSUs from dividends declared, if the Company's cumulative operating income for fiscal 2013 through fiscal 2015 equals or exceeds a threshold of \$109,582,000, and will ratably earn up to a maximum cumulative total of 55,621 RSUs, excluding RSUs from dividends declared, if the Company's operating income during such performance period equals or exceeds \$132,201,000. For the 2011 Awards, the executive officers will earn a cumulative total of 19,531 RSUs, excluding RSUs from dividends declared, if the Company's cumulative operating income for fiscal 2012 through fiscal 2014 equals or exceeds a threshold of \$120,000,000, and will ratably earn up to a maximum cumulative total of 58,590 RSUs, excluding RSUs from dividends declared, if the Company's operating income during such performance period equals or exceeds \$132,000,000.

During the first six months of fiscal 2013, options to purchase 85,949 shares of common stock with an aggregate exercise price of \$618,000 were exercised by the option holders and net-share settled by the Company, such that the Company withheld 30,996 shares of the Company's common stock, which had a fair market value equal to the aggregate exercise price of the stock options.

During the first six months of fiscal 2013 and 2012, certain stock option exercises and vesting restricted stock awards were net-share settled by the Company such that the Company withheld shares of the Company's common stock, which had a fair market value equivalent to the minimum statutory obligation for the applicable income and employment taxes for the awards, and the Company remitted the cash value to the appropriate taxing authorities. The total shares withheld, which were 30,310 and 3,347 shares, respectively, during the first six months of fiscal 2013 and 2012, are reflected as repurchase of common stock in the accompanying financial statements, and were based on the value of the Company's common stock on the exercise or vesting date. The remaining shares, net of those withheld, were delivered to the award holders. Total payments for tax obligations to the tax authorities were \$615,000 and \$55,000 for the first six months of fiscal 2013 and 2012, respectively.

**Table of Contents****10. RETIREMENT PLANS**

The Company had Supplemental Executive Retirement Agreements (the SERP Agreements) with Dan Matthias, the Company's former Chief Executive Officer and Rebecca Matthias, the Company's former President and Chief Creative Officer. The Company's transition agreement with Mr. Matthias in connection with his retirement effective September 30, 2008, amended his SERP Agreement to provide for full vesting of the benefits payable to Mr. Matthias and to increase the total of the amounts payable under his SERP Agreement to approximately 10% more than the amount that would have been payable on September 30, 2012 (the date his SERP Agreement had otherwise been expected to fully vest). The SERP Agreement benefits, totaling \$3,960,000, were being paid to Mr. Matthias in installments, which commenced on April 1, 2009, with the final installment paid on October 1, 2012. During the first six months of fiscal 2013 and 2012, SERP benefits paid to Mr. Matthias totaled \$150,000 and \$300,000, respectively. The Company's obligation under Ms. Matthias' SERP Agreement was fully paid in fiscal 2011.

Net periodic pension cost on a pretax basis for the first six months of fiscal 2012 consisted of interest cost of \$9,000.

**11. RECENT ACCOUNTING PRONOUNCEMENTS**

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. ASU No. 2013-02 requires companies to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, companies are required to present, either on the face of the income statement or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under generally accepted accounting principles in the United States (GAAP) to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. The standard does not change the current requirements for reporting net income or other comprehensive income in financial statements. ASU No. 2013-02 is effective for financial statements issued for annual reporting periods beginning after December 15, 2012 and interim periods within those years. Because this guidance impacts presentation only, the adoption of the new requirements of ASU No. 2013-02 will not have any impact on the Company's consolidated financial position or results of operations.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. ASU No. 2011-05 required companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. It eliminated the option to present components of other comprehensive income as part of the statement of stockholders' equity. The standard did not change the items which must be reported in other comprehensive income. In December 2011, the FASB issued ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, which defers the effective date of the requirement to present separate line items on the statement of income for reclassification adjustments out of accumulated other comprehensive income into net income. ASU No. 2011-05 and No. 2011-12 were effective for financial statements issued for annual reporting periods beginning after December 15, 2011 and interim periods within those years. In accordance with ASU No. 2011-05 and No. 2011-12 the Company has presented two separate but consecutive statements, which include the components of net income and other comprehensive income. Because this guidance impacted presentation only, the adoption of the new requirements of ASU No. 2011-05 and No. 2011-12 did not have any impact on the Company's consolidated financial position or results of operations.

**12. COMMITMENTS AND CONTINGENCIES**

From time to time, the Company is named as a defendant in legal actions arising from normal business activities. Litigation is inherently unpredictable and, although the amount of any liability that could arise with respect to currently pending actions cannot be accurately predicted, the Company does not believe that the resolution of any pending action will have a material adverse effect on its financial position, results of operations or liquidity.

**13. SEGMENT AND ENTERPRISE WIDE DISCLOSURES**

**Operating Segment.** For purposes of the disclosure requirements for segments of a business enterprise, the Company has determined that its business is comprised of one operating segment: the design, manufacture and sale of maternity apparel and related accessories. While the Company offers a wide range of products for sale, the substantial portion of its products are initially distributed through the same distribution facilities, many of the Company's products are manufactured at common contract manufacturer production facilities, the Company's products are

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marketed through a common marketing department, and these products are sold to a similar customer base consisting of expectant mothers.

**Table of Contents****13. SEGMENT AND ENTERPRISE WIDE DISCLOSURES (Continued)**

*Geographic Information.* Information concerning the Company's operations by geographic area was as follows (in thousands):

|  | Three Months Ended March 31, |            | Six Months Ended March 31, |            |
|--|------------------------------|------------|----------------------------|------------|
|  | 2013                         | 2012       | 2013                       | 2012       |
| <b>Net Sales to Unaffiliated Customers</b> |                              |            |                            |            |
| United States                              | \$ 127,772                   | \$ 131,539 | \$ 256,590                 | \$ 261,488 |
| Foreign                                    | 7,087                        | 6,253      | 13,533                     | 12,654     |

|                               | March 31, | September 30, |
|-------------------------------|-----------|---------------|
|                               | 2013      | 2012          |
| <b>Long-Lived Assets, Net</b> |           |               |
| United States                 | \$ 50,399 | \$ 51,449     |
| Foreign                       | 1,722     | 976           |

*Major Customers.* For the periods presented, the Company did not have any one customer who represented more than 10% of its net sales.

**14. INTEREST EXPENSE, NET**

Interest expense, net was comprised of the following (in thousands):

|                       | Three Months Ended March 31, |        | Six Months Ended March 31, |        |
|-----------------------|------------------------------|--------|----------------------------|--------|
|                       | 2013                         | 2012   | 2013                       | 2012   |
| Interest expense      | \$ 132                       | \$ 350 | \$ 337                     | \$ 756 |
| Interest income       | (5)                          | (6)    | (10)                       | (12)   |
| Interest expense, net | \$ 127                       | \$ 344 | \$ 327                     | \$ 744 |

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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Our fiscal year ends on September 30. All references in this discussion to our fiscal years refer to the fiscal year, or periods within the fiscal year, ended on September 30 in the year mentioned. For example, our fiscal 2013 will end on September 30, 2013.

