

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Destination Maternity Corporation:

We have audited the accompanying consolidated balance sheets of Destination Maternity Corporation and subsidiaries as of September 30, 2013 and 2012, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the years in the three-year period ended September 30, 2013. In connection with our audits of the consolidated financial statements, we also have audited the related financial statement schedule, Valuation and Qualifying Accounts. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Destination Maternity Corporation and subsidiaries as of September 30, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 2013, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Destination Maternity Corporation's internal control over financial reporting as of September 30, 2013, based on criteria established in *Internal Control—Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated December 13, 2013 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Philadelphia, Pennsylvania
December 13, 2013

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)

	September 30,	
	2013	2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 24,555	\$ 22,376
Trade receivables, net	12,463	13,197
Inventories	86,546	88,754
Deferred income taxes	8,012	7,557
Prepaid expenses and other current assets	6,927	4,220
Total current assets	<u>138,503</u>	<u>136,104</u>
Property, plant and equipment, net	<u>53,447</u>	<u>51,078</u>
Other assets:		
Deferred financing costs, net of accumulated amortization of \$181 and \$751	807	92
Other intangible assets, net of accumulated amortization of \$1,166 and \$2,123	2,344	1,347
Deferred income taxes	12,470	10,667
Other non-current assets	410	356
Total other assets	<u>16,031</u>	<u>12,462</u>
Total assets	<u>\$ 207,981</u>	<u>\$ 199,644</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit borrowings	\$ —	\$ —
Current portion of long-term debt	—	15,257
Accounts payable	23,810	21,987
Accrued expenses and other current liabilities	39,417	35,544
Total current liabilities	<u>63,227</u>	<u>72,788</u>
Deferred rent and other non-current liabilities	<u>22,121</u>	<u>21,884</u>
Total liabilities	<u>85,348</u>	<u>94,672</u>
Commitments and contingencies (Note 15)		
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, 13,556,331 and 13,370,149 shares issued and outstanding, respectively	136	134
Additional paid-in capital	98,634	95,086
Retained earnings	23,930	9,786
Accumulated other comprehensive loss	(67)	(34)
Total stockholders' equity	<u>122,633</u>	<u>104,972</u>
Total liabilities and stockholders' equity	<u>\$ 207,981</u>	<u>\$ 199,644</u>

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

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share amounts)

	Year Ended September 30,		
	2013	2012	2011
Net sales	\$ 540,259	\$ 541,476	\$ 545,394
Cost of goods sold	249,298	250,765	248,497
Gross profit	290,961	290,711	296,897
Selling, general and administrative expenses	252,026	255,623	257,421
Store closing, asset impairment and asset disposal expenses	1,441	1,983	1,039
Other charges	—	—	193
Operating income	37,494	33,105	38,244
Interest expense, net	532	1,215	2,233
Loss on extinguishment of debt	9	22	37
Income before income taxes	36,953	31,868	35,974
Income tax provision	13,010	12,496	12,986
Net income	<u>\$ 23,943</u>	<u>\$ 19,372</u>	<u>\$ 22,988</u>
Net income per share—Basic	<u>\$ 1.80</u>	<u>\$ 1.48</u>	<u>\$ 1.79</u>
Average shares outstanding—Basic	<u>13,272</u>	<u>13,096</u>	<u>12,820</u>
Net income per share—Diluted	<u>\$ 1.78</u>	<u>\$ 1.46</u>	<u>\$ 1.75</u>
Average shares outstanding—Diluted	<u>13,439</u>	<u>13,267</u>	<u>13,120</u>

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

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	<u>Year Ended September 30,</u>		
	<u>2013</u>	<u>2012</u>	<u>2011</u>
Net income	\$ 23,943	\$ 19,372	\$ 22,988
Foreign currency translation adjustments	(33)	(16)	(18)
Change in fair value of interest rate swap, net of tax	—	90	490
Comprehensive income	<u>\$ 23,910</u>	<u>\$ 19,446</u>	<u>\$ 23,460</u>

