

Destination Maternity Corp
Form 10-Q
August 25, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended July 30, 2016

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-21196

Destination Maternity Corporation

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	13-3045573 (IRS Employer Identification No.)
232 Strawbridge Drive Moorestown, New Jersey (Address of principal executive offices)	08057 (Zip code)

(856) 291-9700

Edgar Filing: Destination Maternity Corp - Form 10-Q

Registrant's telephone number, including area code

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

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

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

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

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

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

Common Stock, \$.01 par value — 14,013,248 shares outstanding as of August 18, 2016

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

INDEX

PART I. FINANCIAL INFORMATION

Item 1.	<u>Financial Statements (unaudited)</u>	3
	<u>Consolidated Balance Sheets</u>	3
	<u>Consolidated Statements of Operations</u>	4
	<u>Consolidated Statements of Comprehensive Income (Loss)</u>	5
	<u>Consolidated Statements of Stockholders' Equity</u>	6
	<u>Consolidated Statements of Cash Flows</u>	7
	<u>Notes to Consolidated Financial Statements</u>	8
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	29
Item 4.	<u>Controls and Procedures</u>	30

PART II. OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	31
Item 1A.	<u>Risk Factors</u>	31
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	31
Item 6.	<u>Exhibits</u>	32
	<u>Signatures</u>	33

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(unaudited)

	July 30, 2016	January 30, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$2,752	\$ 2,116
Trade receivables, net	6,857	10,154
Inventories	70,528	72,509
Deferred income taxes	11,866	13,803
Prepaid expenses and other current assets	9,802	9,792
Total current assets	101,805	108,374
Property and equipment, net of accumulated depreciation and amortization of \$90,435 and \$84,798	89,793	92,673
Other assets:		
Deferred line of credit financing costs, net of accumulated amortization of \$664 and \$611	481	534
Other intangible assets, net of accumulated amortization of \$745 and \$683	1,130	1,148
Deferred income taxes	14,619	15,195
Other non-current assets	1,174	1,150
Total other assets	17,404	18,027
Total assets	\$209,002	\$ 219,074
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit borrowings	\$1,700	\$ 28,400
Current portion of long-term debt	5,897	2,897
Accounts payable	14,692	21,738
Accrued expenses and other current liabilities	32,161	39,488
Total current liabilities	54,450	92,523
Long-term debt	35,700	9,302
Deferred rent and other non-current liabilities	24,038	24,351
Total liabilities	114,188	126,176
Commitments and contingencies (Note 14)		
Stockholders' equity:		

Edgar Filing: Destination Maternity Corp - Form 10-Q

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, 13,997,679 and 13,824,535 shares issued and outstanding	140	138
Additional paid-in capital	105,149	104,784
Retained earnings (accumulated deficit)	(10,403)	(11,951)
Accumulated other comprehensive loss	(72)	(73)
Total stockholders' equity	94,814	92,898
Total liabilities and stockholders' equity	\$209,002	\$ 219,074

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

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Six Months Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Net sales	\$106,529	\$119,306	\$230,959	\$260,918
Cost of goods sold	51,699	63,998	108,857	134,207
Gross profit	54,830	55,308	122,102	126,711
Selling, general and administrative expenses	56,619	61,640	115,394	125,676
Store closing, asset impairment and asset disposal expenses (income)	442	(3,951)	1,048	(2,943)
Other charges	875	1,637	1,544	3,445
Operating income (loss)	(3,106)	(4,018)	4,116	533
Interest expense, net	973	344	1,625	773
Income (loss) before income taxes	(4,079)	(4,362)	2,491	(240)
Income tax (benefit) provision	(1,570)	(1,680)	959	(93)
Net income (loss)	\$(2,509)	\$(2,682)	\$1,532	\$(147)
Net income (loss) per share— Basic	\$(0.18)	\$(0.20)	\$0.11	\$(0.01)
Average shares outstanding— Basic	13,700	13,585	13,692	13,583
Net income (loss) per share— Diluted	\$(0.18)	\$(0.20)	\$0.11	\$(0.01)
Average shares outstanding— Diluted	13,700	13,585	13,697	13,583

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

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)

	Three Months Ended		Six Months Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Net income (loss)	\$ (2,509)	\$ (2,682)	\$ 1,532	\$ (147)
Foreign currency translation adjustments	(1)	(1)	1	(4)
Comprehensive income (loss)	\$ (2,510)	\$ (2,683)	\$ 1,533	\$ (151)

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

5

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(unaudited)