#### **Overview**

We are the leading designer and retailer of maternity apparel in the United States with 1,875 retail locations, including 613 stores in all 50 states, Puerto Rico and Canada, and 1,262 leased departments located within department stores and baby specialty stores throughout the United States and Puerto Rico. In addition to the 1,875 retail locations we operate, through an exclusive licensed arrangement we are the exclusive provider of maternity apparel to Kohl's, which operates approximately 1,155 stores throughout the United States. We also sell merchandise on the Internet, primarily through DestinationMaternity.com and our various brand-specific websites.

In assessing the performance of our business, we consider a variety of operational and financial measures. The key measures for determining how our business is performing are net income determined in accordance with GAAP (GAAP net income) and the corresponding net income (or earnings) per share (diluted), net income before stock-based compensation expense and loss on extinguishment of debt (Non-GAAP adjusted net income) and the corresponding earnings per share (diluted), Adjusted EBITDA (defined below), net sales, comparable sales, and adjusted comparable sales. Adjusted EBITDA represents operating income before deduction for the following non-cash charges: (i) depreciation and amortization expense, (ii) loss on impairment of tangible and intangible assets, (iii) (gain) loss on disposal of assets, and (iv) stock-based compensation expense.

Comparable sales figures include sales at retail locations (which does not include licensed or franchised relationships) that have been in operation by us for at least twelve full months at the beginning of the period for which such data is presented, as well as Internet sales. Comparable sales figures do not include retail locations opened during a period even if such location was opened in connection with the closure of other retail locations in the same geographic area (including, for example, the opening of a new Destination Maternity combo store or superstore). Also, our comparable sales figures generally do not include: (i) retail locations which change store nameplate, location type or format, (ii) retail locations which are expanded, contracted or relocated if the square footage of the retail location has changed by 20% or more, or, if in the judgment of management, such expansion, contraction or relocation materially alters the comparability of the retail location (either with respect to the manner of its operation or otherwise), (iii) in the case of relocations only, retail locations which are not in the same immediate geographical vicinity (such as, without limitation, the same mall, the same part of a mall, or the same street) after the relocation, or (iv) retail locations which, in the judgment of management, have undergone other significant changes which materially alter the comparability of the retail location (either with respect to the manner of its operation or otherwise) (such as, for example only, in the case of closure of retail locations in connection with the cessation of a leased department relationship where the manner of operation of such retail location has been materially altered prior to closure, or in the case of construction in, on or near a retail location, which significantly interferes with the customer traffic, visibility or operation of a retail location).

We report sales on a calendar quarter basis, rather than on a 4-5-4 retail fiscal calendar where each fiscal week and fiscal quarter starts on a Sunday and ends on a Saturday. Thus, for each calendar period, there is a days adjustment calendar shift which may help or hurt reported calendar quarter and fiscal year to date sales and comparable sales due to different days of the week typically contributing more sales than other days of the week. In order to quantify and eliminate the effect on reported comparable sales results of the days adjustment calendar shift, we also present comparable sales on an adjusted basis. For example, for the second quarter of fiscal 2013, adjusted comparable sales were measured for the period Tuesday January 1, 2013 through Sunday March 31, 2013 compared to the period Tuesday January 3, 2012 through Sunday April 1, 2012 and for the first six months of fiscal 2013, adjusted comparable sales were measured for the period Monday October 1, 2012 through Sunday March 31, 2013 compared to the period Monday October 3, 2011 through Sunday April 1, 2012.

Following is a summary of our results for the second quarter and first six months of fiscal 2013 with regard to each of the key measures noted above:

#### ***Second Quarter Fiscal 2013 Financial Results***

GAAP net income for the second quarter of fiscal 2013 was \$5.9 million, or \$0.44 per share (diluted), an 18% increase compared to GAAP net income of \$5.0 million, or \$0.38 per share (diluted), for the second quarter of fiscal 2012. This represents an increase of 16% in diluted earnings per share.

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Non-GAAP adjusted net income for the second quarter of fiscal 2013 was \$6.4 million, or \$0.48 per share (diluted), a 19% increase compared to the comparably adjusted non-GAAP net income for the second quarter of fiscal 2012 of \$5.4 million, or \$0.40 per share (diluted). This represents a 20% increase in comparably adjusted diluted earnings per share.

Adjusted EBITDA was \$13.7 million for the second quarter of fiscal 2013, an increase of 6.6% compared to \$12.9 million of Adjusted EBITDA for the second quarter of fiscal 2012.

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Net sales for the second quarter of fiscal 2013 decreased 2.1% to \$134.9 million from \$137.8 million for the second quarter of fiscal 2012.

Comparable sales for the second quarter of fiscal 2013 increased 1.6% compared to a comparable sales increase of 3.2% for the second quarter of fiscal 2012. Our second quarter fiscal 2013 reported comparable sales increase of 1.6% was unfavorably impacted by 0.8 percentage points primarily from having one less day in the quarter compared to the second quarter of fiscal 2012, due to 2012 being a leap year. Our second quarter fiscal 2012 reported comparable sales increase of 3.2% was favorably impacted by approximately 2.5 percentage points due to 1) having an extra day in the quarter compared to the second quarter of fiscal 2011, and 2) the benefit of a days shift in the calendar month of March compared to fiscal 2011, with an extra Friday and Saturday compared to March 2011, and one less Tuesday and Wednesday compared to March 2011. Adjusting for these calendar shifts our adjusted comparable sales increased 2.4% for the second quarter of fiscal 2013 and increased 0.7% for the second quarter of fiscal 2012.

***First Six Months of Fiscal 2013 Financial Results***

GAAP net income for the first six months of fiscal 2013 was \$9.7 million, or \$0.73 per share (diluted), a 34% increase compared to GAAP net income of \$7.2 million, or \$0.55 per share (diluted) for the first six months of fiscal 2012. This represents an increase of 33% in diluted earnings per share.

Non-GAAP adjusted net income for the first six months of fiscal 2013 was \$10.7 million, or \$0.80 per share (diluted), a 33% increase compared to the comparably adjusted non-GAAP net income for the first six months of fiscal 2012 of \$8.0 million, or \$0.60 per share (diluted). This represents a 33% increase in comparably adjusted diluted earnings per share.

Adjusted EBITDA was \$24.5 million for the first six months of fiscal 2013, a 15% increase compared to \$21.2 million of Adjusted EBITDA for the first six months of fiscal 2012.

Net sales for the first six months of fiscal 2013 decreased 1.5% to \$270.1 million from \$274.1 million for the first six months of fiscal 2012.

Comparable sales for the first six months of fiscal 2013 increased 1.9% versus a comparable sales decrease of 0.6% for the first six months of fiscal 2012. Our first six months of fiscal 2013 reported comparable sales increase of 1.9% was unfavorably impacted by 1.2 percentage points primarily as a result of 1) having one less Saturday compared to the first six months of fiscal 2012, and 2) having one less day compared to the first six months of fiscal 2012 due to the leap year in 2012. Our first six months of fiscal 2012 reported comparable sales decrease of 0.6% was favorably impacted by approximately 1.0 percentage point due to 1) having an extra day in the six month period compared to the first six months of fiscal 2011, and 2) the benefit of the calendar shift in March 2012 compared to March 2011. Adjusting for these calendar shifts our adjusted comparable sales increased 3.1% for the first six months of fiscal 2013 and decreased 1.6% for the first six months of fiscal 2012.