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

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

	Common Stock		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total
	Number of Shares	Amount				
Balance as of September 30, 2010	12,691	\$ 127	\$ 88,399	\$ (16,348)	\$ (580)	\$ 71,598
Net income	—	—	—	22,988	—	22,988
Change in fair value of interest rate swap, net of tax	—	—	—	—	490	490
Foreign currency translation adjustments	—	—	—	—	(18)	(18)
Cash dividends	—	—	—	(6,901)	—	(6,901)
Stock-based compensation	117	1	2,343	—	—	2,344
Exercise of stock options, net	547	5	2,280	—	—	2,285
Excess tax benefit from stock option exercises and restricted stock vesting	—	—	2,695	—	—	2,695
Repurchase and retirement of common stock	(129)	(1)	(2,785)	—	—	(2,786)
Balance as of September 30, 2011	13,226	132	92,932	(261)	(108)	92,695
Net income	—	—	—	19,372	—	19,372
Change in fair value of interest rate swap, net of tax	—	—	—	—	90	90
Foreign currency translation adjustments	—	—	—	—	(16)	(16)
Cash dividends	—	—	—	(9,325)	—	(9,325)
Stock-based compensation	91	1	2,356	—	—	2,357
Exercise of stock options, net	84	1	106	—	—	107
Excess tax benefit from stock option exercises and restricted stock vesting	—	—	289	—	—	289
Repurchase and retirement of common stock	(31)	—	(597)	—	—	(597)
Balance as of September 30, 2012	13,370	134	95,086	9,786	(34)	104,972
Net income	—	—	—	23,943	—	23,943
Foreign currency translation adjustments	—	—	—	—	(33)	(33)
Cash dividends	—	—	—	(9,799)	—	(9,799)
Stock-based compensation	97	1	2,770	—	—	2,771
Exercise of stock options, net	123	1	743	—	—	744
Excess tax benefit from stock option exercises and restricted stock vesting	—	—	760	—	—	760
Repurchase and retirement of common stock	(34)	—	(725)	—	—	(725)
Balance as of September 30, 2013	13,556	\$ 136	\$ 98,634	\$ 23,930	\$ (67)	\$ 122,633

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,		
	2013	2012	2011
Operating Activities			
Net income	\$ 23,943	\$ 19,372	\$ 22,988
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	12,424	12,445	12,769
Stock-based compensation expense	2,771	2,357	2,344
Loss on impairment of long-lived assets	786	1,876	768
Loss on disposal of assets	528	115	270
Loss on extinguishment of debt	9	22	37
Deferred income tax (benefit) provision	(3,007)	(1,378)	2,679
Amortization of deferred financing costs	203	105	170
Changes in assets and liabilities:			
Decrease (increase) in:			
Trade receivables	727	(2,188)	(680)
Inventories	2,205	1,611	(9,632)
Prepaid expenses and other current assets	(2,708)	2,577	(1,634)
Other non-current assets	(54)	(12)	(26)
Increase (decrease) in:			
Accounts payable, accrued expenses and other current liabilities	4,058	6,201	(5,525)
Deferred rent and other non-current liabilities	268	(406)	(3,085)
Net cash provided by operating activities	<u>42,153</u>	<u>42,697</u>	<u>21,443</u>
Investing Activities			
Capital expenditures	(15,059)	(9,256)	(12,270)
Additions to intangible assets	(963)	(265)	(313)
Withdrawal from grantor trust	—	—	1,504
Net cash used in investing activities	<u>(16,022)</u>	<u>(9,521)</u>	<u>(11,079)</u>
Financing Activities			
Increase (decrease) in cash overdrafts	1,278	(401)	(1,147)
Repayment of long-term debt	(15,257)	(16,085)	(13,819)
Deferred financing costs paid	(927)	(61)	(26)
Withholding taxes on stock-based compensation paid in connection with repurchase of common stock	(725)	(597)	(2,786)
Cash dividends paid	(9,799)	(9,325)	(6,901)
Proceeds from exercise of stock options	744	107	2,285
Excess tax benefit from exercise of stock options and restricted stock vesting	760	289	2,695
Net cash used in financing activities	<u>(23,926)</u>	<u>(26,073)</u>	<u>(19,699)</u>
Effect of exchange rate changes on cash and cash equivalents	(26)	(12)	(13)
Net Increase (Decrease) in Cash and Cash Equivalents	<u>2,179</u>	<u>7,091</u>	<u>(9,348)</u>
Cash and Cash Equivalents, Beginning of Year	<u>22,376</u>	<u>15,285</u>	<u>24,633</u>
Cash and Cash Equivalents, End of Year	<u>\$ 24,555</u>	<u>\$ 22,376</u>	<u>\$ 15,285</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 and subsidiaries (the "Company") is a specialty designer and retailer of maternity clothing. The Company operated 1,907 retail locations as of September 30, 2013, including 596 stores and 1,311 leased departments, throughout the United States, Puerto Rico and Canada, and markets its maternity apparel on the Internet through its DestinationMaternity.com and brand-specific websites. The Company also markets maternity apparel at Kohl's® stores throughout the United States under an exclusive product and license agreement. Further the Company has store franchise and product supply relationships in the Middle East, South Korea and India. The Company was incorporated in Delaware in 1982.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Principles of Consolidation and Basis of Financial Statement Presentation

The accompanying consolidated financial statements include the accounts of the Company and its direct and indirect wholly-owned subsidiaries: Cave Springs, Inc., Mothers Work Canada, Inc., Destination Maternity Apparel Private Limited and Mothers Work Services, Inc. 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 2013" ended on September 30, 2013.

