be adversely impacted, as we may have difficulty shipping merchandise to our main distribution facility and retail locations, as well as fulfilling catalog and website orders.

The terms of our debt instruments impose financial and operating restrictions.

Our credit facility and the indenture governing the senior notes both contain restrictive covenants that limit our ability to engage in activities that may be in our long term best interests. These covenants limit or restrict, among other things, our ability to:

- incur additional indebtedness;
- pay dividends or make other distributions in respect of our equity securities, or purchase or redeem capital stock, or make certain investments;
- have our subsidiaries pay dividends, make loans or transfer assets to us;
- sell assets, including the capital stock of our subsidiaries;
- enter into any transactions with our affiliates;
- transfer any capital stock of any subsidiary or permit any subsidiary to issue capital stock;
- create liens;
- enter into certain sale/leaseback transactions; and
- effect a consolidation or merger or transfer of all or substantially all of our assets.

These limitations and restrictions may adversely affect our ability to finance our future operations or capital needs or engage in other business activities that may be in our best interests. In addition, our ability to borrow under the credit facility is subject to borrowing base requirements. If we breach any of the covenants in our credit facility or our indenture, we may be in default under our credit facility or our indenture. If we default, the holders of the senior notes or the lender under our credit facility could declare all borrowings owed to them, including accrued interest and other fees, to be due and payable.

Our share price may be volatile and could decline substantially.

The market price of our common stock has been, and is expected to continue to be, volatile, both because of actual and perceived changes in our financial results and prospects and because of general volatility in the stock market. The factors that could cause fluctuations in our share price may include, among other factors discussed in this section, the following:

- actual or anticipated variations in the financial results and prospects of our business or other companies in the retail business;
- changes in financial estimates by Wall Street research analysts;
- actual or anticipated changes in the U.S. economy or the retailing environment;
- changes in the market valuations of other specialty apparel or retail companies;
- announcements by our competitors or us;
- additions and departures of key personnel;
- changes in accounting principles;
- the passage of legislation or other developments affecting us or our industry;
- the trading volume of our common stock in the public market;

- changes in economic conditions;
- financial market conditions;
- natural disasters, terrorist acts, acts of war or periods of civil unrest;
- the realization of some or all of the risks described in this section entitled "Risk Factors"; and
- any goodwill impairment would require a write down that would likely negatively affect our stock price.

In addition, the stock markets have experienced significant price and trading volume fluctuations from time to time, and the market prices of the equity securities of retailers have been extremely volatile and have recently experienced sharp price and trading volume changes. These broad market fluctuations may adversely affect the market price of our common stock.

Our charter documents contain certain anti-takeover provisions, and we are entitled to certain other protective provisions under Delaware law.

We are a Delaware corporation and the anti-takeover provisions of Delaware law impose various impediments to the ability of a third party to acquire control of the Company, even if a change of control would be beneficial to our existing stockholders. We also have adopted a stockholder rights plan, commonly known as a "poison pill," that entitles our stockholders to acquire additional shares of us, or a potential acquirer of us, at a substantial discount to their market value in the event of an attempted takeover. In addition, our amended and restated certificate of incorporation and by-laws contain provisions that may discourage, delay or prevent a merger or acquisition involving us that our stockholders may consider favorable by, among other things:

- authorizing the issuance of preferred stock, the terms of which may be determined at the discretion of our board of directors;
- restricting the ability of stockholders to call special meetings of stockholders;
- providing for a classified board of directors, with staggered three-year terms; and
- establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at meetings.

These provisions may also reduce the market value of our common stock.

We do not expect to pay cash dividends in the foreseeable future.

We have not paid any cash dividends on our common stock since our initial public offering and do not anticipate paying cash dividends on our common stock in the foreseeable future. In addition, the terms of our senior notes and our credit facility significantly restrict our ability to declare or pay dividends on our common stock. Even if our ability to pay dividends was not restricted under the terms of the indenture governing our senior notes or our credit facility, any future payment of dividends would still be at the discretion of our board of directors and would be based upon any applicable restrictive financial covenants, earnings, capital requirements and our financial condition, among other factors, at the time any such dividend is considered.

Any increase in our sales and marketing efforts that target markets outside the U.S. would expose us to additional risks associated with international operations.

We believe that in the future, an opportunity for sales growth may come from the development of international sales. We may not be successful in these efforts, and other than our existing operations in

Canada, we presently have no commitment, agreement or plans relating to any product distribution or the development of selling operations outside of North America. International operations and sales subject us to risks and challenges that we would otherwise not face if we conducted our business only in the U.S. For example, we may depend on third parties to market our products through foreign sales channels, and we may be challenged by laws and business practices favoring local competitors. In addition, our ability to succeed in foreign markets will depend on our ability to protect our intellectual property. We must also adopt our pricing structure to address different pricing environments and may face difficulty in enforcing revenue collection internationally. To the extent we achieve significant sales outside of the U.S. in the future, we may have significant exposure to fluctuating foreign currency exchange rates.

We could have failures in our system of internal controls.

We maintain a documented system of internal controls which is reviewed and monitored by management, who meet regularly with our audit committee of the board of directors. We believe we have a well-designed system to maintain adequate internal controls on the business. We cannot assure you that there will not be any control deficiencies in the future. Should we become aware of any control deficiencies, we would report them to the audit committee and recommend prompt remediation. We have devoted significant resources to document, test, monitor and improve our internal controls and will continue to do so; however, we cannot be certain that these measures will ensure that our controls are adequate in the future or that adequate controls will be effective in preventing fraud. If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud. Any failures in the effectiveness of our internal controls could have a material adverse effect on our financial condition or operating results or cause us to fail to meet reporting obligations.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

We own our principal executive offices and distribution facility, which is located at 456 North Fifth Street, Philadelphia, Pennsylvania, subject to a mortgage under the terms of which we owe approximately $2.8 million as of September 30, 2006. This facility consists of approximately 318,000 square feet, of which approximately 45,000 square feet is dedicated to office space and the remaining square footage is used for finished goods warehousing and distribution. On August 26, 2002, we entered into a ten-year lease for a facility located at 2001 Kitty Hawk Avenue, Philadelphia, Pennsylvania in the Philadelphia Naval Business Center. The area leased at this facility, which we use for raw material cutting, warehousing and distribution, consists of approximately 64,000 square feet of space. To facilitate our store growth in Canada, we entered into a three-year lease commencing November 1, 2002 for approximately 12,000 square feet of finished goods warehouse and distribution space in Mississauga, Ontario in Canada. We renewed the lease in Canada through October 31, 2007. We believe that these facilities will be adequate to support our anticipated distribution needs for the near term and, potentially, longer. In the event we need additional space to meet our future distribution needs, we believe that such space would be readily available. Our facilities are subject to state and local regulations that range from building codes to health and safety.

