

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
AND COMPREHENSIVE LOSS (Continued)
(in thousands)

	Common Stock		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total	Comprehensive Loss
	Number of Shares	Amount					
Balance as of September 30, 2008	6,071	\$ 61	\$ 83,274	\$ 7,505	\$ (1,372)	\$ 89,468	
Net loss	—	—	—	(40,682)	—	(40,682)	\$ (40,682)
Amortization of prior service cost for retirement plans, net of tax	—	—	—	—	123	123	123
Change in fair value of interest rate swap, net of tax	—	—	—	—	(392)	(392)	(392)
Comprehensive loss							\$ (40,951)
Stock-based compensation	38	—	2,031	—	—	2,031	
Exercise of stock options	5	—	55	—	—	55	
Tax benefit shortfall from stock option exercises and restricted stock vesting	—	—	(789)	—	—	(789)	
Repurchase and retirement of common shares	(2)	—	(14)	—	—	(14)	
Balance as of September 30, 2009	<u>6,112</u>	<u>\$ 61</u>	<u>\$ 84,557</u>	<u>\$ (33,177)</u>	<u>\$ (1,641)</u>	<u>\$ 49,800</u>	

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

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended September 30,		
	2009	2008	2007
Operating Activities			
Net loss	\$(40,682)	\$ (1,389)	\$ (393)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	14,982	15,974	16,410
Stock-based compensation expense	2,031	2,281	2,101
Loss on impairment of long-lived assets	667	1,628	1,781
Loss on impairment of goodwill	50,389	—	—
(Gain) loss on disposal of assets	(48)	546	(422)
Loss on extinguishment of debt	123	97	9,423
Accretion of discount on notes	—	—	89
Deferred income tax provision (benefit)	1,318	(969)	(3,067)
Amortization of deferred financing costs	221	246	437
Changes in assets and liabilities:			
Decrease (increase) in:			
Trade receivables	556	5,009	(463)
Inventories	9,184	12,429	(6,226)
Prepaid expenses and other current assets	2,920	(784)	1,788
Other non-current assets	(15)	247	(44)
Increase (decrease) in:			
Accounts payable, accrued expenses and other current liabilities	769	(14,702)	7,389
Deferred rent and other non-current liabilities	110	7,209	(1,405)
Net cash provided by operating activities	<u>42,525</u>	<u>27,822</u>	<u>27,398</u>
Investing Activities			
Purchase of short-term investments	—	—	(19,550)
Proceeds from sale of short-term investments	—	—	28,975
Withdrawal from (contribution to) grantor trust	—	2,684	(2,662)
Capital expenditures	(12,639)	(15,688)	(15,444)
Proceeds from sale of property, plant and equipment	—	—	85
Proceeds from sale of assets held for sale	526	—	493
Purchase of intangible assets	(342)	(343)	(9)
Net cash used in investing activities	<u>(12,455)</u>	<u>(13,347)</u>	<u>(8,112)</u>
Financing Activities			
Increase (decrease) in cash overdrafts	(380)	1,524	(584)
Proceeds from issuance of long-term debt	—	—	90,000
Repayment of long-term debt	(21,237)	(14,534)	(116,039)
Premium on repurchase of long-term debt	—	—	(6,469)
Deferred financing costs	—	(21)	(1,065)
Repurchase of common stock	(14)	(118)	—
Payout of redeemed Series A preferred stock	(16)	—	—
Proceeds from exercise of stock options	55	692	3,737
Excess tax benefit from exercise of stock options	—	—	2,360
Net cash used in financing activities	<u>(21,592)</u>	<u>(12,457)</u>	<u>(28,060)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>8,478</u>	<u>2,018</u>	<u>(8,774)</u>
Cash and Cash Equivalents, Beginning of Year	<u>12,148</u>	<u>10,130</u>	<u>18,904</u>
Cash and Cash Equivalents, End of Year	<u>\$ 20,626</u>	<u>\$ 12,148</u>	<u>\$ 10,130</u>

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

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF BUSINESS

Destination Maternity Corporation (formerly Mothers Work, Inc.) and subsidiaries (the "Company") is a specialty designer and retailer of maternity clothing. On December 8, 2008, the Company changed its corporate name from "Mothers Work, Inc." to "Destination Maternity Corporation." The name change was accomplished through the merger of a newly-formed, wholly-owned subsidiary, DM Newco, Inc., into Mothers Work, Inc. The Company operated 1,084 retail locations as of September 30, 2009, including 724 stores and 360 leased departments, throughout the United States Puerto Rico, Guam and Canada and markets its maternity apparel on the Internet through its DestinationMaternity.com and brand-specific websites. In addition, the Company markets maternity apparel at Kohl's® stores throughout the United States under an exclusive product and license agreement. The Company is expanding internationally and has entered into exclusive store franchise and product supply relationships in India and the Middle East. The Company was incorporated in Delaware in 1982.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its direct and indirect wholly-owned subsidiaries of Cave Springs, Inc., Mothers Work Canada, Inc., Maternity Factory Warehouse Centre, Inc. (a wholly-owned subsidiary of Mothers Work Canada, Inc.), Mothers Work Services, Inc., Destination Maternity Apparel Private Limited and Confecciones Acona S.A. All significant intercompany transactions and accounts have been eliminated in consolidation.

b. Fiscal Year-End

The Company operates on a fiscal year ending September 30 of each year. All references to fiscal years of the Company refer to the fiscal years ended on September 30 in those years. For example, the Company's "fiscal 2009" ended on September 30, 2009.

c. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

d. Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, cash in the bank and short-term investments with an original maturity of three months or less when purchased. Cash overdrafts of \$4,450,000 and \$4,830,000 were included in accounts payable as of September 30, 2009 and 2008, respectively.