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. Book cash overdrafts, which are outstanding checks in excess of funds on deposit, of \$4,730,000 and \$3,452,000 were included in accounts payable as of September 30, 2013 and 2012, 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. 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.

f. 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. 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 fair value of the asset with the carrying value. During fiscal 2013, 2012 and 2011, the Company recorded impairment write-downs of property, plant and equipment totaling \$754,000, \$1,875,000 and \$759,000, respectively, on a pretax basis.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

g. Intangible Assets

Intangible assets with definite useful lives consist primarily of patent and lease acquisition costs. The Company capitalizes legal costs incurred to defend its patents when a successful outcome is deemed probable and to the extent of an evident increase in the value of the patents. Intangible assets 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 2013 the Company capitalized \$1,093,000 of legal costs incurred in connection with a lawsuit asserting infringement of Company patents. During fiscal 2013, 2012 and 2011, the Company recorded write-downs of intangible assets totaling \$32,000, \$1,000 and \$9,000, respectively, on a pretax basis. The Company has not identified any indefinite-lived intangible assets. Aggregate amortization expense of intangible assets in fiscal 2013, 2012 and 2011 was \$149,000, \$142,000 and \$135,000, respectively.

Estimated amortization expense of the Company's intangible assets as of September 30, 2013, for the next five fiscal years, is as follows (in thousands):

<u>Fiscal Year</u>	
2014	\$ 198
2015	180
2016	175
2017	168
2018	163

h. Interest Rate Derivatives

The Company mitigated a portion of its floating rate interest risk on variable rate long-term debt through an interest rate swap agreement that expired on April 18, 2012. 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") and recognized the derivative on the balance sheet at fair value. In accordance with applicable accounting standards for derivative instruments, changes in the fair value of a derivative that is designated as, and meets all the criteria for, a cash flow hedge were recorded in accumulated other comprehensive loss and reclassified into earnings as the underlying hedged item affected earnings. The Company formally documented the relationship between the hedging instrument and hedged items. The Company formally assessed at the inception of the hedge and on a quarterly basis, whether the derivative was highly effective in offsetting changes in cash flows of the hedged item. For fiscal 2012 and 2011, the Company's interest rate swap was determined to have no ineffectiveness.

i. Deferred Financing Costs

Deferred financing costs are amortized to interest expense over the term of the related debt agreement. Amortization expense of deferred financing costs in fiscal 2013, 2012 and 2011 was \$203,000, \$105,000 and \$170,000, respectively. In connection with debt extinguishments, in fiscal 2013, 2012 and 2011 the Company wrote off \$9,000, \$22,000 and \$37,000, respectively, of unamortized deferred financing costs (see Note 9). In connection with its current credit facility entered into on November 1, 2012, the Company incurred approximately \$988,000 in deferred financing costs, of which \$927,000 was paid in fiscal 2013 and \$61,000 was paid in fiscal 2012 (see Note 8).

Estimated amortization expense of the Company's deferred financing costs as of September 30, 2013 is as follows (in thousands):

<u>Fiscal Year</u>	
2014	\$ 198
2015	198
2016	198
2017	198
2018	15

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

j. 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.

k. 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.

l. Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, 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 bore interest at variable rates, which adjusted based on market conditions, and the carrying value of the long-term debt approximated fair value. The fair value of the Company's debt was determined using a discounted cash flow analysis based on interest rates available to the Company. A significant portion of the Company's floating rate interest risk on variable rate long-term debt was mitigated through an interest rate swap agreement that expired on April 18, 2012.

m. 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 delivered to customers for licensed brand product and Internet sales, and when merchandise is shipped to international franchisees. A liability is established for the retail value of gift cards sold and merchandise credits issued. The liability is relieved and revenue is recognized when gift cards or merchandise credits are redeemed by customers as tender for merchandise purchased. 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.