**Table of Contents****Results of Operations**

The following tables set forth certain operating data as a percentage of net sales and as a percentage change for the three and six months ended March 31:

|   | % of Net Sales (1)                 |        |                                  |        | % Change Period to Period<br>Favorable<br>(Unfavorable)      |  |
|---|------------------------------------|--------|----------------------------------|--------|--|--|
|   | Three<br>Months Ended<br>March 31, |        | Six<br>Months Ended<br>March 31, |        | Three<br>Months<br>Ended<br>March<br>31,<br>2013 vs.<br>2012 | Six<br>Months<br>Ended<br>March<br>31,<br>2013 vs.<br>2012 |
|   | 2013                               | 2012   | 2013                             | 2012   |  |  |
| Net sales   | 100.0%                             | 100.0% | 100.0%                           | 100.0% | (2.1)%   | (1.5)%   |
| Cost of goods sold (2)                                      | 45.9                               | 46.5   | 46.6                             | 47.7   | 3.4  | 3.7  |
| Gross profit  | 54.1                               | 53.5   | 53.4                             | 52.3   | (1.1)  | 0.5  |
| Selling, general and administrative expenses (3)            | 46.7                               | 46.9   | 47.1                             | 47.3   | 2.5  | 1.9  |
| Store closing, asset impairment and asset disposal expenses | 0.2                                | 0.4    | 0.3                              | 0.4    | 51.4   | 26.4   |
| Operating income  | 7.2                                | 6.2    | 6.0                              | 4.6    | 13.0   | 27.5   |
| Interest expense, net                                       | 0.1                                | 0.2    | 0.1                              | 0.3    | 63.1   | 56.0   |
| Loss on extinguishment of debt                              |                                    |        | 0.0                              | 0.0    |  | 10.0   |
| Income before income taxes                                  | 7.1                                | 6.0    | 5.9                              | 4.3    | 16.2   | 32.8   |
| Income tax provision  | 2.7                                | 2.4    | 2.3                              | 1.7    | (13.4)   | (30.6)   |
| Net income  | 4.4%                               | 3.6%   | 3.6%                             | 2.6%   | 18.0%  | 34.2%  |

(1) Components may not add to total due to rounding.

(2) Cost of goods sold includes merchandise costs (including customs duty expenses), expenses related to inventory shrinkage, product related corporate expenses (including expenses related to our payroll, benefit costs and operating expenses of our buying departments), inventory reserves (including lower of cost or market reserves), inbound freight charges, purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs, and the other costs of our distribution network.

(3) Selling, general and administrative expenses includes advertising and marketing expenses, corporate administrative expenses, store expenses (including store payroll and store occupancy expenses), and store opening expenses.

The following tables set forth certain information concerning the number of our retail locations, and international franchised locations for the periods indicated:

| Retail Locations (1) | Three Months Ended March 31, |                               |                           |        |                               |                           |
|----------------------|------------------------------|-------------------------------|---------------------------|--------|-------------------------------|---------------------------|
|                      | Stores                       | 2013<br>Leased<br>Departments | Total Retail<br>Locations | Stores | 2012<br>Leased<br>Departments | Total Retail<br>Locations |
| Beginning of period  | 621                          | 1,266                         | 1,887                     | 656    | 1,405                         | 2,061                     |
| Opened               | 8                            | 5                             | 13                        | 4      | 6                             | 10                        |
| Closed               | (16)                         | (9)                           | (25)                      | (17)   | (27)                          | (44)                      |
| End of period        | 613                          | 1,262                         | 1,875                     | 643    | 1,384                         | 2,027                     |

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| Retail Locations (1) | Six Months Ended March 31, |                       |                           |        |                       |                           |
|----------------------|----------------------------|-----------------------|---------------------------|--------|-----------------------|---------------------------|
|                      | 2013                       |                       |                           | 2012   |                       |                           |
|                      | Stores                     | Leased<br>Departments | Total Retail<br>Locations | Stores | Leased<br>Departments | Total Retail<br>Locations |
| Beginning of period  | 625                        | 1,383                 | 2,008                     | 658    | 1,694                 | 2,352                     |
| Opened               | 10                         | 18                    | 28                        | 4      | 8                     | 12                        |
| Closed               | (22)                       | (139)                 | (161)                     | (19)   | (318)                 | (337)                     |
| End of period        | 613                        | 1,262                 | 1,875                     | 643    | 1,384                 | 2,027                     |

(1) Excludes international franchised locations.

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| International Franchised Locations | Three Months Ended March 31, |                        |  |        |                        |  |
|------------------------------------|------------------------------|------------------------|--|--------|------------------------|--|
|                                    | 2013                         |                        |  | 2012   |                        |  |
|                                    | Stores                       | Shop-in-Shop Locations | Total International Franchised Locations | Stores | Shop-in-Shop Locations | Total International Franchised Locations |
| Beginning of period                | 16                           | 121                    | 137                                      | 15     | 63                     | 78                                       |
| Opened                             |                              | 3                      | 3  |        | 18                     | 18                                       |
| Closed                             |                              |                        |  | (1)    | (1)                    | (2)                                      |
| End of period                      | 16                           | 124                    | 140                                      | 14     | 80                     | 94                                       |

| International Franchised Locations | Six Months Ended March 31, |                        |  |        |                        |  |
|------------------------------------|----------------------------|------------------------|--|--------|------------------------|--|
|                                    | 2013                       |                        |  | 2012   |                        |  |
|                                    | Stores                     | Shop-in-Shop Locations | Total International Franchised Locations | Stores | Shop-in-Shop Locations | Total International Franchised Locations |
| Beginning of period                | 16                         | 103                    | 119                                      | 15     | 51                     | 66                                       |
| Opened                             | 1                          | 22                     | 23                                       |        | 31                     | 31                                       |
| Closed                             | (1)                        | (1)                    | (2)                                      | (1)    | (2)                    | (3)                                      |
| End of period                      | 16                         | 124                    | 140                                      | 14     | 80                     | 94                                       |

**Three Months Ended March 31, 2013 and 2012**

**Net Sales.** Our net sales for the second quarter of fiscal 2013 decreased by 2.1%, or \$2.9 million, to \$134.9 million from \$137.8 million for the second quarter of fiscal 2012. Comparable sales for the second quarter of fiscal 2013 increased 1.6% compared to a comparable sales increase of 3.2% for the second quarter of fiscal 2012. Our second quarter fiscal 2013 reported comparable sales increase of 1.6% was unfavorably impacted by 0.8 percentage points primarily from having one less day in the quarter compared to the second quarter of fiscal 2012, due to 2012 being a leap year. Our second quarter fiscal 2012 reported comparable sales increase of 3.2% was favorably impacted by approximately 2.5 percentage points due to 1) having an extra day in the quarter compared to the second quarter of fiscal 2011, and 2) the benefit of a days shift in the calendar month of March compared to fiscal 2011, with an extra Friday and Saturday compared to March 2011, and one less Tuesday and Wednesday compared to March 2011. Adjusting for these calendar shifts our adjusted comparable sales increased 2.4% for the second quarter of fiscal 2013 and increased 0.7% for the second quarter of fiscal 2012. The decrease in total reported sales for the second quarter of fiscal 2013 compared to the second quarter of fiscal 2012 resulted primarily from the closure of all of our remaining leased departments within Babies R Us® stores during the month of October 2012, and our continued efforts to close underperforming stores, partially offset by the increase in comparable sales.