The Company maintains cash accounts that, at times, may exceed federally insured limits. The Company has not experienced any losses from maintaining cash accounts in excess of such limits. Management believes that it is not exposed to any significant credit risks on its cash accounts.

e. Investments

The Company's investments may be classified as either held-to-maturity or available-for-sale. Held-to-maturity securities are carried at amortized cost and represent those securities that the Company has both the intent and ability to hold to maturity. Available-for-sale securities are carried at fair value, and are classified

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

as such because these securities are not actively traded and do not meet the classification of held-to-maturity. Interest on investments, as well as amortization of discounts and premiums, is included in interest income. Unrealized gains and losses on available-for-sale securities are excluded from earnings and are reported as accumulated other comprehensive income (loss) until realized. When available-for-sale securities are sold, the cost of the securities is specifically identified and is used to determine the realized gain or loss.

f. Inventories

Inventories are valued at the lower of cost or market. Cost is determined by the "first-in, first-out" (FIFO) method. Inventories of goods manufactured by the Company include the cost of materials, freight, direct labor, and manufacturing and distribution overhead.

g. Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation and amortization are computed for financial reporting purposes on a straight-line basis, using service lives ranging principally from five to ten years for furniture and equipment and forty years for the building. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term or their useful life. The cost of assets sold or retired and the related accumulated depreciation or amortization are removed from the accounts with any resulting gain or loss included in net income (loss). Maintenance and repairs are expensed as incurred except for the capitalization of major renewals and betterments that extend the life of the asset. Long-lived assets are reviewed for impairment whenever adverse events, or changes in circumstances or business climate indicate that the carrying value may not be recoverable. Factors used in the evaluation include, but are not limited to, management's plans for future operations, brand initiatives, recent operating results and projected cash flows. If the associated undiscounted cash flows are insufficient to support the recorded asset, an impairment loss is recognized to reduce the carrying value of the asset. The amount of the impairment loss is determined by comparing the discounted expected future cash flows with the carrying value.

During fiscal 2009, 2008 and 2007, the Company recorded impairment write-downs of property, plant and equipment totaling \$665,000, \$1,615,000 and \$1,776,000, respectively, on a pretax basis.

h. Goodwill and Intangible Assets

Goodwill represents the excess of cost over the fair value of net assets acquired in business combinations. Goodwill is reviewed for impairment at least annually or when events or changes in circumstances indicate the carrying value of the goodwill might exceed the fair value in accordance with applicable accounting standards. Management has determined that the Company has one reporting unit based on its reporting structure. The Company makes its annual assessment of impairment as of September 30 of each fiscal year. The fair value of the Company's single reporting unit at each measurement date is determined based on a combination of the fair market value of the Company's outstanding common stock on a control basis, a discounted cash flow analysis and other generally accepted valuation methodologies and, if necessary, with the assistance of an outside independent valuation specialist. As part of the Company's impairment analysis as of September 30, 2008, an outside independent valuation was obtained and the fair value of the Company's single reporting unit exceeded the carrying value. As a result of a substantial decrease in the market price of the Company's common stock subsequent to September 30, 2008, reflecting deteriorating overall economic conditions and the very difficult equity market conditions, the Company reassessed the carrying value of its goodwill as of December 31, 2008, in accordance with interim period accounting requirements, and concluded that the goodwill was fully impaired.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Consequently, the Company recorded non-cash goodwill impairment charges of \$50,389,000, on both a pretax and after tax basis, in fiscal 2009 (see Note 5).

Intangible assets with definite useful lives, which primarily consist of lease acquisition costs and patents, are amortized over the shorter of their useful life or, if applicable, the lease term. Management reviews the carrying amount of these intangible assets as impairment indicators arise, to assess the continued recoverability based on future undiscounted cash flows and operating results from the related asset, future asset utilization and changes in market conditions. During fiscal 2009, 2008 and 2007, the Company recorded write-downs of intangible assets totaling \$2,000, \$13,000 and \$5,000, respectively, on a pretax basis. The Company has not identified any indefinite-lived intangible assets. Aggregate amortization expense of intangible assets in fiscal 2009, 2008 and 2007 was \$109,000, \$119,000 and \$153,000, respectively.

Estimated amortization expense for the next five fiscal years is as follows (in thousands):

<u>Fiscal Year</u>	
2010	\$109
2011	96
2012	87
2013	80
2014	66

i. Interest Rate Derivatives

The Company mitigates a portion of its floating rate interest risk on variable rate long-term debt through an interest rate swap agreement. In accordance with applicable accounting standards for derivative instruments, the Company recognizes the derivative on the balance sheet at fair value. On the date the derivative instrument was entered into, the Company designated it as a hedge of the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"). Changes in the fair value of a derivative that is designated as, and meets all the criteria for, a cash flow hedge are recorded in accumulated other comprehensive loss and reclassified into earnings as the underlying hedged item affects earnings. The Company formally documents the relationship between hedging instruments and hedged items. The Company also formally assesses at the inception of the hedge and on a quarterly basis, whether the derivative is highly effective in offsetting changes in cash flows of the hedged item. Any portion of the change in fair value of the derivative associated with hedge ineffectiveness is included in current earnings. As of September 30, 2009 and for the year then ended, the Company's interest rate swap was determined to have no ineffectiveness.

j. Deferred Financing Costs

Deferred financing costs (see Note 10) are amortized to interest expense over the term of the related debt agreement. Amortization expense of deferred financing costs in fiscal 2009, 2008 and 2007 was \$221,000, \$246,000 and \$437,000, respectively. In connection with debt extinguishments, in fiscal 2009, 2008 and 2007 the Company wrote off \$123,000, \$97,000 and \$2,173,000 of unamortized deferred financing costs (see Note 10).

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Estimated amortization expense of deferred financing costs for the next five fiscal years is as follows (in thousands):

<u>Fiscal Year</u>	
2010	\$204
2011	203
2012	137
2013	41
2014	—

k. Deferred Rent

Rent expense on operating leases, including rent holidays and scheduled rent increases, is recorded on a straight-line basis over the term of the lease commencing on the date the Company takes possession of the leased property, which is generally four to six weeks prior to a store's opening date. The net excess of rent expense over the actual cash paid has been recorded as a deferred rent liability in the accompanying Consolidated Balance Sheets. Tenant improvement allowances received from landlords are also included in the accompanying Consolidated Balance Sheets as deferred rent liabilities and are amortized as a reduction of rent expense over the term of the lease from the possession date.

l. Treasury (Reacquired) Shares

Shares repurchased are retired and treated as authorized but unissued shares, with the cost in excess of par value of the reacquired shares charged to additional paid-in capital and the par value charged to common stock.

m. Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, investments, trade receivables and accounts payable approximate fair value due to the short-term nature of those instruments. The majority of the Company's long-term debt bears interest at variable rates, which adjust based on market conditions, and the carrying value of the long-term debt approximates fair value. The difference between the carrying value and fair value of long-term debt held by the Company with fixed rates of interest is not significant. A portion of the Company's floating rate interest risk on variable rate long-term debt is mitigated through an interest rate swap agreement. As of September 30, 2009 and 2008, the estimated fair value of the interest rate swap was an unrealized loss of \$(2,025,000) and \$(1,404,000), respectively.

n. Revenue Recognition, Sales Returns and Allowances

Revenue is recognized at the point of sale for retail store sales, including leased department sales, or when merchandise is shipped to customers for licensed product and Internet sales, and when merchandise is shipped to the international franchisees. Allowances for returns are recorded as a reduction of revenue, based on the Company's historical experience. Revenues are recorded net of applicable sales taxes.