n. 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. Revenue from marketing partnership programs is recognized when goods or services are provided. Also included in net sales are fees and royalties related to international franchise agreements. International franchise fees are earned by the Company when all material services or conditions related to the international 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.

o. Cost of Goods Sold

Cost of goods sold in the accompanying Consolidated Statements of Income 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.

p. Shipping and Handling Fees and Costs

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

q. Selling, General and Administrative Expenses

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

r. Advertising Costs

The Company expenses the costs of advertising when the advertising first occurs. Advertising expenses, including Internet advertising expenses, were \$16,984,000, \$13,878,000 and \$11,712,000 in fiscal 2013, 2012 and 2011, respectively.

s. Stock-based Compensation

The Company recognizes employee stock-based compensation as a cost in the accompanying Consolidated Statements of Income. Stock-based awards are measured at the grant date fair value and are recorded generally on a straight-line basis over the vesting period, net of estimated forfeitures. Excess tax benefits related to stock option exercises and restricted stock vesting, which are recognized in stockholders' equity, are reflected as financing cash inflows.

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.

Under the accounting standard for uncertain income tax positions, recognition of a tax benefit occurs when a tax position is estimated by management to be 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. Recognized tax positions are measured at the largest amount that management believes has a greater than 50% likelihood of being finalized. The Company records interest and penalties related to unrecognized tax benefits in income tax provision.

v. Net Income per Share 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 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 lapse of restrictions on restricted stock awards and exercise of stock options into shares of common stock as if those stock options were exercised. 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 13).

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The following table summarizes those effects for the diluted net income per share calculation (in thousands, except per share amounts):

	Year Ended September 30,		
	2013	2012	2011
Net income	\$ 23,943	\$ 19,372	\$ 22,988
Net income per share—Basic	\$ 1.80	\$ 1.48	\$ 1.79
Net income per share—Diluted	\$ 1.78	\$ 1.46	\$ 1.75
Average number of shares outstanding—Basic	13,272	13,096	12,820
Incremental shares from the assumed exercise of outstanding stock options	108	122	239
Incremental shares from the assumed lapse of restrictions on restricted stock awards	59	49	61
Average number of shares outstanding—Diluted	13,439	13,267	13,120

In addition to performance-based RSUs, for fiscal 2013, 2012 and 2011, stock options and unvested restricted stock totaling approximately 196,000, 321,000 and 164,000 shares, respectively, were excluded from the calculation of Diluted EPS as their effect would have been antidilutive.

On January 26, 2011, the Company announced the initiation of a regular quarterly cash dividend. During fiscal 2013, 2012 and 2011 the Company paid cash dividends totaling \$9,799,000 (\$0.725 per share), \$9,325,000 (\$0.70 per share) and \$6,901,000 (\$0.525 per share), respectively. On November 14, 2013 the Company declared a quarterly cash dividend of \$0.1875 per share payable on December 27, 2013, which will require approximately \$2,600,000 of available cash.

w. Statements of Cash Flows

In fiscal 2013, 2012 and 2011, the Company paid interest, including payments made on its interest rate swap agreement (see Note 9), of \$360,000, \$1,359,000 and \$2,266,000, respectively, and made income tax payments, net of refunds, of \$16,188,000, \$7,432,000 and \$9,804,000, respectively.

x. Business and Credit Risk

Financial instruments, primarily cash and cash equivalents and trade receivables, potentially subject the Company to concentrations of credit risk. The Company limits its credit risk associated with cash and cash equivalents by placing such investments in highly liquid funds and instruments. Trade receivables associated with third-party credit cards are processed by financial institutions, which are monitored for financial stability. Trade receivables associated with licensed brand, leased department, international franchise and other relationships are evaluated for collectibility based on a combination of factors, including aging of trade receivables, write-off experience and past payment trends. 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 2013, 2012 or 2011. A significant majority of the Company's purchases during fiscal 2013, 2012 and 2011 were imported. Management believes that any event causing a disruption of imports from any specific country could be mitigated by moving production to readily available alternative sources.

y. Insurance

The Company is self-insured for workers' compensation, general liability and automotive liability claims, and employee-related healthcare claims, 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 for loss occurrences prior to March 1, 2010. 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.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

z. 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.

aa. Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU No. 2013-11 requires presentation of an unrecognized tax benefit in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit would be presented in the financial statements as a liability and would not be combined with deferred tax assets. ASU No. 2013-11 is effective for financial statements issued for annual reporting periods beginning after December 15, 2013 and interim periods within those years. Adoption of the new requirements of ASU No. 2013-11 is not expected to have a material impact on the Company's consolidated financial position or results of operations.