As of March 31, 2013, we operated a total of 613 stores and 1,875 total retail locations, compared to 643 stores and 2,027 total retail locations as of March 31, 2012. During the second quarter of fiscal 2013, we opened eight stores, including three Destination Maternity multi-brand stores, and we closed 16 stores, with five of the store closings related to Destination Maternity store openings. In connection with our new broad-based partnership with Bed Bath & Beyond Inc. and its subsidiary, Buy Buy Baby, Inc., which we previously announced in May 2012, we discontinued operation of our 124 remaining leased departments in Babies R Us stores in late October 2012 and began to open leased departments in select buybuy BABY® stores. The decrease in leased department locations at the end of March 2013 compared to March 2012 predominantly reflects this change of partners in October 2012. According to Bed Bath & Beyond Inc.'s latest public disclosure, as of April 10, 2013 there are 83 buybuy BABY stores. As of March 31, 2013, the Company operates leased departments in 14 of these stores. Over time, we expect to significantly increase the number of buybuy BABY stores in which we have a maternity apparel leased department. In addition, our Oh Baby by Motherhood® collection is available at Kohl's stores throughout the United States.

**Gross Profit.** Our gross profit for the second quarter of fiscal 2013 decreased by 1.1%, or \$0.8 million, to \$73.0 million from \$73.8 million for the second quarter of fiscal 2012, and our gross profit as a percentage of net sales (gross margin) for the second quarter of fiscal 2013 was 54.1% compared to 53.5% for the second quarter of fiscal 2012. The decrease in gross profit for the second quarter of fiscal 2013 compared to the second quarter of fiscal 2012 was due to our lower sales. The increase in gross margin for the second quarter of fiscal 2013 compared to the second quarter of fiscal 2012 was primarily due to lower product costs.



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**Selling, General and Administrative Expenses.** Our selling, general and administrative expenses for the second quarter of fiscal 2013 decreased by 2.5%, or \$1.6 million, to \$63.0 million from \$64.6 million for the second quarter of fiscal 2012. As a percentage of net sales, selling, general and administrative expenses decreased to 46.7% for the second quarter of fiscal 2013 compared to 46.9% for the second quarter of fiscal 2012. This decrease in expense for the quarter resulted primarily from lower expenses related to our continued efforts to close underperforming stores (primarily payroll and occupancy costs), partially offset by higher advertising and marketing expenses and higher variable incentive compensation expense.

**Store Closing, Asset Impairment and Asset Disposal Expenses.** Our store closing, asset impairment and asset disposal expenses for the second quarter of fiscal 2013 decreased by \$0.3 million, to \$0.3 million from \$0.6 million for the second quarter of fiscal 2012, which primarily reflected lower impairment charges for write-downs of long-lived assets.

**Operating Income.** We had operating income of \$9.7 million for the second quarter of fiscal 2013, an increase of 13.0% compared to \$8.6 million for the second quarter of fiscal 2012. Operating income as a percentage of net sales for the second quarter of fiscal 2013 increased to 7.2% from 6.2% for the second quarter of fiscal 2012. The increase in operating income and operating income percentage was primarily due to our lower selling, general and administrative expenses, partially offset by lower gross profit.

**Interest Expense, Net.** Our net interest expense for the second quarter of fiscal 2013 decreased to \$0.1 million from \$0.3 million for the second quarter of fiscal 2012. This decrease was due to our lower debt level, primarily as a result of the \$23.4 million of Term Loan prepayments we made in the previous twelve months.

**Income Tax Provision.** For the second quarter of fiscal 2013 our effective tax rate was 38.5% compared to 39.4% for the second quarter of fiscal 2012. Our effective tax rates for the second quarter of fiscal 2013 and 2012 were higher than the statutory federal tax rate of 35% primarily due to the effect of state income taxes, net of federal benefit, and to a lesser extent, additional income tax expense (including interest and penalties) recognized as required by the accounting standard for uncertain income tax positions. We expect our effective tax rate for the full year fiscal 2013 to be approximately 38.5%.

**Net Income.** Net income for the second quarter of fiscal 2013 was \$5.9 million, or \$0.44 per share (diluted), compared to net income of \$5.0 million, or \$0.38 per share (diluted), for the second quarter of fiscal 2012. Net income for the second quarter of fiscal 2013 and 2012 includes (net of tax) stock-based compensation expense of \$0.5 million and \$0.4 million, respectively. Before stock-based compensation expense, our second quarter fiscal 2013 net income was \$6.4 million, or \$0.48 per share (diluted), compared to \$5.4 million, or \$0.40 per share (diluted), for the second quarter of fiscal 2012.

Our average diluted shares outstanding of 13,402,000 for the second quarter of fiscal 2013 were 1.2% higher than the 13,248,000 average diluted shares outstanding for the second quarter of fiscal 2012, primarily as a result of the exercise of stock options and vesting of restricted stock.

Following is a reconciliation of GAAP net income and net income per share (EPS) (diluted) to Non-GAAP adjusted net income and net income per share (diluted) for the three months ended March 31, 2013 and 2012 (in thousands, except per share amounts):

|   | Three Months Ended March 31, |                   |                |               |                   |                |
|---|------------------------------|-------------------|----------------|---------------|-------------------|----------------|
|   | 2013                         |                   |                | 2012          |                   |                |
|   | Net<br>Income                | Diluted<br>Shares | Diluted<br>EPS | Net<br>Income | Diluted<br>Shares | Diluted<br>EPS |
| As reported   | \$ 5,877                     | 13,402            | \$ 0.44        | \$ 4,979      | 13,248            | \$ 0.38        |
| Stock-based compensation expense, net of tax        | 501                          |                   |                | 382           |                   |                |
| As adjusted before stock-based compensation expense | \$ 6,378                     | 13,402            | \$ 0.48        | \$ 5,361      | 13,248            | \$ 0.40        |

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Following is a reconciliation of net income to Adjusted EBITDA for the three months ended March 31, 2013 and 2012 (in thousands):

|  | <b>Three Months Ended March 31,</b> |             |
|--|-------------------------------------|-------------|
|  | <b>2013</b>                         | <b>2012</b> |
| Net income                                   | \$ 5,877                            | \$ 4,979    |
| Add: income tax provision                    | 3,678                               | 3,242       |
| Add: interest expense, net                   | 127                                 | 344         |
| Operating income                             | 9,682                               | 8,565       |
| Add: depreciation and amortization expense   | 3,081                               | 3,109       |
| Add: loss on impairment of long-lived assets | 195                                 | 517         |
| Add: (gain) loss on disposal of assets       | (14)                                | 95          |
| Add: stock-based compensation expense        | 803                                 | 610         |
| Adjusted EBITDA                              | \$ 13,747                           | \$ 12,896   |