We lease our store premises for terms averaging from seven to ten years. Certain leases allow us to terminate or reduce our obligations at specified points in time in the event that the applicable store does not achieve a specified sales volume. Some of our store leases also provide for contingent payments based on sales volume, escalations of the base rent, as well as increases in operating costs, marketing costs and real estate taxes.

As of September 30, 2006, the following number of store leases are set to expire as listed in the table below. We do not expect the expiration of any leases to have a material adverse impact on our business or operations.

Fiscal Year Leases Expire	Number of Stores
2007	88
2008	100
2009	121
2010	110
2011	69
2012 and later	322
Total	810

In addition to the stores we operate, we have arrangements with department and specialty stores, including Babies "R" Us, Bloomingdale's, Macy's and Sears, to operate maternity departments in their stores. These leased departments typically involve the lease partner collecting all of the revenue from the leased department. The revenue is remitted to us, less a fixed percentage of the volume earned by the lease partner as stipulated in the agreement. We provide at least some amount of staffing for each of the leased departments, with the amount varying depending on the specific arrangement.

Item 3. Legal Proceedings

On January 12, 2005, a purported class action was filed against us in the U.S. District Court for the District of Connecticut. The complaint alleged that, under applicable federal and state law, certain former and current employees should have received overtime compensation. The plaintiffs in this case sought unspecified actual damages, penalties and attorneys' fees. We understand that similar proceedings have been brought against other retail companies. In July 2006, the parties settled the outstanding claims and entered into a confidential settlement agreement, and on August 1, 2006, the District Court approved the settlement and dismissed the case. The terms of the settlement did not and will not have a material adverse effect on our results of operation or financial position.

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

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

PART II.

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is traded on the Nasdaq Global Market under the symbol "MWRK." The following table sets forth for the periods indicated below the reported high and low sales prices of our common stock as reported on the Nasdaq Global Market:

	High	Low
Fiscal Year Ended September 30, 2005:		
Quarter ended December 31, 2004	$ 18.66	$ 11.75
Quarter ended March 31, 2005	15.59	12.43
Quarter ended June 30, 2005	15.00	11.58
Quarter ended September 30, 2005	13.66	10.00
Fiscal Year Ended September 30, 2006:		
Quarter ended December 31, 2005	$ 13.19	$ 6.72
Quarter ended March 31, 2006	26.21	12.79
Quarter ended June 30, 2006	35.20	20.12
Quarter ended September 30, 2006	50.83	30.26

As of December 4, 2006, there were 917 holders of record and 2,695 estimated beneficial holders of our common stock.

We have not paid any cash dividends on our common stock since our initial public offering and do not anticipate paying cash dividends on our common stock in the foreseeable future. In addition, the terms of our 11¼% senior notes due 2010 (the "Senior Notes") and our credit facility significantly restrict our ability to declare or pay dividends on our common stock. Even if we were not restricted under the terms of our Senior Notes or our credit facility from being able to pay dividends, any future payment of dividends would still be at the discretion of our Board of Directors and would be based upon certain restrictive financial covenants, earnings, capital requirements and our financial condition, among other factors, at the time any such dividend is considered.

Up to a total of 1,975,000 options may be issued under our 1987 Stock Option Plan. Under our 2005 Equity Incentive Plan (the "2005 Plan"), awards may be granted in the form of options, stock appreciation rights, restricted stock or restricted stock units. Up to 500,000 shares of our common stock may be issued in respect of awards under our 2005 Plan, with no more than 250,000 of those shares permitted to be issued in respect of restricted stock or restricted stock units granted under the 2005 Plan.

Item 6. Selected Consolidated Financial and Operating Data

The following tables set forth selected data pertaining to the consolidated statement of operations, operating, cash flow and other, and balance sheet as of and for the periods indicated. The selected consolidated statement of operations and balance sheet data for each of the five fiscal years presented below are derived from our consolidated financial statements. You should read this information in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes included elsewhere in this report.

	Year Ended September 30,				
	2006	2005	2004	2003	2002 (1)
	(in thousands, except per share amounts)				
Statement of Operations Data:					
Net sales	$ 602,744	$ 561,627	$ 518,051	$ 492,447	$ 453,159
Cost of goods sold (2)	288,082	277,453	242,751	227,961	214,659
Gross profit	314,662	284,174	275,300	264,486	238,500
Selling, general and administrative expenses (2)	284,334	269,936	252,030	228,466	205,355
Operating income	30,328	14,238	23,270	36,020	33,145
Interest expense, net (2)	14,534	15,293	14,765	14,469	13,961
Loss on extinguishment of debt (1)(2)	873	—	—	—	2,515
Income (loss) before income taxes	14,921	(1,055)	8,505	21,551	16,669
Income tax provision (benefit)	5,819	(880)	3,466	8,337	6,269
Net income (loss)	9,102	(175)	5,039	13,214	10,400
Dividends on preferred stock (1)	—	—	—	—	3,942
Net income (loss) available to common stockholders	$ 9,102	$ (175)	$ 5,039	$ 13,214	$ 6,458
Net income (loss) per share—Basic	$ 1.70	$ (0.03)	$ 0.97	$ 2.52	$ 1.65
Average shares outstanding—Basic	5,348	5,242	5,212	5,236	3,914
Net income (loss) per share—Diluted	$ 1.63	$ (0.03)	$ 0.92	$ 2.34	$ 1.52
Average shares outstanding—Diluted	5,591	5,242	5,501	5,646	4,261

(1) In August 2002, as part of a refinancing, we repurchased our existing 12⅝% senior notes and Series A and Series C Preferred Stock and, in connection therewith, incurred $3.0 million of after-tax one-time charges, including approximately $2.6 million of non-cash charges.

(2) Fiscal 2002 has been reclassified from amounts previously reported to conform to the current year presentation.