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 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 deferred 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.

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 September 30, 2013 and 2012, the Company's trade receivables were net of allowance for doubtful accounts of \$147,000 and \$201,000, respectively.

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

4. INVENTORIES

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

	<u>2013</u>	<u>2012</u>
Finished goods	\$ 79,087	\$ 82,795
Work-in-progress	2,709	2,804
Raw materials	4,750	3,155
	<u>\$ 86,546</u>	<u>\$ 88,754</u>

5. PROPERTY, PLANT AND EQUIPMENT, NET

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

	<u>2013</u>	<u>2012</u>
Land	\$ 1,400	\$ 1,400
Building and improvements	16,211	15,843
Furniture and equipment	73,363	69,504
Leasehold improvements	88,298	84,702
	<u>179,272</u>	<u>171,449</u>
Less: accumulated depreciation and amortization	(125,825)	(120,371)
	<u>\$ 53,447</u>	<u>\$ 51,078</u>

Aggregate depreciation and amortization expense of property, plant and equipment in fiscal 2013, 2012 and 2011 was \$12,275,000, \$12,303,000 and \$12,634,000, respectively. During fiscal 2013, 2012 and 2011, the Company recorded pretax charges of \$754,000, \$1,875,000 and \$759,000, respectively, related to the impairment of leasehold improvements and furniture and equipment at certain of its retail locations.

6. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

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

	<u>2013</u>	<u>2012</u>
Employee compensation and benefits	\$ 9,243	\$ 5,918
Insurance, primarily self-insurance reserves	5,899	5,341
Gift certificates and store credits	4,182	4,194
Deferred rent	3,400	3,599
Sales taxes	2,876	3,097
Product return reserve	2,702	2,225
Accounting and legal	1,106	1,215
Income taxes payable	166	1,350
Other	9,843	8,605
	<u>\$ 39,417</u>	<u>\$ 35,544</u>

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

7. 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>2013</u>	<u>2012</u>
Deferred rent	\$ 21,132	\$ 21,245
Less: current portion included in accrued expenses and other current liabilities	(3,400)	(3,599)
Non-current deferred rent	17,732	17,646
Accrued income taxes	4,218	4,063
Other	171	175
	<u>\$ 22,121</u>	<u>\$ 21,884</u>

8. LINE OF CREDIT

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 credit facility (the "Prior Credit Facility"). The Credit Facility consists of two tranches: (1) a senior secured revolving credit and letter of credit facility of up to \$55,000,000 ("Tranche A") and (2) 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, were permitted to be used to repay then existing term loan or other debt (see Note 9), and may be used to provide financing for working capital, letters of credit, capital expenditures, dividends, share repurchases and other general corporate purposes.

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 (1) the lender's base rate plus the applicable margin, or (2) 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.

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: (1) nonpayment of obligations due under the Credit Facility, (2) failure to perform any covenant or agreement contained in the Credit Facility, (3) material misrepresentations, (4) failure to pay, or certain other defaults under, other material indebtedness of the Company, (5) certain bankruptcy or insolvency events, (6) a change of control, (7) material uninsured losses, (8) indictments of the Company or senior management in a material forfeiture action, and (9) customary ERISA defaults, among others.

In connection with the execution of the Credit Facility, the Company incurred deferred financing costs of \$988,000, of which \$927,000 was paid in fiscal 2013 and \$61,000 was paid in fiscal 2012. These deferred financing costs are being amortized over the term of the Credit Facility agreement and included in "interest expense, net" in the Consolidated Statements of Income. 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 various affirmative and negative covenants and representations and warranties. 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.

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

8. LINE OF CREDIT (Continued)

The Prior Credit Facility was amended on July 25, 2011 to decrease the maximum available for borrowings from \$65,000,000 to \$55,000,000 and to extend its maturity date from March 13, 2012 to January 13, 2013. The amendment also increased the Company's effective interest rate on borrowings, if any, by approximately 0.75% per annum and increased the applicable interest rate margins. 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 (see Note 9). The interest rate on outstanding borrowings was equal to, at the Company's election, either (1) the lender's prime rate plus the applicable margin, or (2) a LIBOR rate plus the applicable margin. From July 25, 2011 to November 1, 2012, the applicable margins were 0.75% for prime rate borrowings and 1.75% for LIBOR rate borrowings. Prior to July 25, 2011 there was no applicable margin for prime rate borrowings and the applicable margin for LIBOR rate borrowings was 1.00%. The applicable margins for both prime rate and LIBOR rate borrowings were the lowest available margins based upon the availability calculation made in accordance with the Prior Credit Facility.