**Six Months Ended March 31, 2013 and 2012**

**Net Sales.** Our net sales for the first six months of fiscal 2013 decreased by 1.5%, or \$4.0 million, to \$270.1 million from \$274.1 million for the first six months of fiscal 2012. Comparable sales for the first six months of fiscal 2013 increased 1.9% versus a comparable sales decrease of 0.6% for the first six months of fiscal 2012. Our first six months of fiscal 2013 reported comparable sales increase of 1.9% was unfavorably impacted by 1.2 percentage points primarily as a result of 1) having one less Saturday compared to the first six months of fiscal 2012, and 2) having one less day compared to the first six months of fiscal 2012 due to the leap year in 2012. Our first six months of fiscal 2012 reported comparable sales decrease of 0.6% was favorably impacted by approximately 1.0 percentage point due to 1) having an extra day in the six month period compared to the first six months of fiscal 2011, and 2) the benefit of the calendar shift in March 2012 compared to March 2011. Adjusting for these calendar shifts our adjusted comparable sales increased 3.1% for the first six months of fiscal 2013 and decreased 1.6% for the first six months of fiscal 2012. The decrease in total reported sales for the first six months of fiscal 2013 compared to the first six months of fiscal 2012 resulted primarily from the closure of all of our remaining leased departments within Babies R Us stores during the month of October 2012, and our continued efforts to close underperforming stores, partially offset by the increase in comparable sales.

During the first six months of fiscal 2013, we opened ten stores, including six Destination Maternity multi-brand stores, and we closed 22 stores, with seven of the store closings related to Destination Maternity store openings.

**Gross Profit.** Our gross profit for the first six months of fiscal 2013 increased by 0.5%, or approximately \$0.7 million, to \$144.1 million from \$143.4 million for the first six months of fiscal 2012, and our gross margin for the first six months of fiscal 2013 was 53.4% compared to 52.3% for the first six months of fiscal 2012. The increase in gross profit for the first six months of fiscal 2013 compared to the first six months of fiscal 2012 was due to our higher gross margin. The increase in gross margin for the first six months of fiscal 2013 compared to the first six months of fiscal 2012 was primarily due to lower product costs.

**Selling, General and Administrative Expenses.** Our selling, general and administrative expenses for the first six months of fiscal 2013 decreased by 1.9%, or \$2.4 million, to \$127.3 million from \$129.7 million for the first six months of fiscal 2012. As a percentage of net sales, selling, general and administrative expenses decreased to 47.1% for the first six months of fiscal 2013 compared to 47.3% for the first six months of fiscal 2012. This decrease in expense for the six months resulted primarily from lower expenses related to our continued efforts to close underperforming stores (primarily payroll and occupancy costs), partially offset by higher advertising and marketing expenses and higher variable incentive compensation expense.

**Store Closing, Asset Impairment and Asset Disposal Expenses.** Our store closing, asset impairment and asset disposal expenses for the first six months of fiscal 2013 decreased by \$0.3 million, to \$0.7 million from \$1.0 million for the first six months of fiscal 2012, which primarily reflected lower impairment charges for write-downs of long-lived assets.

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**Loss on Extinguishment of Debt.** In November 2012, we prepaid the remaining \$13.4 million of our outstanding Term Loan. The \$13.4 million Term Loan prepayment resulted in a pretax charge of \$9,000 in the first six months fiscal 2013, representing the write-off of unamortized deferred financing costs. In December 2011, we prepaid \$5.0 million in principal amount of our Term Loan resulting in a pretax charge of \$10,000 in the first six months of fiscal 2012.

**Operating Income.** We had operating income of \$16.1 million for the first six months of fiscal 2013, an increase of 27.5% compared to \$12.7 million for the first six months of fiscal 2012. Operating income as a percentage of net sales for the first six months of fiscal 2013 increased to 6.0% from 4.6% for the first six months of fiscal 2012. The increase in operating income and operating income percentage was primarily due to our lower selling, general and administrative expenses, and to a lesser extent our higher gross profit.

**Interest Expense, Net.** Our net interest expense for the first six months of fiscal 2013 decreased to \$0.3 million from \$0.7 million for the first six months of fiscal 2012. This decrease was due to our lower debt level, primarily as a result of the \$23.4 million of Term Loan prepayments we made in the previous twelve months.

**Income Tax Provision.** For the first six months of fiscal 2013 our effective tax rate was 38.5% compared to 39.1% for the first six months of fiscal 2012. Our effective tax rates for the first six months of fiscal 2013 and 2012 were higher than the statutory federal tax rate of 35% primarily due to the effect of state income taxes, net of federal benefit, and to a lesser extent, additional income tax expense (including interest and penalties) recognized as required by the accounting standard for uncertain income tax positions. We expect our effective tax rate for the full year fiscal 2013 to be approximately 38.5%.

**Net Income.** Net income for the first six months of fiscal 2013 was \$9.7 million, or \$0.73 per share (diluted), compared to net income of \$7.2 million, or \$0.55 per share (diluted), for the first six months of fiscal 2012. Net income for the first six months of fiscal 2013 includes (net of tax) stock-based compensation expense of \$0.9 million and loss on extinguishment of debt of \$6,000. Net income for the first six months of fiscal 2012 includes (net of tax) stock-based compensation expense of \$0.7 million and loss on extinguishment of debt of \$6,000. Before stock-based compensation expense and loss on extinguishment of debt, our first six months fiscal 2013 net income was \$10.6 million, or \$0.80 per share (diluted), compared to \$8.0 million, or \$0.60 per share (diluted), for the first six months of fiscal 2012.

Our average diluted shares outstanding of 13,373,000 for the first six months of fiscal 2013 were 1.1% higher than the 13,221,000 average diluted shares outstanding for the first six months of fiscal 2012, primarily as a result of the exercise of stock options and vesting of restricted stock.