	Common Stock			Retained	Accumulated	Total
	Number of Shares	Amount	Additional Paid-in Capital	Earnings (Accumulated Deficit)	Other Comprehensive Loss	
Balance as of January 30, 2016	13,825	\$ 138	\$ 104,784	\$ (11,951)	\$ (73)	\$ 92,898
Net income	—	—	—	1,532	—	1,532
Foreign currency translation adjustments	—	—	—	—	1	1
Dividends forfeited	—	—	—	16	—	16
Stock-based compensation	174	2	966	—	—	968
Exercise of stock options, net	1	—	3	—	—	3
Tax benefit shortfall from stock options and restricted stock	—	—	(586)	—	—	(586)
Repurchase and retirement of common stock	(2)	—	(18)	—	—	(18)
Balance as of July 30, 2016	13,998	\$ 140	\$ 105,149	\$ (10,403)	\$ (72)	\$ 94,814
Balance as of January 31, 2015	13,807	\$ 138	\$ 102,370	\$ 3,558	\$ (64)	\$ 106,002
Net loss	—	—	—	(147)	—	(147)
Foreign currency translation adjustments	—	—	—	—	(4)	(4)
Cash dividends	—	—	—	(5,531)	—	(5,531)
Stock-based compensation	54	1	1,551	—	—	1,552
Exercise of stock options, net	5	—	42	—	—	42
Tax benefit shortfall from stock options and restricted stock	—	—	(18)	—	—	(18)
Repurchase and retirement of common stock	(4)	—	(57)	—	—	(57)
Balance as of August 1, 2015	13,862	\$ 139	\$ 103,888	\$ (2,120)	\$ (68)	\$ 101,839

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

6

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended	
	July 30, 2016	August 1, 2015
Operating Activities		
Net income (loss)	\$1,532	\$(147)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	8,927	8,139
Stock-based compensation expense	968	1,552
Loss on impairment of long-lived assets	733	1,054
Loss on disposal of assets	215	14
Grow NJ award benefit	1,833	—
Deferred income tax benefit	(75)	(18)
Amortization of deferred financing costs	139	100
Changes in assets and liabilities:		
Decrease (increase) in:		
Trade receivables	3,297	(1,082)
Inventories	1,981	2,208
Prepaid expenses and other current assets	(10)	3,048
Other non-current assets	(24)	130
Increase (decrease) in:		
Accounts payable, accrued expenses and other current liabilities	(14,057)	(7,611)
Deferred rent and other non-current liabilities	(153)	(135)
Net cash provided by operating activities	5,306	7,252
Investing Activities		
Capital expenditures	(6,800)	(18,884)
Proceeds from sale of property and equipment	2	21
Additions to intangible assets	(45)	(83)
Net cash used in investing activities	(6,843)	(18,946)
Financing Activities		
Decrease in cash overdraft	(425)	(1,047)
(Decrease) increase in line of credit borrowings	(26,700)	21,000
Proceeds from long-term debt	32,000	—
Repayment of long-term debt	(1,436)	(1,622)
Deferred financing costs paid	(1,252)	(38)
Withholding taxes on stock-based compensation paid in connection with repurchase of common stock	(18)	(57)
Cash dividends paid	—	(5,531)
Proceeds from exercise of stock options	3	42

Edgar Filing: Destination Maternity Corp - Form 10-Q

Net cash provided by financing activities	2,172	12,747
Effect of exchange rate changes on cash and cash equivalents	1	(3)
Net Increase in Cash and Cash Equivalents	636	1,050
Cash and Cash Equivalents, Beginning of Period	2,116	1,349
Cash and Cash Equivalents, End of Period	\$2,752	\$2,399
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$1,245	\$755
Cash paid for income taxes	\$214	\$(1,612)

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

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. BASIS OF FINANCIAL STATEMENT PRESENTATION

The accompanying unaudited consolidated financial statements for the three and six months ended July 30, 2016 and August 1, 2015 have been prepared in accordance with the requirements for Form 10-Q and Article 10 of Regulation S-X, and accordingly, certain information and footnote disclosures have been condensed or omitted. See the Company's Annual Report on Form 10-K as of and for the year ended January 30, 2016 for Destination Maternity Corporation and subsidiaries (the "Company" or "Destination Maternity") as filed with the Securities and Exchange Commission ("SEC") for additional disclosures including a summary of the Company's accounting policies.