As of September 30, 2013, the Company had no outstanding borrowings under the Credit Facility and \$5,695,000 in letters of credit, with \$55,305,000 of availability under the Credit Facility. As of September 30, 2012, the Company had no outstanding borrowings under the Prior Credit Facility and \$7,084,000 in letters of credit, with \$47,916,000 of availability under the Prior Credit Facility. As of September 30, 2013, Tranche A borrowings under the Credit Facility would have resulted in interest at a rate between approximately 1.68% and 3.75% per annum, and Tranche A-1 borrowings under the Credit Facility would have resulted in interest at a rate between approximately 3.18% and 5.25% per annum. During fiscal 2013 the Company's average level of direct borrowings (all of which were under the Credit Facility) was \$205,000, and the Company's maximum borrowings at any time were \$6,200,000. During fiscal 2012 and 2011 the Company did not have any direct borrowings under the Prior Credit Facility.

9. LONG-TERM DEBT

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

	2013	2012
Senior secured Term Loan B, variable interest (4.25% as of September 30, 2012), principal of \$225 due quarterly through December 31, 2012 with the remaining balance due March 13, 2013 (remaining balance of \$13,427 was prepaid on November 1, 2012)	\$ —	\$ 13,427
Industrial Revenue Bond, variable interest (0.45% as of September 30, 2012), principal due annually until September 1, 2020 (remaining balance of \$1,830 was prepaid on April 3, 2013)	—	1,830
	—	15,257
Less: current portion	—	(15,257)
	<u>\$ —</u>	<u>\$ —</u>

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 (see Note 8). The interest rate on the Term Loan was equal to, at the Company's election, either (1) the prime rate plus 1.00%, or (2) a LIBOR rate plus the applicable margin. During the first quarter of fiscal 2013 and during fiscal 2012 and 2011, the applicable margin for LIBOR rate borrowings was 2.25%, the lowest available margin based on the Company's 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. The Term Loan could be prepaid at the Company's option, in part or in whole, at any time without any prepayment premium or penalty. During fiscal 2013, 2012 and 2011, the Company prepaid \$13,427,000, \$15,000,000, and \$12,623,000 (including a \$2,623,000 prepayment, related to fiscal 2010 results, required under the annual excess cash flow provision of the Term Loan), respectively, of the outstanding Term Loan. There was no required principal repayment related to fiscal 2011 results.

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

9. LONG-TERM DEBT (Continued)

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 Prior Credit Facility lender. 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 fiscal 2012 and 2011, based on the Company's specified leverage ratios), to a fixed interest rate (7.25% during fiscal 2012 and 2011, 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. During the years ended September 30, 2012 and 2011, pretax losses of \$(144,000) and \$(808,000), respectively, associated with the exchange of interest rate payments under the swap agreement were included as "interest expense" in the accompanying Consolidated Statements of Income.

In connection with the issuance of the Term Loan and amendments of the Prior Credit Facility (see Note 8), the Company incurred deferred financing costs of \$1,112,000. These deferred financing costs were being amortized over the term of the related debt agreement and are included in "interest expense" in the accompanying Consolidated Statements of Income.

The Company had \$1,830,000 outstanding under an Industrial Revenue Bond ("IRB") at September 30, 2012, which was classified as a current liability in the accompanying consolidated balance sheet 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, at which time the Company had no further obligations, and the bonds had no further rights, under the indenture.

10. 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 September 30, 2013 and 2012, the Company had cash equivalents of \$20,425,000 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 bore interest at variable rates, which adjusted based on market conditions and the carrying value of the long-term debt approximated fair value. The fair value of the Company's debt was determined using a discounted cash flow analysis based on interest rates available to the Company, which the Company considered to be Level 2 inputs.

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

10. FAIR VALUE MEASUREMENTS (Continued)

A significant portion of the Company's floating rate interest risk on variable rate long-term debt was mitigated through an interest rate swap agreement that expired on April 18, 2012. The Company's interest rate swap was required to be measured at fair value on a recurring basis. The fair value of the interest rate swap was derived from a discounted cash flow analysis utilizing an interest rate yield curve that was readily available to the public, which the Company considered to be a Level 2 input.