Following is a reconciliation of GAAP net income and net income per share (EPS) (diluted) to Non-GAAP adjusted net income and net income per share (diluted) for the six months ended March 31, 2013 and 2012 (in thousands, except per share amounts):

|  | Six Months Ended March 31, |                   |                |               |                   |                |
|--|----------------------------|-------------------|----------------|---------------|-------------------|----------------|
|  | 2013                       | 2013              |                | 2012          | 2012              |                |
|  | Net<br>Income              | Diluted<br>Shares | Diluted<br>EPS | Net<br>Income | Diluted<br>Shares | Diluted<br>EPS |
| As reported  | \$ 9,719                   | 13,373            | \$ 0.73        | \$ 7,242      | 13,221            | \$ 0.55        |
| Stock-based compensation expense, net of tax   | 934                        |                   |                | 739           |                   |                |
| Loss on extinguishment of debt, net of tax   | 6                          |                   |                | 6             |                   |                |
| As adjusted before stock-based compensation expense and loss on extinguishment of debt | \$ 10,659                  | 13,373            | \$ 0.80        | \$ 7,987      | 13,221            | \$ 0.60        |

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Following is a reconciliation of net income to Adjusted EBITDA for the six months ended March 31, 2013 and 2012 (in thousands):

|  | <b>Six Months Ended March 31,</b> |                  |
|--|-----------------------------------|------------------|
|  | <b>2013</b>                       | <b>2012</b>      |
| Net income                                   | \$ 9,719                          | \$ 7,242         |
| Add: income tax provision                    | 6,084                             | 4,659            |
| Add: interest expense, net                   | 327                               | 744              |
| Add: loss on extinguishment of debt          | 9                                 | 10               |
| <b>Operating income</b>                      | <b>16,139</b>                     | <b>12,655</b>    |
| Add: depreciation and amortization expense   | 6,170                             | 6,319            |
| Add: loss on impairment of long-lived assets | 688                               | 973              |
| Add: (gain) loss on disposal of assets       | (4)                               | 104              |
| Add: stock-based compensation expense        | 1,496                             | 1,180            |
| <b>Adjusted EBITDA</b>                       | <b>\$ 24,489</b>                  | <b>\$ 21,231</b> |

**Regulation G Disclosures**

Management's Discussion and Analysis of Financial Condition and Results of Operations contains non-GAAP financial measures within the meaning of the SEC's Regulation G, including: (a) Adjusted net income, before stock-based compensation expense and loss on extinguishment of debt (Non-GAAP adjusted net income), (b) Adjusted net income per share (diluted), before stock-based compensation expense and loss on extinguishment of debt, and (c) Adjusted EBITDA (operating income before deduction for the following non-cash charges: (i) depreciation and amortization expense, (ii) loss on impairment of tangible and intangible assets, (iii) (gain) loss on disposal of assets, and (iv) stock-based compensation expense).

Our management believes that each of these non-GAAP financial measures provides useful information about the Company's results of operations and/or financial position to both investors and management. Each non-GAAP financial measure is provided because management believes it is an important measure of financial performance used in the retail industry to measure operating results, to determine the value of companies within the industry and to define standards for borrowing from institutional lenders. We use each of these non-GAAP financial measures as a measure of the performance of the Company. We provide these measures to investors to assist them in performing their analysis of our historical operating results. Each of these non-GAAP financial measures reflects a measure of the Company's operating results before consideration of certain charges and consequently, none of these measures should be construed as an alternative to net income or operating income as an indicator of the Company's operating performance, or as an alternative to cash flows from operating activities as a measure of the Company's liquidity, as determined in accordance with generally accepted accounting principles. We may calculate each of these non-GAAP financial measures differently than other companies.

With respect to the non-GAAP financial measures discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations, we have provided reconciliations of the non-GAAP financial measures to the most directly comparable GAAP financial measures.

**Seasonality**

Our business, like that of many other retailers, is seasonal. Our quarterly net sales have historically been highest in our third fiscal quarter, corresponding to the Spring selling season. Given the historically higher sales level in our third fiscal quarter and the relatively fixed nature of most of our operating expenses and interest expense, we have typically generated a very significant percentage of our full year operating income and net income during our third fiscal quarter. Results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year. Quarterly results may fluctuate materially depending upon, among other things, increases or decreases in comparable sales, the timing of new store openings and new leased department openings, net sales and profitability contributed by new stores and leased departments, the timing of the fulfillment of purchase orders under our product and license arrangements, adverse weather conditions, shifts in the timing of certain holidays and promotions, changes in inventory and production levels and the timing of deliveries of inventory, and changes in our merchandise mix.





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### **Liquidity and Capital Resources**

Our cash needs have primarily been for (i) debt service, including principal prepayments, (ii) capital expenditures, including leasehold improvements, fixtures and equipment for new stores, store relocations and expansions of our existing stores, as well as improvements and new equipment for our distribution and corporate facilities and information systems, (iii) quarterly cash dividends, and (iv) working capital, including inventory to support our business. We have historically financed our capital requirements from cash flows from operations, borrowings under our credit facility or available cash balances.

Cash and cash equivalents decreased by \$8.6 million during the first six months of fiscal 2013 compared to an increase of \$12.8 million for the first six months of fiscal 2012.

Cash provided by operations of \$18.0 million for the first six months of fiscal 2013 decreased by \$8.1 million from the \$26.1 million in cash provided by operations for the first six months of fiscal 2012. This decrease in cash provided by operations as compared to the prior year was primarily the result of net working capital changes that provided less cash in the first six months of fiscal 2013 than was provided in the first six months of fiscal 2012, partially offset by higher net income in the first six months of fiscal 2013 compared to the first six months of fiscal 2012. The net working capital changes were primarily (i) a \$3.0 million decrease in inventories in the first six months of fiscal 2013 that provided \$5.5 million less cash compared to the \$8.5 million decrease in inventories in the first six months of fiscal 2012, the combined effect of which reflects our year over year efforts to tightly control our inventory levels, (ii) an increase in prepaid expenses and other current assets in the first six months of fiscal 2013, reflecting timing of receipt of construction allowances from landlords, compared to a decrease in the first six months of fiscal 2012, and (iii) a smaller increase in accounts payable, accrued expenses and other liabilities in the first six months of fiscal 2013, compared to the increase in the first six months of fiscal 2012, partially offset by a smaller increase in trade receivables in the first six months of fiscal 2013 compared to the increase in the first six months of fiscal 2012, which primarily reflects collection timing. Our working capital changes, quarterly net income and cash flow adjustments may fluctuate significantly and net cash provided by operating activities for any interim period is not necessarily indicative of the results that may be achieved for a full fiscal year.

During the first six months of fiscal 2013 we used cash provided by operations and a portion of our available cash to fund repayments of long-term debt, to pay for capital expenditures, to pay our quarterly cash dividends, and to provide \$2.1 million of cash collateral for our IRB letter of credit (see below). On November 1, 2012, we prepaid the remaining Term Loan balance of \$13.4 million in connection with the execution of our new Credit Facility. For the first six months of fiscal 2013, we spent \$6.0 million on capital expenditures, including \$4.3 million for leasehold improvements, fixtures and equipment for new store facilities, as well as improvements to existing stores, and \$1.7 million for our information systems and distribution and corporate facilities. In the first six months of fiscal 2013, we paid \$4.7 million for our quarterly cash dividends.

During the first six months of fiscal 2012 we used cash provided by operations to fund repayments of long-term debt, to pay our quarterly cash dividends, and to pay for capital expenditures. Our \$5.5 million of repayments of long-term debt in the first six months of fiscal 2012 consisted predominantly of a \$5.0 million prepayment of our Term Loan. In the first six months of fiscal 2012, we paid \$4.6 million for our quarterly cash dividends. For the first six months of fiscal 2012, we spent \$3.9 million on capital expenditures, including \$2.8 million for leasehold improvements, fixtures and equipment for new store facilities, as well as improvements to existing stores, and \$1.1 million for our information systems and distribution and corporate facilities. The remaining cash provided during the first six months of fiscal 2012 was used primarily to increase our available cash.