	Year Ended September 30,				
	2006	2005	2004	2003	2002
	(unaudited; in thousands, except operating data and ratios)				
Operating Data:					
Comparable store sales increase (decrease) (1)	4.3 %	(2.5)%	(4.9)%	0.3 %	2.2%
Average net sales per gross square foot (2)	$ 305	$ 295	$ 311	$ 345	$ 362
Average net sales per store (2)	$ 570,000	$ 534,000	$ 537,000	$ 572,000	$ 589,000
Gross store square footage at period end (3)	1,532,000	1,579,000	1,569,000	1,451,000	1,231,000
Gross retail location square footage at period end (4)	1,819,000	1,874,000	1,693,000	1,541,000	1,313,000
Number of retail locations at period end:					
Motherhood Maternity stores	659	690	717	688	616
Mimi Maternity stores	106	117	121	119	104
A Pea in the Pod stores	33	37	41	44	43
Destination Maternity superstores	12	8	4	—	—
Total stores	810	852	883	851	763
Leased departments	731	739	232	155	146
Total retail locations	1,541	1,591	1,115	1,006	909
Other Financial Data:					
Adjusted EBITDA (5)	$ 51,715	$ 33,906	$ 40,579	$ 50,213	$ 45,422
Ratio of total debt to Adjusted EBITDA	2.3x	3.8x	3.2x	2.6x	2.8x
Ratio of Adjusted EBITDA to interest expense	3.6x	2.2x	2.7x	3.5x	3.3x
Cash flows provided by operating activities	42,413	7,324	18,256	36,139	31,056
Cash flows used in investing activities	(23,166)	(11,414)	(23,020)	(22,169)	(20,219)
Cash flows used in financing activities	(3,380)	(1,340)	(2,500)	(4,648)	(14,786)
Capital expenditures	13,933	17,644	21,540	25,344	12,242
Balance Sheet Data (at end of period):					
Working capital	$ 83,772	$ 71,228	$ 67,833	$ 62,708	$ 55,214
Total assets	287,736	273,317	271,370	263,536	247,139
Total debt	118,349	128,856	127,917	128,047	128,282
Stockholders' equity	80,700	63,328	62,903	58,858	45,708

(1) Comparable store sales figures represent sales at retail locations that have been in operation by Mothers Work for at least twelve full months at the beginning of the period for which such data is presented. As used in this Form 10-K, "retail locations" include stores and leased departments, and exclude locations where Kohl's sells our products under an exclusive product and license agreement.

(2) Based on stores in operation by Mothers Work during the entire twelve-month period (which does not include leased department or licensed relationships).

(3) Based on stores in operation by Mothers Work at the end of the period.

(4) Based on all retail locations in operation at the end of the period.

(5) Adjusted EBITDA represents operating income before deduction for the following non-cash charges: (i) depreciation and amortization expense; (ii) loss on impairment of long-lived assets; (iii) (gain) loss on disposal of assets; and (iv) stock-based compensation expense. We have presented Adjusted EBITDA to enhance your understanding of our operating results. Adjusted EBITDA is provided because management believes it is an important measure of financial performance used in the retail industry to measure operating results, to determine the value of companies within the industry and to define standards for borrowing from institutional lenders. We use Adjusted EBITDA as a measure of the performance of the Company. We provide Adjusted EBITDA to investors to assist them in performing their analysis of our historical operating results. Adjusted EBITDA reflects a measure of our operating results before consideration of certain non-cash charges and consequently, you should not construe Adjusted EBITDA as an alternative to net income (loss) or operating income as an indicator of our

operating performance, or as an alternative to cash flows from operating activities as a measure of our liquidity, as determined in accordance with generally accepted accounting principles. We may calculate Adjusted EBITDA differently than other companies. Presented below is a reconciliation of net income (loss) and operating income (the most directly comparable financial measures calculated and presented in accordance with GAAP) to Adjusted EBITDA.

Reconciliation of Net Income (Loss) to Adjusted EBITDA

(in thousands)

(unaudited)

	Year Ended September 30,				
	2006	2005	2004	2003	2002
Net income (loss)	$ 9,102	$ (175)	$ 5,039	$ 13,214	$ 10,400
Add: income tax provision (benefit)	5,819	(880)	3,466	8,337	6,269
Add: interest expense, net	14,534	15,293	14,765	14,469	13,961
Add: loss on extinguishment of debt	873	—	—	—	2,515
Operating income	30,328	14,238	23,270	36,020	33,145
Add: depreciation and amortization expense	16,118	15,502	14,270	12,930	11,789
Add: loss on impairment of long-lived assets	2,612	3,440	1,816	616	303
Add: (gain) loss on disposal of assets	(139)	726	1,223	647	185
Add: stock-based compensation expense	2,796	—	—	—	—
Adjusted EBITDA	$ 51,715	$ 33,906	$ 40,579	$ 50,213	$ 45,422

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The following discussion should be read in conjunction with the consolidated financial statements and their related notes included elsewhere in this report.

We are the leading designer and retailer of maternity apparel in the United States with 1,541 retail locations, including 810 stores in all 50 states, Puerto Rico and Canada and 731 leased departments. We operate our stores under the Motherhood Maternity, Mimi Maternity, A Pea in the Pod and Destination Maternity retail concepts and also sell our merchandise on the Internet at our MaternityMall.com and our brand-specific websites, as well as through an exclusive product and license agreement with Kohl's. In addition to our 810 stores, our retail locations include 731 leased departments within department and specialty stores. We design and contract manufacture approximately 90% of the merchandise we sell.

Critical Accounting Policies and Estimates

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. These generally accepted accounting principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our consolidated financial statements and the reported amounts of net sales and expenses during the reporting period.

Our significant accounting policies are described in Note 2 of "Notes to Consolidated Financial Statements." We believe that the following discussion addresses our critical accounting policies, which are those that are most important to the portrayal of our financial condition and results of operations and require management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. If actual results were to differ significantly from estimates made, future reported results could be materially affected. However, we are not currently aware of any reasonably likely events or circumstances that would result in materially different results.

Our senior management has reviewed these critical accounting policies and estimates and the related Management's Discussion and Analysis of Financial Condition and Results of Operations with the Audit Committee of our Board of Directors.

Inventories. We value our inventories, which consist primarily of maternity apparel, at the lower of cost or market. Cost is determined on the first-in, first-out method (FIFO) and includes the cost of merchandise, freight, duty and broker fees. A periodic review of inventory quantities on hand is performed in order to determine if inventory is properly valued at the lower of cost or market. Factors related to current inventories such as future consumer demand and fashion trends, current aging, current analysis of merchandise based on receipt date, current and anticipated retail markdowns or wholesale discounts, and class or type of inventory are analyzed to determine estimated net realizable values. Criteria utilized by us to quantify aging trends include factors such as the amount of merchandise received within the past twelve months, merchandise received more than one year before with quantities on-hand in excess of 12 months of sales, and merchandise currently selling below cost. A provision is recorded to reduce the cost of inventories to its estimated net realizable value, if required. Inventories as of September 30, 2006 and 2005 totaled \$94.3 million and \$105.9 million, respectively, representing 32.8% and 38.8% of total assets, respectively. Given the significance of inventories to our consolidated financial statements, the determination of net realizable values is considered to be a critical accounting estimate. Any significant unanticipated changes in the factors noted above could have a significant impact on the value of our inventories and our reported operating results.