o. Other Revenues

Included in net sales are revenues earned by the Company through a variety of marketing partnership programs utilizing the Company's opt-in customer database and various in-store marketing initiatives, focused on baby and parent-related products and services. Also included in net sales are fees and royalties related to international franchise agreements. Franchise fees are earned by the Company when all material services or conditions related to the franchise agreement have been substantially performed or satisfied and royalties are earned based on net sales of the Company's international franchisees and may include minimum guaranteed royalties.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

p. Cost of Goods Sold

Cost of goods sold in the accompanying Consolidated Statements of Operations includes: merchandise costs (including customs duty expenses), expenses related to inventory shrinkage, product-related corporate expenses (including expenses related to payroll, benefit costs and operating expenses of the Company's 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 the Company's distribution network.

q. Shipping and Handling Fees and Costs

The Company includes shipping and handling revenue earned from its e-commerce activities in net sales. Shipping and handling costs, which are included in cost of goods sold in the accompanying Consolidated Statements of Operations, include shipping supplies, related labor costs and third-party shipping costs.

r. Selling, General and Administrative Expenses

Selling, general and administrative expenses in the accompanying Consolidated Statements of Operations include: advertising and marketing expenses, corporate administrative expenses, store expenses (including store payroll and store occupancy expenses), and store opening expenses.

s. Advertising Costs

The Company expenses the costs of advertising when the advertising first occurs. Advertising expenses, including Internet advertising expenses, were \$11,213,000, \$12,697,000 and \$11,938,000 in fiscal 2009, 2008 and 2007, respectively.

t. Store Closing, Asset Impairment and Asset Disposal Expenses

Store closing expenses include lease termination fees, gains or losses on disposal of closed store assets and recognition of unamortized deferred rent. Asset impairment expenses represent losses recognized to reduce the carrying value of impaired long-lived assets. Asset disposal expenses represent gains or losses on disposal of assets other than in connection with store closings, including assets disposed from remodeling or relocation of stores.

u. Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities as well as from net operating loss carryforwards. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date.

The Company adopted the provisions of the accounting standard for uncertain income tax positions effective as of October 1, 2007. Under this standard, recognition of a tax benefit occurs when a tax position is more-likely-than-not to be sustained upon examination, based solely on its technical merits. Derecognition of a previously recognized tax position would occur if it is subsequently determined that the tax position no longer meets the more-likely-than-not threshold of being sustained. The accounting standard also provided guidance on the measurement of uncertain income tax positions. The Company records interest and penalties related to unrecognized tax benefits in income tax provision (benefit).

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

v. Earnings (Loss) per Share

Basic earnings (loss) per share ("Basic EPS") is computed by dividing net income (loss) by the weighted average number of common shares outstanding, excluding restricted stock awards for which the restrictions have not lapsed. Diluted earnings (loss) per share ("Diluted EPS") is computed by dividing net income (loss) by the weighted average number of common shares outstanding, after giving effect to the potential dilution, if applicable, from the assumed lapse of restrictions on restricted stock awards and from the exercise of stock options into shares of common stock as if those stock options were exercised (see Note 14).

Options and restricted stock totaling 947,338, 1,039,866 and 962,220 shares of the Company's common stock were outstanding as of September 30, 2009, 2008 and 2007, respectively, but were not included in the computation of Diluted EPS for fiscal 2009, 2008 and 2007, due to the Company's net loss position. Had the Company reported a profit for fiscal 2009, 2008 and 2007, the average number of dilutive shares outstanding for computation of Diluted EPS would have been approximately 6,067,000, 6,048,000, and 6,135,000, respectively.

w. Statements of Cash Flows

In fiscal 2009, 2008 and 2007, the Company paid interest, including payments made on its interest rate swap agreement (see Note 10), of \$4,809,000, \$7,169,000 and \$10,415,000, respectively, and made income tax payments, net of refunds, of \$2,357,000, \$552,000 and \$(972,000), respectively.

x. Subsequent Events

The Company has evaluated subsequent events through December 14, 2009, the date these consolidated financial statements were issued.

y. Business and Credit Risk

Financial instruments, primarily cash and cash equivalents, investments and accounts receivable, potentially subject the Company to concentrations of credit risk. The Company limits its credit risk associated with cash and cash equivalents and investments by placing such investments in highly liquid funds and instruments. Receivables associated with third-party credit cards are processed by financial institutions, which are monitored for financial stability. The Company is dependent on key suppliers to provide sufficient quantities of inventory at competitive prices. No single supplier represented 10% or more of net purchases in fiscal 2009, 2008 or 2007. A significant majority of the Company's purchases during fiscal 2009, 2008 and 2007 were imported. Management believes that any event causing a disruption of imports from any specific country could be partially mitigated by moving production to readily available alternative sources.

z. Insurance

The Company is self-insured for workers' compensation and employee-related health care benefits, up to certain stop-loss limits. Such costs are accrued based on known claims and an estimate of incurred but not reported claims. Further, the Company utilizes a cooperative arrangement with a number of other companies to assist in managing certain workers' compensation and general liability insurance risks. The Company's expenses associated with this relationship could be impacted by the loss history associated with the cooperative as a whole. Liabilities associated with these risks are estimated by considering historical claims experience and other actuarial assumptions.

aa. Store Preopening Costs

Non-capital expenditures, such as payroll costs incurred prior to the opening of a new store, are charged to expense in the period in which they were incurred.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

bb. New Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 168 establishes the FASB Accounting Standards Codification ("ASC") as the source of authoritative accounting principles recognized by the FASB to be applied to nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles ("GAAP"). Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. SFAS No. 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. SFAS No. 168 and the ASC are not intended to change GAAP and the adoption of SFAS No. 168 did not have any impact on the Company's consolidated financial position or results of operations but does change the way specific accounting standards are referenced.

In June 2008, the FASB issued Staff Position ("FSP") EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. FSP EITF 03-6-1 provides guidance for the calculation of earnings per share under FASB ASC 260, Earnings Per Share, for share-based payment awards with rights to dividends or dividend equivalents. The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. The adoption of this guidance will not have any impact on the Company's consolidated financial position, results of operations or reported earnings per share.