On November 1, 2012, we entered into a five-year \$61.0 million senior secured revolving Credit Facility, which replaced our \$55.0 million Prior Credit Facility. The Credit Facility consists of two tranches: (i) a senior secured revolving credit and letter of credit facility of up to \$55.0 million ( Tranche A ) and (ii) a senior secured first-in, last-out revolving credit facility of up to \$6.0 million ( Tranche A-1 ). The Credit Facility will mature on November 1, 2017. Upon our request and with the consent of the lender, permitted borrowings under Tranche A may be increased up to an additional \$15.0 million, in increments of \$2.5 million, up to a Tranche A maximum limit of \$70 million. Proceeds from advances under the Credit Facility, with certain restrictions, may be used to repay our existing debt, and to provide financing for working capital, letters of credit, capital expenditures, dividends, share repurchases and other general corporate purposes. Under the Credit Facility, we are required to maintain minimum Excess Availability (as defined in the related Credit Facility agreement) equal to 10% of the Borrowing Base (as defined in the related Credit Facility agreement). The Credit Facility is secured by a security interest in our trade receivables, inventory, equipment, real estate interests, letter of credit rights, cash, intangibles and certain other assets.

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As of March 31, 2013, we had no outstanding borrowings under the Credit Facility and \$5.1 million in letters of credit, with \$55.9 million of availability under our Credit Facility. As of March 31, 2012, we had no outstanding borrowings and \$7.6 million in letters of credit, with \$47.4 million of availability under our Prior Credit Facility. As of March 31, 2013, a letter of credit for \$1.9 million related to our outstanding obligation under the IRB (see below), which was issued under the Prior Credit Facility, was outstanding. As of March 31, 2013, we had \$2.1 million on deposit with the agent bank for the Prior Credit Facility as cash collateral for the letter of credit. On April 3, 2013, the IRB trustee drew down \$1.8 million plus accrued interest under the letter of credit in connection with our redemption of the remaining bonds (see below). Funds for the draw were provided from the cash collateral on deposit with the agent bank for the Prior Credit Facility. The remaining \$0.3 million of cash collateral was returned to us after the original letter of credit was cancelled. As of March 31, 2013, Tranche A borrowings under the Credit Facility would have resulted in interest at a rate between approximately 1.70% and 3.75% per annum, and Tranche A-1 borrowings under the Credit Facility would have resulted in interest at a rate between approximately 3.20% and 5.25% per annum. During the first six months of fiscal 2013, our average level of direct borrowings (all of which was under the Credit Facility) was \$0.4 million, and our maximum borrowings at any time were \$6.2 million. During the first six months of fiscal 2013 and 2012, we did not have any direct borrowings under the Prior Credit Facility.

On November 1, 2012, we prepaid the remaining Term Loan balance of \$13.4 million in connection with the execution of our new Credit Facility. Prior to its repayment, the Term Loan required minimum principal repayments in quarterly installments of \$225,000 each, in addition to an annual principal repayment equal to 25% of Excess Cash Flow (as defined in the Term Loan Agreement) in excess of \$5.0 million for each fiscal year, based on our Consolidated Leverage Ratio. There was no required principal repayment related to fiscal 2011 results. The Term Loan was permitted to be prepaid at our option, in part or in whole, at any time without any prepayment premium or penalty. During the first six months of fiscal 2013 and 2012, we made optional prepayments of \$13.4 million and \$5.0 million, respectively, on the outstanding Term Loan.

We had \$1.8 million outstanding under an IRB at March 31, 2013. On February 11, 2013, we notified the IRB trustee of our intention to redeem all remaining outstanding bonds effective April 3, 2013. As provided under the indenture of trust for the bonds, on April 3, 2013, the IRB trustee drew down \$1.8 million plus accrued interest under the letter of credit issued as security for the bonds (see above), at which time we had no further obligations, and the bonds had no further rights, under the indenture.

During the first six months of fiscal 2013 and 2012 we paid cash dividends of approximately \$4.7 million (or \$0.35 per share) and \$4.6 million (or \$0.35 per share), respectively. On April 22, 2013 we declared a quarterly cash dividend of \$0.1875 per share payable on June 28, 2013, which will total approximately \$2.5 million, resulting in approximately \$9.8 million of cash dividends for fiscal 2013. The \$0.1875 per share cash dividend represents a 7.1% increase from our previous quarterly dividend rate of \$0.175 per share and an annual dividend rate of \$0.75 per share compared to our previous annual rate of \$0.70 per share. Based on our new current quarterly dividend rate of \$0.1875 per share, our cash dividends will be approximately \$10.1 million on a pro forma annualized basis.

Our management believes that our current cash and working capital positions, expected operating cash flows and available borrowing capacity, will be sufficient to fund our working capital, capital expenditures and dividend payment requirements, and to fund stock repurchases, if any, for at least the next 12 months.

## **Critical Accounting Policies and Estimates**

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. These generally accepted accounting principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our consolidated financial statements and the reported amounts of net sales and expenses during the reporting period. Our critical accounting policies are described in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended September 30, 2012. As of March 31, 2013, there were no material changes in, or additions to, our critical accounting policies or in the assumptions or estimates we used to prepare the financial information appearing in this report.

## **Recent Accounting Pronouncements**

In February 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. ASU No. 2013-02 requires companies to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, companies are required to present, either on the face of the income statement or in the notes, significant amounts reclassified



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out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. The standard does not change the current requirements for reporting net income or other comprehensive income in financial statements. ASU No. 2013-02 is effective for financial statements issued for annual reporting periods beginning after December 15, 2012 and interim periods within those years. Because this guidance impacts presentation only, the adoption of the new requirements of ASU No. 2013-02 will not have any impact on our consolidated financial position or results of operations.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. ASU No. 2011-05 required companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. It eliminated the option to present components of other comprehensive income as part of the statement of stockholders' equity. The standard did not change the items which must be reported in other comprehensive income. In December 2011, the FASB issued ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, which defers the effective date of the requirement to present separate line items on the statement of income for reclassification adjustments out of accumulated other comprehensive income into net income. ASU No. 2011-05 and No. 2011-12 were effective for financial statements issued for annual reporting periods beginning after December 15, 2011 and interim periods within those years. In accordance with ASU No. 2011-05 and No. 2011-12 we have presented two separate but consecutive statements, which include the components of net income and other comprehensive income. Because this guidance impacted presentation only, the adoption of the new requirements of ASU No. 2011-05 and No. 2011-12 did not have any impact on our consolidated financial position or results of operations.