Long-Lived Assets. Our long-lived assets consist principally of store leasehold improvements (included in the "Property, plant and equipment, net" line item in our consolidated balance sheets) and, to a much lesser extent, lease acquisition costs (included in the "Other intangible assets, net" line item in our consolidated balance sheets). These long-lived assets are recorded at cost and are amortized using the straight-line method over the shorter of the lease term or their useful life. Net long-lived assets as of September 30, 2006 and 2005 totaled $72.2 million and $77.1 million, respectively, representing 25.1% and 28.2% of total assets, respectively.

In assessing potential impairment of these assets, we periodically evaluate the historical and forecasted operating results and cash flows on a store-by-store basis. Newly opened stores may take time to generate positive operating and cash flow results. Factors such as (i) store type, that is, company store or leased department, (ii) store concept, that is, Motherhood, Mimi, A Pea in the Pod or Destination Maternity, (iii) store location, for example, urban area versus suburb, (iv) current marketplace awareness of our brands, (v) local customer demographic data, (vi) anchor stores within the mall in which our store is located and (vii) current fashion trends are all considered in determining the time frame required for a store to achieve positive financial results, which is assumed to be within two years from the date a store location is opened. If economic conditions are substantially different from our expectations, the carrying value of certain of our long-lived assets may become impaired. As a result of our impairment assessment, we recorded write-downs of long-lived assets of $2.6 million and $3.4 million during fiscal 2006 and fiscal 2005, respectively.

Goodwill. The purchase method of accounting for business combinations requires the use of estimates and judgments to allocate the purchase price paid for acquisitions to the fair value of the net tangible and identifiable intangible assets. Goodwill represents the excess of the aggregate purchase price over the fair value of net assets acquired in business combinations and is separately disclosed in our consolidated balance sheets. As of both September 30, 2006 and 2005, goodwill totaled $50.4 million, representing 17.5% and 18.4% of total assets, respectively. In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires that goodwill no longer be amortized, but instead be tested for impairment at least annually or as impairment indicators arise.

The impairment test requires us to compare the fair value of business reporting units to their carrying value, including assigned goodwill. In assessing potential impairment of goodwill, we have determined that we have one reporting unit for purposes of applying SFAS No. 142 based on our reporting structure. The fair value of our single reporting unit is determined based on the fair market value of our outstanding common stock on a control basis and, if necessary, an outside independent valuation is obtained to determine the fair value. The carrying value of our single reporting unit, expressed on a per share basis, is represented by the book value per share of our outstanding common stock. The results of the annual impairment tests performed as of September 30, 2006, 2005 and 2004 indicated the fair value of the reporting unit exceeded its carrying value. As part of the Company's impairment analysis as of September 30, 2005, an outside independent valuation was obtained and the fair value of the Company's single reporting unit exceeded the carrying value. As of September 30, 2006, our book value was $14.35 per share of outstanding common stock and the closing trading price of our common stock was $48.12 per share. If the per share fair value of our single reporting unit was less than the book value per share on September 30, 2006, our goodwill would likely have been impaired.

Accounting for Income Taxes. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process requires us to estimate our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as depreciation of property and equipment and valuation of inventories, for tax and accounting purposes. We determine our provision for income taxes based on federal and state tax laws and regulations currently in effect, some of which have been recently revised. Legislation changes currently proposed by certain of the states in which we operate, if enacted, could increase our transactions or activities subject to tax. Any such legislation that becomes law could result in an increase in our state income tax expense and our state income taxes paid, which could have a material and adverse effect on our net income or cash flow.

The temporary differences between the book and tax treatment of income and expenses result in deferred tax assets and liabilities, which are included within our consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income. As of September 30, 2005, we determined that the deferred tax assets should reflect the state tax benefits for several of the states in which we are operating. This determination was made in accordance with the provisions of SFAS No. 109, "Accounting for Income Taxes." Actual results could differ from our assessments if adequate taxable income is not generated in future periods. Net deferred tax assets as of September 30, 2006 and 2005 totaled $18.6 million and $19.3 million, respectively, representing 6.5% and 7.1% of total assets, respectively. To the extent we believe that recovery is not more likely than not, we must establish a valuation allowance. To the extent we establish a valuation allowance or change the allowance in a future period, income tax expense will be impacted.

Accounting for Contingencies. From time to time, we are named as a defendant in legal actions arising from our normal business activities. We account for contingencies such as these in accordance with SFAS No. 5, "Accounting for Contingencies." SFAS No. 5 requires us to record an estimated loss contingency when information available prior to issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. An interpretation of SFAS No. 5 further states that when there is a range of loss and no amount within that range is a better estimate than any other, then the minimum amount of the range shall be accrued. Accounting for contingencies arising from contractual or legal proceedings requires management, after consultation with outside legal counsel, to use its best judgment when estimating an accrual related to such contingencies. As additional information becomes known, our accrual for a loss contingency could fluctuate, thereby creating variability in our results of operations from period to period. Likewise, an actual loss arising from a loss contingency which significantly exceeds the amount accrued for in our financial statements could have a material adverse impact on our operating results for the period in which such actual loss becomes known.

Results of Operations

The following table sets forth certain operating data from our consolidated statements of operations as a percentage of net sales and as a percentage change for the periods indicated:

	% of Net Sales (1) Year Ended September 30,			% Increase (Decrease) Year Ended September 30,	
	2006	2005	2004	2006 vs. 2005	2005 vs. 2004
Net sales	100.0 %	100.0 %	100.0 %	7.3 %	8.4 %
Cost of goods sold (2)	47.8	49.4	46.9	3.8	14.3
Gross profit	52.2	50.6	53.1	10.7	3.2
Selling, general and administrative expenses (3)	47.2	48.1	48.6	5.3	7.1
Operating income	5.0	2.5	4.5	113.0	(38.8)
Interest expense, net	2.4	2.7	2.9	(5.0)	3.6
Loss on extinguishment of debt	0.1	—	—	N.M.	0.0
Income (loss) before income taxes	2.5	(0.2)	1.6	N.M.	(112.4)
Income tax provision (benefit)	1.0	(0.2)	0.7	N.M.	(125.4)
Net income (loss)	1.5 %	(0.0)%	1.0 %	N.M.	(103.5)

N.M.—Not meaningful

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

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

(3)The "Selling, general and administrative expenses" line item includes: advertising and marketing expenses, corporate administrative expenses, store expenses (including store payroll and store occupancy expenses), store opening and store closing expenses, and store asset impairment charges.