3. INVENTORIES

Inventories as of September 30 were comprised of the following (in thousands):

	<u>2009</u>	<u>2008</u>
Finished goods	\$72,814	\$81,028
Work-in-progress	2,470	2,904
Raw materials	3,588	4,124
	<u>\$78,872</u>	<u>\$88,056</u>

4. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment as of September 30 was comprised of the following (in thousands):

	<u>2009</u>	<u>2008</u>
Land	\$ 1,400	\$ 1,400
Building and improvements	14,252	13,469
Furniture and equipment	65,903	62,937
Leasehold improvements	105,474	105,657
	<u>187,029</u>	<u>183,463</u>
Less: accumulated depreciation and amortization	<u>(124,177)</u>	<u>(117,365)</u>
	<u>\$ 62,852</u>	<u>\$ 66,098</u>

During fiscal 2009, 2008 and 2007, the Company recorded pretax charges of \$665,000, \$1,615,000 and \$1,776,000, respectively, related to the impairment of leasehold improvements and furniture and equipment at

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. PROPERTY, PLANT AND EQUIPMENT, NET (Continued)

certain of its retail locations. Aggregate depreciation and amortization expense of property, plant and equipment in fiscal 2009, 2008 and 2007 was \$14,873,000, \$15,855,000 and \$16,257,000, respectively.

As of September 30, 2008, \$207,000 of assets (not included above) were separately reflected in the accompanying Consolidated Balance Sheet as "assets held for sale." The assets held for sale related to manufacturing and warehouse facilities located in Costa Rica that were acquired and shut down in a fiscal 2002 business purchase. Two of these facilities were previously sold for an aggregate of \$718,000. The remaining facility was sold during the first quarter of fiscal 2009 for \$526,000 and the Company recognized a \$319,000 gain on disposal of assets.

5. GOODWILL IMPAIRMENT

For purposes of the Company's impairment testing under the accounting standard for goodwill, the Company has one reporting unit based on the Company's reporting structure. The fair value of the Company's single reporting unit is determined based on a combination of the fair market value of the Company's outstanding common stock on a control basis, a discounted cash flow analysis and other generally accepted valuation methodologies and, if necessary, with the assistance of an outside independent valuation specialist. As a result of a substantial decrease in the market price of the Company's common stock subsequent to September 30, 2008, reflecting deteriorating overall economic conditions and the very difficult equity market conditions, the Company reassessed the carrying value of its goodwill as of December 31, 2008, in accordance with interim period accounting requirements, and concluded that its goodwill was impaired. Consequently, the Company recorded a preliminary non-cash goodwill impairment charge of \$47,000,000, on both a pretax and after tax basis, in the first quarter of fiscal 2009. The final results of the Company's evaluation completed during the second quarter of fiscal 2009 indicated the goodwill was fully impaired. Accordingly, the Company recorded a \$3,389,000 non-cash goodwill impairment charge, on both a pretax and after tax basis, in the second quarter of fiscal 2009, representing the remaining carrying value of the goodwill as of December 31, 2008. The goodwill impairment analysis involved calculating the implied fair value of the Company's goodwill by allocating the fair value of the Company's single reporting unit to all assets and liabilities other than goodwill (including both recognized and unrecognized intangible assets) and comparing the residual amount to the carrying value of goodwill. The non-cash goodwill impairment charges do not have any adverse effect on the covenant calculations under the Company's debt agreements or the Company's overall compliance with the covenants of the Company's debt agreements.

6. RESTRUCTURING AND OTHER CHARGES

On July 1, 2008, the Company announced that it was streamlining its merchandise brands and store nameplates and was implementing cost reductions in order to simplify its business model, reduce overhead costs and improve its merchandise assortments. Pursuant to the strategic restructuring, the Company rebranded its Mimi Maternity® merchandise brand under its A Pea in the Pod® brand beginning with the Spring 2009 collection, which initially debuted in November 2008. The Company also streamlined its store nameplates, by renaming its single-brand Mimi Maternity stores as A Pea in the Pod, and by renaming its multi-brand Mimi Maternity stores as Destination Maternity®. In connection with the strategic restructuring the Company also reduced its corporate and field management headcount, and during fiscal 2009 began to implement actions to achieve further cost reductions. The objectives of the Company's restructuring and cost reduction program, are to improve and simplify critical processes, consolidate activities and infrastructure, and reduce its expense structure to be more appropriately aligned with the generation of revenue. The Company incurred pretax expense of \$1,557,000 from its restructuring and cost reduction actions in fiscal 2009, consisting of \$1,072,000 for

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. RESTRUCTURING AND OTHER CHARGES (Continued)

consulting services related to the Company's cost reduction initiatives, \$357,000 for cash severance expense and severance-related benefits, and \$128,000 of non-cash expense for accelerated depreciation of existing store signs resulting from planned store signage changes. The Company incurred pretax expense of \$936,000 from its restructuring in fiscal 2008, consisting of \$691,000 for cash severance expense and severance-related benefits, and \$245,000 of non-cash expense for accelerated depreciation of existing store signs. As of September 30, 2009, the Company had a commitment under a consulting agreement for minimum fees and expenses of approximately \$1,600,000, of which approximately \$600,000 was recorded in fiscal 2009, based upon services rendered in fiscal 2009. Remaining amounts to be charged to expense in fiscal 2010 related to the agreement, not to exceed \$3,300,000, will be based upon services rendered and performance results achieved.

A summary of the charges incurred and reserves recorded in connection with the restructuring and cost reduction activities during fiscal 2009 and 2008 is as follows (in thousands):

	Balance Accrued September 30, 2008	Year Ended September 30, 2009		Balance Accrued September 30, 2009	Cumulative Charges Incurred to September 30, 2009
		Charges Incurred	Payments/ Adjustments		
Severance and related benefits	\$ 224	\$ 357	\$ (544)	\$ 37	\$ 1,048
Accelerated depreciation of store signage	—	128	(128) (1)	—	373
Other cost reduction initiatives	—	1,072	(434)	638	1,072
Total	\$ 224	\$ 1,557	\$ (1,106)	\$ 675	\$ 2,493

	Balance Accrued September 30, 2007	Year Ended September 30, 2008		Balance Accrued September 30, 2008
		Charges Incurred	Payments/ Adjustments	
Severance and related benefits	\$ —	\$ 691	\$ (467)	\$ 224
Accelerated depreciation of store signage	—	245	(245) (1)	—
Total	\$ —	\$ 936	\$ (712)	\$ 224

(1) Adjustment to reduce net book value of associated property, plant and equipment.

In connection with the retirement of Dan Matthias, the Company's former Chief Executive Officer ("Former CEO"), the Company recognized pretax expense of \$2,525,000 in the fourth quarter of fiscal 2008, included in "restructuring and other charges" in the accompanying Consolidated Statements of Operations. The charge reflects benefit costs and payroll taxes related to an amendment to the executive's supplemental retirement agreement with the Company (see Notes 17 and 18). Subsequent to his retirement, the Former CEO continued to serve the Company as non-executive Chairman of the Board and is available to the Company in a consulting capacity, for which the Former CEO is being paid an annual retainer of \$200,000 through September 2012. In November 2009, the Former CEO entered into a letter agreement with the Company, which confirmed that he would not seek reelection to the Board of Directors after the expiration of his current term in January 2010. The letter agreement does not change the terms of payment under the annual retainer for advisory services, however the Company will incur a pretax charge of \$583,000, primarily in the first quarter of fiscal 2010, representing the amount due for the remaining term of the advisory arrangement.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. RESTRUCTURING AND OTHER CHARGES (Continued)

In connection with the announced retirement of Rebecca Matthias, the Company's President and Chief Creative Officer, at the end of fiscal 2010, the Company will incur a pretax charge of approximately \$889,000 in the first quarter of fiscal 2010. The charge reflects benefit costs related to an amendment to the executive's supplemental retirement agreement with the Company (see Notes 17 and 18).

7. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

As of September 30, accrued expenses and other current liabilities were comprised of the following (in thousands):

	<u>2009</u>	<u>2008</u>
Employee compensation and benefits	\$15,379	\$10,596
Income taxes payable	512	—
Interest	749	1,012
Deferred rent	3,320	4,302
Sales taxes	2,646	2,627
Insurance	1,275	835
Accounting and legal	1,114	1,464
Accrued store construction costs	1,226	760
Gift certificates and store credits	4,954	4,960
futuretrust® college savings program	1,226	1,811
Supplemental executive retirement plan benefits	900	1,560
Other	8,709	7,879
	<u>\$42,010</u>	<u>\$37,806</u>

8. DEFERRED RENT AND OTHER NON-CURRENT LIABILITIES

As of September 30, deferred rent and other non-current liabilities were comprised of the following (in thousands):

	<u>2009</u>	<u>2008</u>
Deferred rent	\$24,753	\$25,611
Less: current portion included in accrued expenses and other current liabilities	(3,320)	(4,302)
Non-current deferred rent	21,433	21,309
Supplemental executive retirement plan benefits	4,426	4,323
Accrued state income taxes	2,440	2,166
Interest rate swap	2,025	1,404
Other	148	189
	<u>\$30,472</u>	<u>\$29,391</u>

9. LINE OF CREDIT

The Company has a \$65,000,000 senior secured revolving credit facility (the "Credit Facility"). On March 13, 2007, in connection with the refinancing of its senior long-term debt, the Company amended the Credit Facility in order to permit the refinancing transaction (see Note 10). This amendment of the Credit Facility also extended its maturity from October 15, 2009 to March 13, 2012. Upon the Company's request and with the

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. LINE OF CREDIT (Continued)

consent of the lender, permitted borrowings under the Credit Facility may be increased up to an additional \$20,000,000, in increments of \$2,500,000, up to a maximum limit of \$85,000,000. Proceeds from advances under the Credit Facility, with certain restrictions, may be used to provide financing for working capital, letters of credit, capital expenditures, debt prepayments, dividends, share repurchases and other general corporate purposes. The Company paid certain closing fees in connection with the negotiation and execution of the Credit Facility, as amended. The Company also pays an unused line fee under the Credit Facility.

The Credit Facility contains various affirmative and negative covenants and representations and warranties. There are no financial covenant requirements under the Credit Facility unless Excess Availability (as defined in the agreement) falls below 10% of the Borrowing Base (as defined in the agreement) in which case the Company would be required to meet a certain minimum fixed charge coverage ratio (which increases from 1.00x to 1.10x during the term of the Credit Facility). During all of fiscal 2009, 2008 and 2007, the Company exceeded the applicable excess availability requirements under the Credit Facility and was not subject to any financial covenants. The Credit Facility is secured by a security interest in the Company's accounts receivable, inventory, real estate interests, letter of credit rights, cash, intangibles and certain other assets. The security interest granted to the Credit Facility Lender is, in certain respects, subordinate to the security interest granted to the Term Lenders. The interest rate on outstanding borrowings is equal to, at the Company's election, either the lender's prime rate or the lender's LIBOR rate plus the applicable margin. The applicable margin for LIBOR rate borrowings is variable, ranging from 1.00% to 1.50%, based upon the availability calculation made in accordance with the Credit Facility. The applicable margin for LIBOR rate borrowings, based upon the availability calculation made in accordance with the agreement, has been the lowest available margin since the inception of the Credit Facility.

Any amounts outstanding under the Credit Facility may be accelerated and become due and payable immediately and all loan and letter of credit commitments thereunder may be terminated upon an event of default and expiration of any applicable cure period. Events of default include: (i) nonpayment of obligations due under the Credit Facility, (ii) failure to perform any covenant or agreement contained in the Credit Facility, (iii) material misrepresentations, (iv) failure to pay, or certain other defaults under, other material indebtedness of the Company, (v) certain bankruptcy or insolvency events, (vi) a change of control, (vii) material uninsured losses, (viii) indictments of the Company or senior management in a material forfeiture action, and (ix) customary ERISA defaults, among others.

As of September 30, 2009, the Company had no outstanding borrowings under the Credit Facility and \$11,545,000 in letters of credit, with \$35,984,000 of availability under the credit line based on the Company's Borrowing Base formula, compared to no outstanding borrowings and \$10,605,000 in letters of credit, with \$45,870,000 of availability under the credit line as of September 30, 2008. Borrowings under the Credit Facility as of September 30, 2009 would have borne interest at a rate of between approximately 1.25% and 3.25% per annum. During fiscal 2009 and 2008, the Company's average level of direct borrowings under the Credit Facility was \$249,000 and \$5,162,000, respectively.

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DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. LONG-TERM DEBT

The following table summarizes the Company's long-term debt as of September 30 (in thousands):

	2009	2008
Senior secured Term Loan B, interest is variable (2.95% as of September 30, 2009; effective rate of 6.44% including effect of interest rate swap), principal of \$225 due quarterly through December 31, 2012 with the remaining balance due March 13, 2013	\$54,750	\$75,650
Industrial Revenue Bond, interest is variable (0.40% as of September 30, 2009), principal due annually until September 1, 2020 (collateralized in full by a standby letter of credit)	2,356	2,516
<i>Government Mortgage Notes:</i>		
Interest at 3.0%, principal due monthly until May 1, 2011 (collateralized by a second mortgage on certain property and equipment at the Company's headquarters)	269	424
Interest at 2.0%, principal due monthly until March 1, 2011 (collateralized by certain equipment at the Company's headquarters)	34	56
	57,409	78,646
Less: current portion	(7,013)	(1,860)
	<u>\$50,396</u>	<u>\$76,786</u>

Long-term debt maturities as of September 30, 2009 are as follows (in thousands):

<u>Fiscal Year</u>	
2010	\$ 7,013
2011	1,196
2012	1,085
2013	46,475
2014	200
2015 and thereafter	1,440
	<u>\$ 57,409</u>

In November 2006, the Company's Board of Directors authorized the repurchase of \$25,000,000 principal amount of the Company's 11 1/4% senior notes (the "Senior Notes"). On December 8, 2006, the Company completed the repurchase of the authorized amount at 105.625% of the \$25,000,000 principal amount, plus accrued and unpaid interest. In connection with the December 2006 repurchase, the Company recorded a pretax charge totaling \$2,093,000, representing the premium paid of \$1,406,000 plus the write-off of unamortized debt issuance discount and deferred financing costs of \$687,000. On April 18, 2007, the Company completed the redemption of the remaining outstanding amount of its Senior Notes at 105.625% of the \$90,000,000 principal amount, plus accrued and unpaid interest. In connection with the April 2007 redemption, the Company recorded a pretax charge totaling \$7,330,000, representing the premium paid of \$5,063,000 plus the write-off of unamortized debt issuance discount and deferred financing costs of \$2,267,000.