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

The Company operates on a fiscal year ending on the Saturday nearest January 31 of each year. References to the Company's fiscal 2016 refer to the fiscal year, or periods within such fiscal year, which began January 31, 2016 and will end January 28, 2017. References to the Company's fiscal 2015 refer to the fiscal year, or periods within such fiscal year, which began February 1, 2015 and ended January 30, 2016.

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

Basic net income (loss) (or earnings) per share ("Basic EPS") is computed by dividing net income (loss) by the weighted average number of common shares outstanding, excluding restricted stock awards for which the restrictions have not lapsed. Diluted net income (loss) (or earnings) per share ("Diluted EPS") is computed by dividing net income (loss) by the weighted average number of common shares outstanding, after giving effect to the potential dilution, if applicable, from the assumed exercise of outstanding stock options and from the assumed lapse of restrictions on restricted stock awards. Common shares issuable in connection with the award of performance-based restricted stock units ("RSUs") are excluded from the calculation of EPS until the RSUs' performance conditions are achieved and the shares in respect of the RSUs become issuable (see Note 12).

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

	Three Months Ended			August 1, 2015		
	July 30, 2016			Net		
	Loss	Shares	EPS	Loss	Shares	EPS
Basic EPS	\$(2,509)	13,700	\$(0.18)	\$(2,682)	13,585	\$(0.20)

Edgar Filing: Destination Maternity Corp - Form 10-Q

Incremental shares from the assumed exercise of outstanding stock options	—	—	—	—		
Incremental shares from the assumed lapse of restrictions on restricted stock awards	—	—	—	—		
Diluted EPS	\$(2,509)	13,700	\$(0.18)	\$(2,682)	13,585	\$(0.20)

	Six Months Ended July 30, 2016			August 1, 2015		
	Net Income	Shares	EPS	Net Loss	Shares	EPS
Basic EPS	\$1,532	13,692	\$0.11	\$(147)	13,583	\$(0.01)
Incremental shares from the assumed exercise of outstanding stock options	—	1		—	—	
Incremental shares from the assumed lapse of restrictions on restricted stock awards	—	4		—	—	
Diluted EPS	\$1,532	13,697	\$0.11	\$(147)	13,583	\$(0.01)

In addition to performance-based RSUs, for the six months ended July 30, 2016 stock options and unvested restricted stock totaling approximately 1,124,000 shares were excluded from the calculation of Diluted EPS as their effect would have been

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

antidilutive. Options and unvested restricted stock totaling approximately 1,171,000 and 1,127,000 shares of the Company's common stock were outstanding as of July 30, 2016 and August 1, 2015, respectively, but were not included in the computation of Diluted EPS for the three months ended July 30, 2016 and for the three and six months ended August 1, 2015 due to the Company's net loss. Had the Company reported a profit for the three months ended July 30, 2016 and the three and six months ended August 1, 2015 the weighted average number of dilutive shares outstanding for computation of Diluted EPS would have been approximately 13,707,000, 13,607,000 and 13,616,000 shares, respectively.

During the six months ended August 1, 2015 the Company paid cash dividends totaling \$5,531,000 (or \$0.40 per share). In connection with a debt refinancing in March 2016 the Company suspended its quarterly dividend and accordingly no cash dividends were paid by the Company during the six months ended July 30, 2016 (see Note 7). During the six months ended July 30, 2016 \$16,000 of previously declared and undistributed dividends, for which payment was subject to completion of service requirements under restricted stock awards, were forfeited back to the Company in connection with the cancellation of the awards.

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 July 30, 2016 and January 30, 2016 the Company's trade receivables were net of allowance for doubtful accounts of \$178,000 and \$170,000, respectively.

4. INVENTORIES

Inventories were comprised of the following (in thousands):

	July 30, 2016	January 30, 2016
Finished goods	\$69,528	\$71,229

Edgar Filing: Destination Maternity Corp - Form 10-Q

Work-in-progress	272	420
Raw materials	728	860
	\$70,528	\$72,509

5. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

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

	July 30, 2016	January 30, 2016
Employee compensation and benefits	\$7,514	\$10,519
Insurance, primarily self-insurance reserves	6,068	6,326
Gift certificates and store credits	3,591	4,477
Deferred rent	3,338	3,310
Sales and use taxes	2,714	2,654
Accounting and legal	1,672	1,378
Product return reserve	1,651	1,736
Accrued property and equipment additions	1,012	840
Income taxes payable	42	52
Other	4,559	8,196
	\$32,161	\$39,488