The following table sets forth certain information regarding the number of our retail locations, including stores and leased maternity departments for the fiscal years indicated:

	Year Ended September 30,								
	2006			2005			2004		
Retail Locations	Stores	Leased Departments	Total Retail Locations	Stores	Leased Departments	Total Retail Locations	Stores	Leased Departments	Total Retail Locations
Beginning of period	852	739	1,591	883	232	1,115	851	155	1,006
Opened	17	39	56	27	517	544	93	81	174
Closed	(59)	(47)	(106)	(58)	(10)	(68)	(61)	(4)	(65)
End of period	810	731	1,541	852	739	1,591	883	232	1,115

Years Ended September 30, 2006 and 2005

Net Sales. Our net sales for fiscal 2006 increased by 7.3%, or $41.1 million, to $602.7 million from $561.6 million for fiscal 2005. The increase in net sales for the fiscal year was primarily driven by increased comparable store sales, as well as increased sales from our proprietary Two Hearts Maternity collection, which expanded to an additional 497 Sears locations during late March 2005. We also realized sales increases from the full year contribution of our Oh Baby! by Motherhood licensed arrangement with Kohl's, which launched during the second quarter of fiscal 2005, as well as from our internet sales and our marketing partnerships. Comparable store sales increased by 4.3% during fiscal 2006, based on 932 retail locations, versus a comparable store sales decrease of 2.5% during fiscal 2005, based on 832 retail locations.

As of September 30, 2006, we operated a total of 810 stores and 1,541 total retail locations: 659 Motherhood Maternity stores (including 97 Motherhood Maternity Outlet stores), 106 Mimi Maternity stores, 33 A Pea in the Pod stores, 12 Destination Maternity superstores, and 731 leased maternity departments, of which 549 were in Sears stores and the balance were primarily under the Motherhood brand. In addition, our Oh Baby! by Motherhood collection is available at Kohl's stores throughout the United States. In comparison, as of September 30, 2005, we had 1,591 total retail locations: 690 Motherhood Maternity stores (including 99 Motherhood Maternity Outlet stores), 117 Mimi Maternity stores, 37 A Pea in the Pod stores, eight Destination Maternity superstores, and 739 leased departments. As of September 30, 2006, our store total included 48 multi-brand stores, including 12 Destination Maternity superstores, with the remaining multi-brand stores under the Mimi Maternity brand. In comparison, as of September 30, 2005, we operated 47 multi-brand stores, including eight Destination Maternity superstores. These multi-brand store figures for fiscal 2006 and fiscal 2005 exclude our A Pea in the Pod stores, which have traditionally carried a full line of both A Pea in the Pod and Mimi branded merchandise. During fiscal 2006, we opened 17 stores, including four multi-brand stores, and closed 59 stores, with 15 of these store closings related to multi-brand store openings. In addition, during fiscal 2006, the Company opened 39 leased department locations and closed 47 leased department locations.

Gross Profit. Our gross profit for fiscal 2006 increased by 10.7%, or $30.5 million, to $314.7 million compared to $284.2 million for fiscal 2005, reflecting the increase in net sales as well as an increase in gross profit margin. Gross profit as a percentage of net sales (gross margin) was 52.2% for fiscal 2006, compared to 50.6% for fiscal 2005. The increase in gross margin of 1.6 percentage points compared to the prior year resulted primarily from a higher maintained gross margin in our stores, largely due to lower markdowns compared to last year, as well as the benefit of spreading product overhead costs over a larger sales volume, slightly offset by the lower gross margin associated with sales from our licensed arrangement with Kohl's.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses for fiscal 2006 increased by 5.3%, or $14.4 million, to $284.3 million from $269.9 million for fiscal 2005. This increase in expense resulted primarily from increases in accrued incentive compensation expense related to improvements in our operating performance compared to fiscal 2005, stock-based compensation expense, rent and related expenses for our retail locations, and employee wages and benefits for our retail locations. As a percentage of net sales, selling, general and administrative expenses decreased to 47.2% for fiscal 2006 compared to 48.1% for fiscal 2005. This decrease in the expense percentage for the fiscal year resulted primarily from the favorable expense leverage from our comparable store sales increase, the additional sales from our Sears and Kohl's relationships for the full year, and a continued sharp focus on expense control. This favorable expense leverage offset increases as a percentage of net sales in accrued incentive compensation expense and stock-based compensation expense. We incurred charges relating to store closings of $1.9 million for fiscal 2006 (primarily lease termination fees) as compared to $1.6 million for fiscal 2005. The majority of the store closing charges for fiscal 2006 and fiscal 2005 were for stores closed in connection with multi-brand store openings, with most of the store closing charges for fiscal 2006 related to the opening of our world flagship Destination Maternity store in New York City in February 2006. We incurred impairment charges for write-downs of long-lived assets of $2.6 million for fiscal 2006, as compared to $3.4 million for fiscal 2005. We also incurred $2.8 million of non-cash expenses related to stock-based compensation expense, including $2.5 million in selling, general and administrative expense, in fiscal 2006 versus none in fiscal 2005, since we adopted the provisions of SFAS No. 123(R), "Share-Based Payment," as of the beginning of fiscal 2006.

Operating Income. Our operating income for fiscal 2006 increased by 113.0%, or $16.1 million, to $30.3 million from $14.2 million for fiscal 2005, due to our increased sales volume and higher gross margin, which more than offset the impact of increased selling, general and administrative expenses. Operating income as a percentage of net sales (operating income margin) for fiscal 2006 increased to 5.0% from 2.5% for fiscal 2005. Excluding non-cash stock-based compensation expense, our operating income for fiscal 2006 was $33.1 million, which represents a 5.5% adjusted operating income margin. We were not required to recognize, and therefore did not recognize, any non-cash stock-based compensation expense in fiscal 2005. The increase in operating income margin was primarily due to our increased gross margin and, to a lesser extent, due to favorable leverage of operating expenses resulting from increased sales.

Interest Expense, Net. Our net interest expense for fiscal 2006 decreased by 5.0%, or $0.8 million, to $14.5 million from $15.3 million in fiscal 2005. The decrease in interest expense resulted primarily from our increased balance of cash and short-term investments and the resulting increased interest income. During fiscal 2006, our average level of direct borrowings under our credit facility was $0.3 million, but we did not have any direct borrowings under our credit facility as of September 30, 2006. During fiscal 2005, our average level of direct borrowings under our credit facility was $3.1 million.

Loss on Extinguishment of Debt. In August and September 2006, we repurchased $10.0 million principal amount of our outstanding Senior Notes. The $10.0 million Senior Note repurchase resulted in a fourth quarter pre-tax charge of $0.9 million, representing the premium paid plus the write-off of unamortized debt issuance discount and deferred financing costs.