On March 13, 2007, the Company entered into 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 and were used to redeem the remaining \$90,000,000 principal amount of the Senior Notes. The interest rate on the Term Loan is equal to, at the Company's election, either (i) the prime rate

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. LONG-TERM DEBT (Continued)

plus 1.00%, or (ii) a LIBOR rate plus the applicable margin. The applicable margin was initially fixed at 2.50% through and including the fiscal quarter ended September 30, 2007. Thereafter, the applicable margin for LIBOR rate borrowings is either 2.25% or 2.50%, depending on the Company's Consolidated Leverage Ratio (as defined). Based upon the Company's applicable quarterly Consolidated Leverage Ratio during fiscal 2008 and 2009, the applicable margin for LIBOR rate borrowings remained at 2.50% for fiscal 2008 and 2009. Based upon the Company's Consolidated Leverage Ratio as of September 30, 2009, the applicable margin for LIBOR rate borrowings will be 2.25% for the second quarter of fiscal 2010. The Company is required to make minimum repayments of the principal amount of the Term Loan in quarterly installments of \$225,000 each. The Company is also required to make an annual principal repayment equal to 25% or 50% of Excess Cash Flow (as defined) in excess of \$5,000,000 for each fiscal year, with the 25% or 50% factor depending on the Company's Consolidated Leverage Ratio. The required principal repayment for fiscal 2009, which was calculated based on the 25% factor, is \$5,765,000, is due in December 2009, and is reflected in "current portion of long-term debt" in the accompanying Consolidated Balance Sheet. The required principal repayment for fiscal 2008, which was calculated based on the 50% factor, was \$622,000 and was paid in December 2008. Future maturities of long-term debt for fiscal years 2011 and thereafter, included in the table above, do not include estimates of potential required excess cash flow principal repayments, if any. Additionally, the Term Loan can be prepaid at the Company's option, in part or in whole, at any time without any prepayment premium or penalty. During fiscal 2009 and 2008, the Company prepaid \$20,000,000 (including the \$622,000 prepayment required under the annual excess cash flow provision of the Term Loan) and \$13,000,000, respectively, of the outstanding Term Loan. At September 30, 2009, the Company's indebtedness under the Term Loan Agreement was \$54,750,000.

The Term Loan is secured by a security interest in the Company's accounts receivable, inventory, real estate interests, letter of credit rights, cash, intangibles and certain other assets. The security interest granted to the Term Lenders is, in certain respects, subordinate to the security interest granted to the Credit Facility Lender. The Term Loan Agreement imposes 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 contains quarterly financial covenants that require the Company to maintain a specified maximum permitted Consolidated Leverage Ratio and a specified minimum permitted Consolidated Interest Coverage Ratio (as defined). Since the inception of the Term Loan, the Company has been in compliance with the financial covenants of its Term Loan Agreement. Any amounts outstanding under the Term Loan may be accelerated and become due and payable immediately upon an event of default and expiration of any applicable cure period. Events of default include: (i) nonpayment of obligations due under the Term Loan, (ii) failure to perform any covenant or agreement contained in the Term Loan, (iii) material misrepresentations, (iv) failure to pay, or certain other defaults under, other material indebtedness of the Company, (v) certain bankruptcy or insolvency events, (vi) a change of control, (vii) material uninsured losses, (viii) indictments of the Company or senior management in a material forfeiture action, and (ix) customary ERISA defaults, among others.

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 that commenced on April 18, 2007, the date the \$90,000,000 Term Loan proceeds were received, and expires on April 18, 2012. The interest rate swap agreement enables 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 of LIBOR plus 2.50% (subject to reduction to LIBOR plus 2.25% if the Company achieves a specified leverage ratio), to a fixed interest rate of 7.50% (subject to reduction to 7.25% if the Company achieves a specified leverage ratio) for the significant majority of the Term Loan. The notional amount of the interest rate swap was \$75,000,000 at the inception of the swap agreement and decreases over time to a notional amount of \$5,000,000 at the expiration date. The notional

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. LONG-TERM DEBT (Continued)

amount of the swap was \$42,500,000 as of September 30, 2009 and over the next eighteen months decreases as follows: to \$35,000,000 starting October 19, 2009; to \$27,500,000 starting April 19, 2010; and to \$20,000,000 starting October 18, 2010. As of September 30, 2009 and 2008, the estimated fair value of the interest rate swap was an unrealized loss of \$(2,025,000) and \$(1,404,000), respectively, which were included in “deferred rent and other non-current liabilities” in the accompanying Consolidated Balance Sheets. During the years ended September 30, 2009, 2008 and 2007, pretax (loss) gain of \$(1,413,000), \$(720,000), and \$121,000, respectively, associated with the exchange of interest rate payments under the swap agreement were included as “interest expense” in the accompanying Consolidated Statements of Operations. The Company expects to reclassify \$(1,433,000) of pretax unrealized loss from accumulated other comprehensive loss into interest expense in fiscal 2010.

In connection with the issuance of the Term Loan and the amendment of the Credit Facility (see Note 9), the Company incurred deferred financing costs of \$1,086,000. These deferred financing costs are being amortized over the term of the related debt agreement and are included in “interest expense” in the accompanying Consolidated Statements of Operations.

11. FAIR VALUE MEASUREMENTS

The Company adopted the accounting standard for fair value measurements on October 1, 2008. The accounting standard 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

A portion of the Company’s floating rate interest risk on variable rate long-term debt is mitigated through an interest rate swap agreement. The Company’s interest rate swap is required to be measured at fair value on a recurring basis. At September 30, 2009, the interest rate swap was a liability with a fair value of \$2,025,000, included in “deferred rent and other non-current liabilities” in the accompanying Consolidated Balance Sheet. The fair value of the interest rate swap was derived from a discounted cash flow analysis utilizing an interest rate yield curve that is readily available to the public or can be derived from information available in publicly quoted markets, which the Company considers to be Level 2 inputs.