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 has not elected the fair value option for its financial assets and liabilities that had not been previously measured at fair value.

11. COMMON AND PREFERRED STOCK

In July 2008, the Company's Board approved a program to repurchase up to \$7,000,000 of the Company's outstanding common stock. In July 2012, the Company's Board extended its authorization of the program from July 31, 2012 to July 31, 2014, and increased the amount of the Company's outstanding stock authorized to be repurchased from \$7,000,000 to \$10,000,000. Under the program, the Company may repurchase shares from time to time through solicited or unsolicited transactions in the open market or in negotiated or other transactions. No shares have been repurchased under this program as of September 30, 2013.

The Company has authorization to issue up to 1,656,381 shares of preferred stock, par value \$0.01, with 300,000 shares authorized for Series B Junior Participating Preferred Stock ("Series B Preferred Stock"). There was no preferred stock issued or outstanding as of September 30, 2013 or 2012.

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 12). 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.

12. RIGHTS AGREEMENT

In October 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 in October 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 (1) the earlier of 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 (2) 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)

13. EQUITY AWARD PLANS

The Company has three equity award plans: the 1994 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 4,350,000 options were able to be issued under the 1987 Plan and the Director Plan (including up to a total of 400,000 options which were issuable under the Director Plan), but 521,354 of these options became unavailable for grant upon the expiration of the 1987 Plan on December 9, 2007 and the expiration of the Director Plan on December 31, 2004. In January 2006, the stockholders of the Company approved the adoption of the 2005 Plan and, subsequently, have approved amendments 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 2,800,000 shares of the Company's common stock may be issued in respect of awards under the 2005 Plan, as amended, with no more than 1,500,000 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 (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 four or five-year periods, although some options have both market price and time vesting requirements, 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. The non-executive chairman of the Company's Board is granted 6,000 shares of restricted stock and each non-employee director, other than the non-executive chairman, of the Company's Board is granted 4,000 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, 2013, there were 1,095,106 shares of the Company's common stock available for grant under the 2005 Plan, with no more than 641,347 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:

	<u>Outstanding Options</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Life</u>	<u>Aggregate Intrinsic Value</u>
	(in thousands)		(years)	(in thousands)
Balance—September 30, 2012	607	\$ 13.05		
Granted	107	20.23		
Exercised	(163)	10.01		
Forfeited	(1)	10.70		
Expired	(2)	18.70		
Balance—September 30, 2013	<u>548</u>	\$ 15.35	6.9	<u>\$9,021</u>
Exercisable—September 30, 2013	<u>210</u>	\$ 11.40	5.2	<u>\$4,280</u>

During the years ended September 30, 2013, 2012 and 2011, the total intrinsic value of options exercised was \$2,080,000, \$1,544,000 and \$9,659,000, respectively. The total cash received from these option exercises was \$744,000, \$107,000 and \$2,285,000, respectively, and the actual tax benefit realized for the tax deductions from these option exercises was \$784,000, \$580,000 and \$3,617,000, respectively. During fiscal 2013, 2012 and 2011, options to purchase 101,949, 119,600 and 368,800 shares of common stock, respectively, with aggregate exercise prices of \$890,000, \$1,007,000 and \$2,428,000, respectively, were exercised by the option holders and net-share settled by the Company, such that the Company withheld 39,934, 51,041 and 109,926 shares of the Company's common stock, respectively, which had a fair market value equal to the aggregate exercise prices of the options.

The weighted average fair value of stock options granted during fiscal 2013, 2012 and 2011 was estimated to be \$7.98, \$6.17 and \$9.69 per option share, respectively. The weighted average fair value of each option granted is calculated on the date of grant using the Black-Scholes option pricing model.

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

13. EQUITY AWARD PLANS (Continued)

Weighted-average assumptions for option grants were as follows:

	Year Ended September 30,		
	2013	2012	2011
Expected dividend yield	3.5%	4.5%	3.2%
Expected price volatility	59.6%	63.0%	62.5%
Risk-free interest rate	0.8%	1.0%	2.4%
Expected life	5.5 years	5.5 years	5.8 years

Expected dividend yield was determined using a weighted average of the Company's annualized dividend rate compared to the market price of the Company's common stock as of the grant date. 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 United States 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, 2013:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
	(in thousands)	(years)		(in thousands)	
\$ 3.52 to \$ 6.50	35	3.0	\$ 5.10	30	\$ 5.41
6.51 to 7.00	90	4.6	6.87	90	6.87
7.01 to 14.00	92	5.9	11.79	27	11.55
14.01 to 19.00	85	8.2	15.96	13	16.88
19.01 to 20.00	105	9.1	19.86	1	19.17
20.01 to 22.00	40	7.7	20.62	16	20.62
22.01 to 29.63	101	7.5	22.43	33	22.13
\$ 3.52 to \$29.63	<u>548</u>	6.9	\$ 15.35	<u>210</u>	\$ 11.40