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

6. LINE OF CREDIT

After completion of a debt refinancing on March 25, 2016 the Company has a \$70,000,000 senior secured revolving credit facility (the "Credit Facility"), which was amended and restated in connection with the issuance of the Company's new \$32,000,000 Term Loan (see Note 7). Previously the Credit Facility was \$76,000,000 and consisted of two tranches: 1) a senior secured revolving credit and letter of credit facility of up to \$70,000,000 ("Tranche A") and 2) a senior secured first-in, last-out revolving credit facility of up to \$6,000,000 ("Tranche A-1"). On March 25, 2016 proceeds from the Term Loan were used to repay a portion of the outstanding indebtedness under the Credit Facility, including repayment of the entire balance outstanding under Tranche A-1, which was then terminated. The Company originally entered into a five-year \$61,000,000 Credit Facility on November 1, 2012, which replaced the Company's former \$55,000,000 credit facility (the "Prior Credit Facility"). In accordance with the terms of the Credit Facility, effective June 3, 2015 the Company's permitted borrowings under Tranche A of the Credit Facility were increased by \$15,000,000 at the Company's request. Effective August 25, 2015 the Credit Facility was amended to reflect the increase to Tranche A permitted borrowings and to extend the maturity date to August 25, 2020 from November 1, 2017. In connection with the Term Loan financing the maturity date of the Credit Facility was further extended to March 25, 2021. Proceeds from advances under the Credit Facility, with certain restrictions may be used to provide financing for working capital, letters of credit, capital expenditures, and other general corporate purposes.

The Credit Facility contains various affirmative and negative covenants and representations and warranties. In the event that the outstanding balance of the Term Loan exceeds the Term Loan Borrowing Base (as defined in the related Term Loan Agreement) then a reserve will be imposed against availability under the Credit Facility. The Credit Facility also requires the Company to maintain minimum Excess Availability (as defined in the related Credit Facility agreement) equal to the greater of 10% of the Loan Cap (as defined in the Credit Facility agreement) or \$5,000,000. The Credit Facility is secured by a security interest in the Company's trade receivables, inventory, 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 was 2.00% for Tranche A-1 borrowings. The applicable margin for LIBOR rate borrowings is 1.50% for Tranche A borrowings and was 3.00% for Tranche A-1 borrowings. Tranche A-1 borrowings were deemed to be the first loans made and the last loans repaid. The Company also pays an unused line fee under the Credit Facility of 0.25% per annum. In connection with the original execution and subsequent amendments of the Credit Facility, the Company incurred deferred financing costs of \$1,145,000. 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 Operations.

As of July 30, 2016 the Company had \$1,700,000 in outstanding borrowings under the Credit Facility and \$6,228,000 in letters of credit, with \$34,508,000 of availability under the Credit Facility based on the Company's Borrowing Base formula and minimum Excess Availability requirement. As of August 1, 2015 the Company had \$21,000,000 outstanding borrowings under the Credit Facility, of which \$15,000,000 were Tranche A borrowings and \$6,000,000 were Tranche A-1 borrowings, and \$6,348,000 in letters of credit, with \$27,660,000 of availability under the Credit Facility based on the Company's Borrowing Base formula and minimum Excess Availability requirement. For the three months ended July 30, 2016 and August 1, 2015 Tranche A borrowings had a weighted interest rate of 4.00% and 2.16%, respectively, per annum and Tranche A-1 borrowings had a weighted interest rate of 0.00% and 3.19%, respectively, per annum. For the six months ended July 30, 2016 and August 1, 2015 Tranche A borrowings had a weighted interest rate of 2.54% and 2.91%, respectively, per annum and Tranche A-1 borrowings had a weighted

interest rate of 3.43% and 4.10%, respectively, per annum. During the six months ended July 30, 2016 and August 1, 2015 the Company's average level of direct borrowings under the Credit Facility was \$14,989,000 and \$21,748,000, respectively, and the Company's maximum borrowings at any time were \$42,700,000 and \$31,800,000, respectively.