The fair value accounting standards provide a company with the option to report selected financial assets and liabilities on an instrument-by-instrument basis at fair value and requires such company to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The Company adopted this reporting standard on October 1, 2008 and in accordance with implementation options, the Company chose not to elect the fair value option for its financial assets and liabilities that had not been previously measured at fair value.

12. COMMON AND PREFERRED STOCK

On July 29, 2008, the Company announced that its Board of Directors approved a program to repurchase up to \$7,000,000 of the Company’s outstanding common stock. Under the program, the Company may repurchase

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. COMMON AND PREFERRED STOCK (Continued)

shares from time to time through solicited or unsolicited transactions in the open market or in negotiated or other transactions. The program will be in effect until the end of July 2010. There were no repurchases of common stock under the program during fiscal 2009 and 2008.

The Company has authorization to issue up to 1,656,381 shares of preferred stock, par value \$0.01 with 300,000 shares authorized Series B Junior Participating Preferred Stock ("Series B Preferred Stock"). There was no preferred stock issued or outstanding as of September 30, 2009 or 2008.

The Series B Preferred Stock can be purchased in units equal to one one-thousandth of a share (the "Series B Units") under the terms of the Rights Agreement (see Note 13). The holders of the Series B Units are entitled to receive dividends when and if declared on common stock. Series B Units are junior to the common stock for both dividends and liquidations. Each Series B Unit votes as one share of common stock.

13. RIGHTS AGREEMENT

On October 9, 2005, the Company entered into an Amended and Restated Rights Agreement to renew its then existing Rights Agreement (collectively referred to as the "Rights Agreement") that would otherwise have expired on October 9, 2005. Under the Rights Agreement, the Company provided and will provide one Right (the "Right") for each share of Destination Maternity Corporation common stock now or hereafter outstanding. Under certain limited conditions, as defined in the Rights Agreement, each Right entitles the registered holder to purchase from the Company one Series B Unit at \$85 per share, subject to adjustment. The Rights expire on October 9, 2015 (the "Final Expiration Date").

The Rights Agreement provides the independent directors of the Company with some discretion in determining when the Distribution Date (as defined in the Rights Agreement) shall occur and the date until which the Rights may be redeemed. In addition, the Rights Agreement exempts from its operation any person that acquires, obtains the right to acquire, or otherwise obtains beneficial ownership of 15.0% or more of the then outstanding shares of the Company's common stock (an "Acquiring Person") without any intention of changing or influencing control of the Company provided that such person, as promptly as practicable, divests himself or itself of a sufficient number of shares of common stock so that such person would no longer be an Acquiring Person.

The Rights are not exercisable until the Distribution Date, which will occur upon the earlier of (i) ten business days following a public announcement that an Acquiring Person has acquired beneficial ownership of 15.0% or more of the Company's outstanding common stock, and ten business days following the commencement of a tender offer or exchange offer that would result in a person or group owning 15.0% or more of the Company's outstanding common stock, or (ii) such later date as may be determined by action of a majority of the independent directors. The Rights have certain anti-takeover effects. The Rights will cause substantial dilution to a person or group that attempts to acquire the Company without conditioning the offer on the redemption of the Rights.

The Rights can be mandatorily redeemed by action of a majority of the independent directors at any time prior to the earlier of the Final Expiration Date and the Distribution Date for \$0.01 per Right. Upon exercise and the occurrence of certain events, as defined in the Rights Agreement, each holder of a Right, except the Acquiring Person, will have the right to receive Series B Units, or common stock of the acquiring company, in each case having a value equal to two times the exercise price of the Right.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. EQUITY AWARD PLANS

The Company has three equity award plans: the Director Stock Option Plan (the "Director Plan"), the Amended and Restated 1987 Stock Option Plan (the "1987 Plan") and the Amended and Restated 2005 Equity Incentive Plan (the "2005 Plan"). The Director Plan expired on December 31, 2004 and no further awards may be granted under the Director Plan. The 1987 Plan expired on December 9, 2007, and no further awards may be issued under the 1987 Plan. Options issued under the Director Plan and the 1987 Plan will remain outstanding until they have expired, been exercised or have otherwise terminated. Up to a total of 2,175,000 options were able to be issued under the 1987 Plan and the Director Plan (including up to a total of 200,000 options which were issuable under the Director Plan). In January 2006, the stockholders of the Company approved the adoption of the 2005 Plan and, in January 2009, approved an amendment to increase the number of issuable shares. Under the 2005 Plan, employees, directors, consultants and other individuals who provide services to the Company, may be granted awards in the form of options, stock appreciation rights, restricted stock or restricted stock units. Up to 700,000 shares of the Company's common stock may be issued in respect of awards under the 2005 Plan, with no more than 350,000 of those shares permitted to be issued in respect of restricted stock or restricted stock units granted under the 2005 Plan. Awards of options to purchase the Company's common stock will have exercise prices as determined by the Compensation Committee of the Board of Directors (the "Compensation Committee"), but such exercise prices may not be lower than the fair market value of the stock on the date of grant.

No options have been granted by the Company with an exercise price less than the fair market value of the Company's common stock on the date of grant for any of the periods presented. The majority of the options issued under the plans vest ratably over a five-year period, although some options vest immediately, and options issued under the plans generally expire ten years from the date of grant. Restricted stock awards issued under the 2005 Plan have restrictions that lapse ratably over periods ranging from one to five years. Each non-employee director of the Company's Board of Directors is granted 2,000 shares of restricted stock on an annual basis that will vest one year from the date of grant. The Company issues new shares of common stock upon exercise of vested options. As of September 30, 2009, there were 259,213 shares of the Company's common stock available for grant under the 2005 Plan, with no more than 150,213 of those shares permitted to be issued in respect of restricted stock or restricted stock units granted under the 2005 Plan.

Stock option activity for all plans was as follows:

	Outstanding Options (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Life (years)	Aggregate Intrinsic Value (in thousands)
Balance—September 30, 2008	923	\$ 13.34		
Granted	16	7.03		
Exercised	(5)	11.92		
Forfeited	(19)	21.13		
Expired	(69)	12.68		
Balance—September 30, 2009	<u>846</u>	\$ 13.11	5.5	<u>\$ 4,923</u>
Exercisable—September 30, 2009	<u>547</u>	\$ 13.11	4.2	<u>\$ 3,323</u>

As of September 30, 2009, \$3,360,000 of total unrecognized compensation cost related to non-vested awards is expected to be recognized over a weighted-average period of 1.54 years. During the years ended September 30, 2009, 2008 and 2007, the total intrinsic value of options exercised was \$41,000, \$469,000 and \$6,517,000, respectively. The total cash received from these option exercises was \$55,000, \$692,000 and \$3,737,000, respectively, and the actual tax benefit realized for the tax deductions from these option exercises

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. EQUITY AWARD PLANS (Continued)

was \$15,000, \$175,000 and \$2,541,000, respectively. During fiscal 2007, \$1,422,000 of compensation cost recognized in fiscal 2006 and recorded as a liability was reclassified to additional paid-in capital in conjunction with a modification of the original award.