Restricted stock activity for the 2005 Plan was as follows:

	Outstanding Shares	Weighted Average Grant Date Fair Value
	(in thousands)	
Nonvested—September 30, 2012	215	\$ 16.02
Granted	107	20.98
Vested	(86)	14.52
Forfeited	(10)	16.75
Nonvested—September 30, 2013	<u>226</u>	\$ 18.92

In each of November 2012 and December 2011, the Compensation Committee established the performance goals for the award of performance-based RSUs for four executive officers, under the 2005 Plan. The RSUs earned, if any, under the November 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")

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

13. EQUITY AWARD PLANS (Continued)

will be based on the Company's cumulative operating income, as reflected in the Company's financial statements, with respect to 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 date 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.

As of September 30, 2013, \$5,143,000 of total unrecognized compensation cost related to all non-vested equity awards is expected to be recognized over a weighted-average period of 1.3 years.

During fiscal 2013, 2012 and 2011, 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 in connection with tax obligations, which were 34,125, 30,849 and 128,646, respectively, during fiscal 2013, 2012 and 2011, 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 \$725,000, \$597,000 and \$2,786,000 for fiscal 2013, 2012 and 2011, respectively.

14. INCOME TAXES

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

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Current provision	\$ 16,017	\$ 13,874	\$ 10,307
Deferred (benefit) provision	(1,791)	(1,378)	2,679
Deferred benefit of state net operating loss carryforwards, net of federal effect, recognized based on change in tax regulations	(1,216)	—	—
	<u>\$ 13,010</u>	<u>\$ 12,496</u>	<u>\$ 12,986</u>
Federal provision	\$ 11,485	\$ 8,517	\$ 12,047
State provision	380	2,170	924
Foreign provision	1,145	1,809	15
	<u>\$ 13,010</u>	<u>\$ 12,496</u>	<u>\$ 12,986</u>

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

14. INCOME TAXES (Continued)

A reconciliation of the statutory federal tax rate to the Company's effective income tax rates for the years ended September 30 follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Statutory federal tax rate	35.0%	35.0%	35.0%
State tax rate, net of federal benefit	2.7	2.7	3.3
Provision for (benefit from) uncertain income tax positions, net of federal effect	1.3	2.4	(1.5)
Benefit of state net operating loss carryforwards, net of federal effect, recognized based on change in tax regulations	(3.3)	—	—
Other	(0.5)	(0.9)	(0.7)
	<u>35.2%</u>	<u>39.2%</u>	<u>36.1%</u>

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):

	<u>2013</u>	<u>2012</u>
Deferred tax assets:		
Deferred rent	\$ 7,964	\$ 7,981
State net operating loss carryforwards	3,141	—
Employee benefit accruals	3,071	2,915
Depreciation and amortization	2,245	1,729
Stock-based compensation	1,029	733
Inventory reserves	745	637
Foreign tax credit carryforwards	—	447
Other accruals	3,203	2,866
Other	1,529	1,444
	<u>22,927</u>	<u>18,752</u>
Valuation allowance	(1,925)	—
	<u>21,002</u>	<u>18,752</u>
Deferred tax liability:		
Prepaid expenses	(520)	(528)
Net deferred tax assets	<u>\$ 20,482</u>	<u>\$ 18,224</u>

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, 2013. There can be no assurance that the Company will generate taxable earnings or any specific level of earnings in the future.

During fiscal 2013, the Company recognized a state income tax benefit, net of federal effect and a valuation allowance, of \$1,216,000, for the estimated carryforward tax benefit of certain state net operating losses, which had previously been projected to expire unused, based upon recently enacted changes in applicable state income tax regulations. The Company assessed that it was unlikely that sufficient future state specific taxable income will be generated to fully use the available state net operating loss carryforwards, and accordingly, a valuation allowance has been recorded to recognize only the portion of the deferred tax asset that is considered more likely than not to be realized. The Company does not record state tax benefits associated with temporary differences for certain other states in which it has net operating losses, 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 state net operating loss carryforwards) as of September 30, 2013 would be approximately \$679,000 higher.