Income Taxes. Our effective tax rate was a provision of 39.0% in fiscal 2006, compared to a benefit of 83.4% in fiscal 2005, which reflected the recognition of certain state deferred tax assets in fiscal 2005. See Note 13 of the Notes to Consolidated Financial Statements for the reconciliation of the statutory federal income tax rate to our effective tax rate.

Net Income (Loss). Net income for fiscal 2006 was $9.1 million, or $1.63 per share (diluted), compared to a net loss of $0.2 million for fiscal 2005, or $(0.03) per share (diluted). Excluding the debt extinguishment charge, net income for fiscal 2006 was $9.6 million, or $1.72 per share (diluted). Excluding the debt extinguishment charge and non-cash stock-based compensation expense, net income for fiscal 2006 was $11.3 million, or $2.03 per share (diluted). We had no debt extinguishment charges in fiscal 2005 and we did not recognize any non-cash stock-based compensation expense in fiscal 2005.

The average diluted shares outstanding of 5,591,000 shares for fiscal 2006 was 6.7% higher than the 5,242,000 shares outstanding for fiscal 2005. The increase in average diluted shares outstanding primarily reflects the dilutive impact of outstanding stock options in fiscal 2006 due to the net income for fiscal 2006, compared to no dilutive impact from outstanding stock options in fiscal 2005 due to the net loss for fiscal 2005.

Years Ended September 30, 2005 and 2004

Net Sales. Our net sales for fiscal 2005 increased by 8.4%, or approximately $43.5 million, to $561.6 million from $518.1 million for fiscal 2004. Net sales increased primarily due to sales from our new Oh Baby! by Motherhood licensed arrangement with Kohl's, which began during the second quarter of fiscal 2005, and sales from the expansion of our proprietary Two Hearts Maternity collection to an additional 497 Sears locations during late March 2005, partially offset by a decrease in comparable store sales. Comparable store sales decreased by 2.5% during fiscal 2005, based on 832 retail locations, versus a comparable store sales decrease of 4.9% during fiscal 2004, based on 765 retail locations. The decrease in comparable store sales in fiscal 2005 reflected continued strong competitive pressures in the maternity apparel market. We believe this increased competition caused an oversupply of maternity apparel in the market and that the increasingly deep markdowns taken by our competitors to stimulate sales and clear seasonal inventories further adversely affected our net sales for fiscal 2005.

As of September 30, 2005, we operated a total of 852 stores and 1,591 total retail locations: 690 Motherhood Maternity stores (including 99 Motherhood Maternity Outlet stores), 117 Mimi Maternity stores, 37 A Pea in the Pod stores, eight Destination Maternity superstores, and 739 leased maternity departments, of which 574 were in Sears stores and the balance were primarily under the Motherhood brand. In comparison, as of September 30, 2004, we had 1,115 total retail locations: 717 Motherhood Maternity stores (including 106 Motherhood Maternity Outlet stores), 121 Mimi Maternity stores, 41 A Pea in the Pod stores, four Destination Maternity superstores, and 232 leased departments. As of September 30, 2005, our store total included 47 multi-brand stores, including eight Destination Maternity superstores, with the remaining multi-brand stores predominantly under the Mimi Maternity brand. In comparison, as of September 30, 2004, we operated 35 multi-brand stores, including four Destination Maternity superstores. These multi-brand store figures for fiscal 2005 and fiscal 2004 exclude our A Pea in the Pod stores, which have traditionally carried a full line of both A Pea in the Pod and Mimi branded merchandise. During fiscal 2005, we opened 27 stores, including 11 multi-brand stores, and closed 58 stores, with 22 of these store closings related to multi-brand store openings. In addition, during fiscal 2005, the Company opened 517 leased department locations and closed ten leased department locations, with the openings predominantly coming from the expansion of our new Two Hearts Maternity collection at Sears, bringing the total number of our Sears leased departments to 574 locations.

Gross Profit. Our gross profit for fiscal 2005 increased by 3.2%, or $8.9 million, to $284.2 million compared to $275.3 million for fiscal 2004, reflecting the increase in net sales, partially offset by a decrease in gross profit margin. Gross profit as a percentage of net sales (gross margin) was 50.6% for fiscal 2005, compared to 53.1% for fiscal 2004. The decrease in gross margin of 2.5 percentage points compared to the prior year primarily reflects the planned lower gross margin associated with sales from our new Kohl's licensed arrangement, as well as market oversupply conditions and the resulting greater level of markdowns we recognized on sales from our own retail locations in fiscal 2005 compared to fiscal 2004.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses for fiscal 2005 increased by 7.1%, or $17.9 million, to $269.9 million from $252.0 million for fiscal 2004. Compared to fiscal 2004, rent and related expenses for our retail locations, including sales-based payments for our leased departments, increased by $6.0 million and employee wages and benefits for our retail locations increased by $3.3 million, primarily resulting from our new store openings. As a percentage of net sales, selling, general and administrative expenses decreased to 48.1% for fiscal 2005 compared to 48.6% for fiscal 2004. This decrease in the expense percentage for the full year resulted primarily from the favorable expense leverage from the addition of our licensed business, which was offset by the negative expense leverage resulting from our 2.5% decrease in comparable store sales, as well as increased charges for store asset impairments, increased professional fees related to our Sarbanes-Oxley Section 404 compliance program, and higher legal expenses. We incurred impairment charges for write-downs of long-lived assets of $3.4 million for fiscal 2005 as compared to $1.8 million for fiscal 2004. In addition, we incurred charges relating to store closings of $1.6 million for fiscal 2005 (of which $0.5 million represented non-cash long-lived asset write-offs) as compared to $1.8 million for fiscal 2004 (of which $1.2 million represented non-cash long-lived asset write-offs). Most of these fiscal 2005 store closing charges related to multi-brand store openings. Professional fees related to our Sarbanes-Oxley Section 404 compliance program totaled $1.6 million for fiscal 2005. During fiscal 2005, we also recorded a charge of $0.3 million to reduce the carrying values of facilities in Costa Rica, which are being marketed for sale, to their estimated realizable values.

Operating Income. Our operating income for fiscal 2005 decreased by 38.8%, or approximately $9.1 million, to $14.2 million from $23.3 million for fiscal 2004, due to our higher selling, general and administrative expenses, and lower gross margin, which more than offset the impact of increased sales volume. Operating income as a percentage of net sales (operating income margin) for fiscal 2005 decreased to 2.5% from 4.5% for fiscal 2004, primarily due to the adverse impact on operating income margin of our 2.5% decrease in comparable store sales, our increased markdowns, and increased operating expenses for store asset impairment and closing charges, legal expenses, and professional fees related to our Sarbanes-Oxley Section 404 compliance program.