**Forward-Looking Statements**

Some of the information in this report, including the information incorporated by reference (as well as information included in oral statements or other written statements made or to be made by us), contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). The forward-looking statements involve a number of risks and uncertainties. A number of factors could cause our actual results, performance, achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. These factors include, but are not limited to the following: the continuation of economic recovery of the retail industry in general and of apparel purchases in particular, our ability to successfully manage our various business initiatives, the success of our international business and its expansion, our ability to successfully manage, retain and expand our leased department and licensed relationships and marketing partnerships, future sales trends in our various sales channels, unusual weather patterns, changes in consumer spending patterns, raw material price increases, overall economic conditions and other factors affecting consumer confidence, demographics and other macroeconomic factors that may impact the level of spending for maternity apparel (such as fluctuations in pregnancy rates and birth rates), expense savings initiatives, our ability to anticipate and respond to fashion trends and consumer preferences, unanticipated fluctuations in our operating results, the impact of competition and fluctuations in the price, availability and quality of raw materials and contracted products, availability of suitable store locations, continued availability of capital and financing, our ability to hire and develop senior management and sales associates, our ability to develop and source merchandise, our ability to receive production from foreign sources on a timely basis, potential stock repurchases, our ability to generate sufficient free cash flow to continue our regular quarterly cash dividends, the trading liquidity of our common stock, changes in market interest rates, war or acts of terrorism and other factors referenced in our Annual Report on Form 10-K, including those set forth under the caption Risk Factors.

In addition, these forward-looking statements necessarily depend upon assumptions, estimates and dates that may be incorrect or imprecise and involve known and unknown risks, uncertainties and other factors. Accordingly, any forward-looking statements included in this report do not purport to be predictions of future events or circumstances and may not be realized. Forward-looking statements can be identified by, among other things, the use of forward-looking terms such as believes, expects, may, will, should, seeks, pro forma, anticipates, intends, could, estimates, plans, potential, predicts, goal, objective, or the negative of any of these terms, or comparable terminology, or by discussing our outlook, plans, goals, strategy or intentions. Forward-looking statements speak only as of the date made. Except as required by applicable law, including the securities laws of the United States and the rules and regulations of the SEC, we assume no obligation to update any of these forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting these forward-looking statements.

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### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Destination Maternity is exposed to market risk from changes in interest rates. We have not entered into any market sensitive instruments for trading purposes. The analysis below presents the sensitivity of the market value of our financial instruments to selected changes in market interest rates. The range of changes presented reflects our view of changes that are reasonably possible over a one-year period.

As of March 31, 2013, we had cash equivalents of \$8.3 million. Our cash equivalents consist of investments in money market funds that bear interest at variable rates. A change in market interest rates earned on our investments impacts the interest income and cash flows, but does not materially impact the fair market value of the financial instruments. Due to the average maturity and conservative nature of our investment portfolio, we believe a sudden change in interest rates would not have a material effect on the value of our investment portfolio. The impact on our future interest income resulting from changes in investment yields will depend largely on the gross amount of our investment portfolio at that time. However, based upon the conservative nature of our investment portfolio and current experience, we do not believe a decrease in investment yields would have a material negative effect on our interest income.

As of March 31, 2013, the components of our debt portfolio were the \$61.0 million Credit Facility and the \$1.8 million IRB (which was fully redeemed on April 3, 2013), both of which are denominated in United States dollars.

Our Credit Facility has variable interest rates that are tied to market indices. As of March 31, 2013, we had no direct borrowings and \$5.1 million of letters of credit outstanding under our Credit Facility. As of March 31, 2013, Tranche A borrowings under the Credit Facility would have resulted in interest at a rate between approximately 1.70% and 3.75% per annum, and Tranche A-1 borrowings under the Credit Facility would have resulted in interest at a rate between approximately 3.20% and 5.25% per annum. Interest on any future borrowings under the Credit Facility would, to the extent of outstanding borrowings, be affected by changes in market interest rates. A change in market interest rates on the variable rate portion of our debt portfolio would impact the interest expense incurred and cash flows.

Other than as described above, we do not believe that the market risk exposure on other financial instruments is material.

### **Item 4. Controls and Procedures**

#### **Disclosure Controls and Procedures**

Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that are filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed under the Exchange Act is accumulated and communicated to our management on a timely basis to allow decisions regarding required disclosure. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2013. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that as of March 31, 2013, these controls and procedures were effective.

#### **Internal Control over Financial Reporting**

There have been no changes in internal control over financial reporting identified in connection with the foregoing evaluation that occurred during the fiscal quarter ended March 31, 2013, that have 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**

From time to time, we are named as a defendant in legal actions arising from our normal business activities. Although the amount of any liability that could arise with respect to currently pending actions cannot be accurately predicted, we do not believe that the resolution of any pending action will have a material adverse effect on our financial position, results of operations or liquidity.

**Item 1A. Risk Factors**

In addition to the other information set forth in this Form 10-Q, you should carefully consider the factors discussed in Part I, Item 1A Risk Factors of our Form 10-K for the year ended September 30, 2012. The risks described in our Form 10-K are not the only risks that we face. Additional risks not presently known to us or that we do not currently consider significant may also have an adverse effect on us. If any of the risks actually occur, our business, results of operations, cash flows or financial condition could suffer.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table provides information about purchases by us during the quarter ended March 31, 2013 of equity securities that are registered by us pursuant to Section 12 of the Exchange Act:

| Period                          | Total<br>Number of<br>Shares<br>Purchased (1) | Average Price<br>Paid per Share | Total Number of<br>Shares Purchased as<br>Part of a<br>Publicly<br>Announced Program (2) | Maximum<br>Approximate Dollar<br>Value of Shares that<br>May Yet Be<br>Purchased<br>Under the<br>Program (2) |
|---------------------------------|---|---------------------------------|--|--|
| January 1 to January 31, 2013   | 1,367   | \$ 22.64                        |  | \$ 10,000,000  |
| February 1 to February 28, 2013 | 1,058   | \$ 22.15                        |  | \$ 10,000,000  |
| March 1 to March 31, 2013       | 1,261   | \$ 22.58                        |  | \$ 10,000,000  |
| Total                           | 3,686   | \$ 22.48                        |  | \$ 10,000,000  |

- (1) Represents shares repurchased directly from certain employees to satisfy income tax withholding obligations for such employees in connection with restricted stock awards that vested during the period.
- (2) In July 2008, our Board of Directors approved a program to repurchase up to \$7.0 million of our outstanding common stock. Under the program, we may repurchase shares from time to time through solicited or unsolicited transactions in the open market or in negotiated or other transactions. In July 2012, our Board of Directors extended its authorization of the program from July 31, 2012 to July 31, 2014, and increased the amount of our outstanding stock authorized to be repurchased from \$7.0 million to \$10.0 million. No shares have been repurchased under this program as of March 31, 2013.

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**Item 6. Exhibits**

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 31.1               | Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2               | Certification of the Executive Vice President & Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1               | Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                            |
| 32.2               | Certification of the Executive Vice President & Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| *101.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  |

\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.



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**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.

DESTINATION MATERNITY CORPORATION

Date: May 8, 2013

By: */s/* **EDWARD M. KRELL**  
Edward M. Krell  
*Chief Executive Officer*

Date: May 8, 2013

By: */s/* **JUDD P. TIRNAUER**  
Judd P. Tirnauer  
*Executive Vice President &*  
  
*Chief Financial Officer*

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**INDEX OF EXHIBITS FILED WITH  
FORM 10-Q OF DESTINATION MATERNITY CORPORATION  
FOR THE QUARTER ENDED MARCH 31, 2013**

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