On September 26, 2008, the Company granted to an executive officer two stock options, each to purchase 100,000 shares of common stock, under the 2005 Plan (see Note 17). The first stock option vests ratably over a five-year period. The second stock option vests ratably over a five-year period and is subject to the further condition that, on or before the fifth anniversary of the grant date, the closing price for a share of the Company's common stock shall have exceeded \$30.00 for a period of 30 consecutive trading days.

The weighted average fair value of stock options granted during fiscal 2009 and 2008 was estimated to be \$3.66 and \$7.50 per option share, respectively. No options were granted during fiscal 2007. The weighted average fair value of each option granted is calculated on the date of grant using the Black-Scholes option pricing model for most option grants and a Monte Carlo Simulation option pricing model for the fiscal 2008 grant that included a market condition. Weighted-average assumptions for option grants were as follows:

	Year Ended September 30,		
	2009	2008	2007
Dividend yield	none	none	—
Expected price volatility	57%	57%	—
Risk-free interest rates	2.2%	3.0%	—
Expected lives	5.4	6.6	—
	years	years	—

Expected volatility was determined using a weighted average of the historic volatility of the Company's common stock as of the option grant date measured over a period equal to the expected life of the grant. Risk-free interest rates were based on the U. S. Treasury yield curve in effect at the date of the grant. Expected lives were determined using a weighted average of the historic lives of previously issued grants of the Company's options.

The following table summarizes information about stock options outstanding as of September 30, 2009:

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number Outstanding</u> (in thousands)	<u>Weighted Average Remaining Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable</u> (in thousands)	<u>Weighted Average Exercise Price</u>
\$ 7.40 to \$ 9.00	53	4.2	\$ 7.59	37	\$ 7.84
9.01 to 10.00	121	1.0	9.50	121	9.50
10.01 to 12.00	140	5.8	10.05	86	10.07
12.01 to 13.00	224	5.3	12.85	190	12.85
13.01 to 14.00	215	8.7	13.74	35	13.73
14.01 to 23.00	25	5.6	15.99	18	15.72
23.01 to 24.00	24	4.1	23.62	24	23.62
24.01 to 37.05	44	5.0	30.19	36	30.09
\$ 7.40 to \$37.05	846	5.5	\$ 13.11	547	\$ 13.11

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. EQUITY AWARD PLANS (Continued)

Restricted stock activity for the 2005 Plan was as follows:

	Outstanding Shares (in thousands)	Weighted Average Grant Date Fair Value
Nonvested—September 30, 2008	117	\$ 32.98
Granted	44	8.19
Vested	(53)	35.76
Forfeited	(6)	24.71
Nonvested—September 30, 2009	<u>102</u>	<u>\$ 21.36</u>

15. INCOME TAXES

For the years ended September 30, the income tax provision (benefit) was comprised of the following (in thousands):

	2009	2008	2007
Current provision	\$5,262	\$ 359	\$ 2,898
Deferred provision (benefit)	1,318	(969)	(3,067)
	<u>\$6,580</u>	<u>\$ (610)</u>	<u>\$ (169)</u>
Federal provision (benefit)	\$5,416	\$(1,062)	\$ (275)
State provision	1,164	452	106
	<u>\$6,580</u>	<u>\$ (610)</u>	<u>\$ (169)</u>

The reconciliations of the statutory federal tax rate to the Company's effective income tax rates for the years ended September 30 were as follows:

	2009	2008	2007
Statutory federal tax rate	(35.0)%	(34.0)%	(34.0)%
State tax rate, net of federal benefit	1.7	7.9	15.9
Impact of goodwill impairment	51.7	—	—
Provision for uncertain income tax positions, net of federal benefit	0.7	6.3	—
Other	<u>0.2</u>	<u>(10.7)</u>	<u>(12.0)</u>
	<u>19.3%</u>	<u>(30.5)%</u>	<u>(30.1)%</u>

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. INCOME TAXES (Continued)

The deferred tax effects of temporary differences giving rise to the Company's net deferred tax assets as of September 30 were as follows (in thousands):

	2009	2008
Deferred tax assets:		
Net operating loss carryforwards	\$ 304	\$ 2,076
Tax credit carryforwards	—	472
Depreciation	3,045	3,012
Deferred rent	9,395	9,558
Inventory reserves	708	903
Employee benefit accruals	2,116	1,750
Pension benefits	2,051	2,196
Stock-based compensation	1,250	1,442
Other accruals	1,745	1,243
Other	1,673	1,736
	<u>22,287</u>	<u>24,388</u>
Deferred tax liability:		
Prepaid expenses	(839)	(823)
	<u>\$21,448</u>	<u>\$23,565</u>

As of September 30, 2009, the Company has net operating loss carryforwards for federal tax purposes of \$870,000, which were acquired in a fiscal 2002 business acquisition and are subject to annual deduction limitations due to the change in ownership. The net operating loss carryforwards begin to expire in 2021. The Company does not expect the limitations on the acquired net operating loss carryforwards to reduce its ability to ultimately use such carryforwards. The tax benefit of the acquired net operating loss carryforwards was recorded under the purchase method of accounting.

No valuation allowance has been provided for the net deferred tax assets. Based on the Company's historical and projected levels of taxable income, management believes it is more likely than not that the Company will realize the net deferred tax assets as of September 30, 2009. There can be no assurance that the Company will generate taxable earnings or any specific level of earnings in the future.

The Company does not record state tax benefits associated with temporary differences for certain states in which it is operating, given the continued historical uncertainty related to realizing such state tax benefits. Had the state tax benefits been reflected for these states, the deferred tax assets (excluding net operating loss carryforwards) as of September 30, 2009 would be approximately \$830,000 higher. In June 2006, the FASB issued an accounting standard for uncertain income tax positions that clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements and also contains guidance on the measurement of uncertain tax positions. The Company adopted the provisions of the accounting standard for uncertain income tax positions effective as of October 1, 2007. In accordance with the standard, during the first quarter of fiscal 2008, the Company recorded a cumulative effect adjustment of \$74,000, decreasing the liability for unrecognized tax benefits and increasing the September 30, 2007 balance of retained earnings.