Interest Expense, Net. Our net interest expense for fiscal 2005 increased by 3.6%, or $0.5 million, to $15.3 million from $14.8 million in fiscal 2004. The increase in interest expense resulted from having borrowings under our credit facility during a portion of fiscal 2005, the increased amortization expense of deferred financing costs related to our new credit facility entered into in October 2004 and having lower invested balances of cash and short-term investments compared to fiscal 2004. During fiscal 2005, our average level of direct borrowings under our credit facility was $3.1 million, but we did not have any direct borrowings under our credit facility as of September 30, 2005. We did not have any direct borrowings under our credit facility during fiscal 2004.

Income Taxes. Our effective tax rate was a benefit of 83.4% in fiscal 2005, compared to a provision of 40.8% in fiscal 2004, reflecting the recognition of certain state deferred tax assets in fiscal 2005. See Note 13 of the Notes to Consolidated Financial Statements for the reconciliation of the statutory federal income tax rate to our effective tax rate.

Net Income (Loss). Net loss for fiscal 2005 was $0.2 million, or $(0.03) per share (diluted), compared to net income of $5.0 million for fiscal 2004, or $0.92 per share (diluted).

The average diluted shares outstanding of 5,242,000 shares for fiscal 2005 was 4.7% lower than the 5,501,000 shares outstanding for fiscal 2004. The decrease in average diluted shares outstanding reflects no dilutive impact from outstanding stock options in fiscal 2005 due to the net loss for fiscal 2005, compared to the dilutive impact in fiscal 2004, when we generated net income.

Liquidity and Capital Resources

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

In August 2002, we issued $125.0 million of 11¼% senior notes due 2010 (the "Senior Notes"). The Senior Notes were issued at 98.719% of their face amount, resulting in an annual effective interest rate of 11.50%. Interest on the Senior Notes is payable semi-annually in cash on February 1 and August 1, commencing on February 1, 2003. The Senior Notes were issued by Mothers Work, are senior unsecured obligations of Mothers Work and are unconditionally guaranteed on a senior basis by all of our domestic subsidiaries (see Note 15 of the Notes to Consolidated Financial Statements). The Senior Notes are redeemable at our option, in whole or in part, at any time on or after August 1, 2006 at 105.625% of their face amount, plus accrued and unpaid interest, declining ratably to 100% of their face amount, plus accrued and unpaid interest, on or after August 1, 2009. The Senior Notes impose certain restrictions on our ability to, among other things, incur additional indebtedness, pay dividends, repurchase stock, and enter into other various types of transactions. In August 2006, our Board of Directors authorized the repurchase of up to $10.0 million principal amount of the Senior Notes. During August and September 2006, we completed the repurchase of the authorized amount in two transactions at an aggregate of 105.832% of the $10.0 million principal amount, plus accrued and unpaid interest. In November 2006, our Board of Directors authorized the repurchase of an additional $25.0 million principal amount of the Senior Notes. On December 8, 2006, we completed the repurchase of the authorized amount at 105.625% of the $25.0 million principal amount, plus accrued and unpaid interest. After giving effect to both the $10.0 million repurchase in fiscal 2006 and the $25.0 million redemption completed on December 8, 2006, we have $90.0 million remaining outstanding principal amount of the original $125.0 million principal amount of our Senior Notes.

Cash and cash equivalents increased by $15.9 million during fiscal 2006 compared to a decrease of $5.4 million during fiscal 2005. Cash and cash equivalents plus short-term investments increased by $25.3 million during fiscal 2006 compared to a decrease of $11.8 million during fiscal 2005. Cash provided by operations of $42.4 million for fiscal 2006 increased by $35.1 million from $7.3 million for fiscal 2005. This increase in cash provided by operations versus the prior year was primarily the result of cash generated by reducing inventories in fiscal 2006 compared to an increase in inventories during fiscal 2005. Total inventories as of September 30, 2006 were $94.3 million, a decrease of approximately $11.6 million or 11.0% below the $105.9 million inventories balance as of September 30, 2005. During fiscal 2006, we used our cash provided by operations primarily to increase our cash and cash equivalents, to pay for capital expenditures, and to increase our short-term investments. Cash provided by operations of $7.3 million for fiscal 2005 decreased by approximately $11.0 million from $18.3 million for fiscal 2004. This decrease was primarily the result of decreased net income, as well as a larger use of cash for operating capital compared to fiscal 2004, primarily related to inventories and, to a lesser extent, trade receivables. Total inventories as of September 30, 2005 were $105.9 million, an increase of $13.2 million or 14.2% over the $92.7 million inventory balance as of September 30, 2004. This increase in inventories was driven largely by inventory for our new initiatives with Kohl's and Sears, as well as intentionally bringing in Fall merchandise earlier than in fiscal 2004 to enable earlier positioning of Fall merchandise in our stores. During fiscal 2005, we funded our capital expenditures through cash provided by operations, as well as the utilization of net proceeds from the sales (net of purchases) of short-term investments and the utilization of a portion of our balance of cash and cash equivalents. For fiscal 2006, we spent $13.9 million on capital expenditures, including $11.5 million for leasehold improvements, fixtures and equipment principally for new store facilities, as well as improvements to existing stores, and $2.4 million for our distribution and corporate facilities and information systems. This compares to $17.6 million in capital expenditures for fiscal 2005, of which $13.4 million was spent for new store facilities and improvements to existing stores and retail locations, and $4.2 million for our distribution and corporate facilities and information systems. The decrease in capital expenditures was primarily due to decreased expenditures for new stores and decreased expenditures for distribution facilities and information systems compared to last year.

On October 15, 2004, we entered into a new five-year $60.0 million senior secured revolving credit facility (the "Credit Facility") which replaced our former $60 million credit facility. The Credit Facility will mature on October 15, 2009. Upon our request and with the consent of the lender, permitted borrowings under the Credit Facility may be increased up to an additional $15.0 million, in increments of $2.5 million, up to a maximum limit of $75.0 million. 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. We paid certain closing fees in connection with the negotiation and execution of the Credit Facility. We also pay an unused line fee under the Credit Facility and certain early termination fees would be owed if the Credit Facility is terminated prior to its third anniversary. The Credit Facility contains various affirmative and negative covenants and representations and warranties. There are no financial covenant requirements under the Credit Facility unless either (i) Excess Availability (as defined in the agreement) falls below $10 million, or (ii) average Financial Covenant Adjusted Availability (as defined in the agreement) for any calendar month is less than $15 million. If either of the events in item (i) or (ii) above occurs, we would be required to meet a certain minimum fixed charge coverage ratio (which increases from 1.00x during the first two years of the Credit Facility to 1.10x during the fifth year of the Credit Facility). During all of fiscal 2006 and 2005, we exceeded the requirements for the Excess Availability and average Financial Covenant Adjusted Availability. The Credit Facility is secured by a security interest in our accounts receivable, inventory, real estate interests, letter of credit rights, cash, intangibles and certain other assets. The interest rate on outstanding borrowings is equal to, at our 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 1.25% to 1.75%, based upon the availability calculation made in accordance with the agreement. The applicable margin for LIBOR rate borrowings, based upon the availability calculation made in accordance with the agreement, has been 1.25% 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, (v) certain bankruptcy or insolvency events, (vi) a change of control, (vii) material uninsured losses, (viii) indictments of us or senior management in a material forfeiture action, and (ix) customary ERISA defaults, among others.

As of September 30, 2006, outstanding borrowings under the Credit Facility consisted of no direct borrowings and $8.5 million in letters of credit with $51.5 million of availability under the credit line, compared to no direct borrowings and $8.4 million in letters of credit with $51.6 million of availability under the credit line as of September 30, 2005. Borrowings under the Credit Facility as of September 30, 2006 would have borne interest at a rate of between approximately 6.57% and 8.25% per annum. During fiscal 2006 and 2005, our average level of direct borrowings under the Credit Facility was $0.3 million and $3.1 million, respectively. We expect that we may have borrowings under our Credit Facility during certain periods of fiscal 2007, reflecting seasonal and other timing variations in cash flow.

Our management believes that our current cash and working capital positions, expected operating cash flows and available borrowing capacity under our Credit Facility, will be sufficient to fund our working capital, capital expenditures and debt repayment requirements and to fund stock and/or debt repurchases, if any, for at least the next twelve months.

Contractual Obligations and Commercial Commitments

We have entered into agreements that create contractual obligations and commercial commitments. These obligations and commitments will have an impact on future liquidity and the availability of capital resources. The tables below set forth a summary of these obligations and commitments as of September 30, 2006 (in thousands):

Contractual Obligations:

Description	Total Obligations (1)	Payments Due by Period Less Than One Year	One to Three Years	Three to Five Years	After Five Years
Long-term debt	$ 118,630	$ 312	$ 660	$ 115,643	$ 2,015
Interest related to long-term debt (2)	51,807	12,959	25,903	12,945	—
Operating leases (3)	292,703	55,195	95,699	71,465	70,344
Capital lease obligations	612	524	88	—	—
Purchase obligations (4)	80,677	80,677	—	—	—
Total contractual cash obligations	$ 544,429	$ 149,667	$ 122,350	$ 200,053	$ 72,359

(1) The amounts in this table exclude obligations under employment agreements. For a discussion of the employment agreements with certain of our executive officers, see the information contained under the caption "Employment Agreements" in our Proxy Statement, which will be filed with the Securities and Exchange Commission in connection with the Annual Meeting of Stockholders scheduled to be held on January 19, 2007.

(2) Excludes interest under long-term debt obligations where such interest is calculated on a variable basis. The Company had $2.8 million principal amount of such variable interest long-term debt obligations as of September 30, 2006.

(3) Includes store operating leases, which generally provide for payment of direct operating costs in addition to rent. The amounts reflected include future minimum lease payments and exclude such direct operating costs.

(4) Our purchase orders with contract manufacturers are cancelable by us at any time prior to our acceptance of the merchandise. Excludes purchase orders for supplies in the normal course of business.

Commercial Commitments:

Description	Total Obligations	Amount of Commitment Per Period Less Than One Year	One to Three Years	Three to Five Years	After Five Years
Credit facility (1)	$ 8,460	$ 8,460	$—	$—	$—
Other standby letters of credit	—	—	—	—	—
Total commercial commitments	$ 8,460	$ 8,460	$—	$—	$—

(1) Consists of outstanding letter of credit commitments.

New Accounting Pronouncements

SFAS No. 154

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." SFAS No.154 provides guidance on the accounting for and reporting of accounting changes and error corrections. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted. We will adopt SFAS No. 154 effective as of October 1, 2006.

FASB Interpretation No. 48

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes." FASB Interpretation No. 48 provides guidance for the recognition and measurement of uncertain tax positions in an enterprise's financial statements. Recognition involves a determination of whether it is more likely than not that a tax position will be sustained upon examination with the presumption that the tax position will be examined by the appropriate taxing authority that would have full knowledge of all relevant information. This interpretation is effective for fiscal years beginning after December 15, 2006. Early adoption is permitted if the enterprise has not issued financial statements, including interim financial statements, in the period of adoption. The impact from adoption of FASB Interpretation No. 48, if any, on our consolidated financial position or results of operations has not yet been determined.

EITF Issue 06-3

In June 2006, the Emerging Issues Task Force ("EITF") issued EITF Issue 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)." EITF Issue 06-3 provides guidance related to the presentation in financial statements of any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer, including, but not limited to, sales, use, value added, and some excise taxes. The EITF concluded that the presentation of taxes within the scope of EITF Issue 06-3 on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed. In addition, the aggregate amount of any such taxes that are reported on a gross basis should be disclosed in interim and annual financial statements. The guidance in EITF Issue 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. We presently report taxes within the scope of EITF Issue 06-3 on a net basis and adoption is not expected to have an impact on our consolidated financial statements.

Inflation

We do not believe that the relatively moderate levels of inflation which have been experienced in the United States in recent years have had a significant effect on our net sales or profitability. However, there can be no assurance that our business will not be affected by inflation in the future.

Forward-Looking Statements

Some of the information in this report, including the information incorporated by reference (as well as information included in oral statements or other written statements made or to be made by us), contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The forward-looking statements involve a number of risks and uncertainties. A number of factors could cause our actual results, performance, achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. These factors include, but are not limited to: the level of success of our new business initiatives, future sales trends in our existing retail locations, changes in consumer spending patterns, raw material price increases, overall economic conditions, our ability to anticipate and respond to fashion trends and consumer preferences, anticipated fluctuations in our operating results, the impact of competition and pricing, availability of suitable store locations, continued availability of capital and financing, ability to hire and develop senior management and sales associates, ability to develop and source merchandise, ability to receive production from foreign sources on a timely basis, potential stock repurchases, potential debt repurchases, war or acts of terrorism and other factors referenced in this report, including those set forth under the caption "Item 1A. Risk Factors."