7. LONG-TERM DEBT

On March 25, 2016, the Company entered into a Term Loan Credit Agreement (the "Term Loan Agreement") for a \$32,000,000 term loan due March 21, 2021 (the "Term Loan"), the proceeds of which were received on March 25, 2016 and were used to repay a portion of the outstanding indebtedness under the Company's existing Credit Facility (see Note 6). The interest rate on the Term Loan is equal to a LIBOR rate (with a 1.00% LIBOR floor) plus 7.50%. The Company is required to make minimum repayments of the principal amount of the Term Loan in quarterly installments of \$800,000 each, with the remaining outstanding balance payable on the maturity date. Additionally, the Term Loan can be prepaid at the Company's option subject to certain restrictions, in part or in whole at any time, subject to the payment of a prepayment premium as follows: 1) 3% on or prior to the first anniversary of the closing date, 2) 2% from the first anniversary to the second anniversary of the closing date, and 3) 1% after the second anniversary but on or prior to the third anniversary of the closing date.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

The Term Loan is secured by a security interest in substantially all of the assets of the Company, including accounts receivable, inventory, equipment, letter of credit rights, cash, intellectual property and other intangibles, and certain other assets. The security interest granted to the Term Lenders is, in certain respects, subordinate to the security interest granted to the Credit Facility Lender. The Term Loan Agreement prohibits the payment of dividends or share repurchases by the Company for three years and imposes certain restrictions on the Company's ability to, among other things, incur additional indebtedness and enter into other various types of transactions. The Term Loan Agreement requires the Company to maintain Excess Availability (as defined in the related Credit Facility agreement) equal to the greater of 10% of the Loan Cap (as defined in the related Credit Facility agreement) or \$5,000,000. In addition, the Company is required to maintain Consolidated EBITDA (as defined in the related Term Loan Agreement) in an amount not less than the levels specified for each period in the Term Loan Agreement. For the six months ended July 30, 2016 the Company's Consolidated EBITDA exceeded the Consolidated EBITDA requirement of \$9,500,000. The Consolidated EBITDA requirement for the nine months ending October 29, 2016 is \$12,600,000, and the Consolidated EBITDA requirement for the 12 months ending January 28, 2017 is \$19,000,000. The Term Loan Agreement thereafter provides for a Consolidated EBITDA requirement for the four trailing fiscal quarters that increases from this level to \$30,000,000 for the four fiscal quarters ending on February 1, 2020 and thereafter. Also, the Company is prohibited from making capital expenditures (net of tenant allowances) in excess of \$17,000,000 in any period of four fiscal quarters (subject to carry-forward of 50% of any underutilization).

In connection with the execution of the Term Loan Agreement, the Company incurred deferred financing costs of approximately \$1,252,000. These deferred financing costs are reflected as a direct deduction from the Term Loan liability in the Consolidated Balance Sheet and are being amortized over the term of the Term Loan Agreement and included in "interest expense, net" in the Consolidated Statement of Operations.

As of July 30, 2016 and August 1, 2015 there was \$10,763,000 and \$13,378,000, respectively, outstanding under a five-year equipment financing arrangement with the Company's Credit Facility bank. The equipment note bears annual interest at 3.38%, with payments of \$272,000 (including interest) due monthly through December 2019. The equipment note is collateralized by substantially all of the material handling equipment at the Company's distribution facility in Florence, New Jersey.

8. 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

Edgar Filing: Destination Maternity Corp - Form 10-Q

At both July 30, 2016 and January 30, 2016 the Company had cash equivalents of \$4,000. 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 Credit Facility has variable interest rates that are tied to market indices. As of July 30, 2016 and January 30, 2016 the Company had \$1,700,000 and \$28,400,000, respectively, of direct borrowings outstanding under the Credit Facility. The carrying value of the Company's Credit Facility borrowings approximates fair value as the variable interest rates approximate current market rates, which the Company considers to be Level 2 inputs.

The Company's Term Loan, which represents a significant majority of the Company's long-term debt, bears interest at variable rates, which adjust based on market conditions with a minimum annual rate of 8.50%. The carrying value of the Company's Term Loan approximates fair value as the variable interest rates approximate current market rates for similar instruments available to companies with comparable credit quality, which the Company considers to be Level 2 inputs. The fair value of the Company's fixed-rate equipment note was determined using a discounted cash flow analysis based on interest rates currently available to the Company, which the Company considers to be Level 2 inputs. The difference between the carrying value and fair value of long-term debt held by the Company with a fixed rate of interest is not material.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

9. OTHER CHARGES

Subsequent to the appointment of Anthony M. Romano as the Company's new Chief Executive Officer ("CEO") in August 2014, the Company commenced a program to evaluate its business processes, key management personnel and planning resources. In connection with this evaluation, the Company changed its fiscal year and continues to implement changes with a focus on improving inventory management, driving sales productivity, optimizing real estate and controlling costs. Key management changes included elimination of the separate function of President in December 2015 in a further effort to streamline the Company's operations and its reporting structure. The Company implemented an improved product life cycle calendar in fiscal 2015 and expects to complete the implementation of a new planning and allocation tool and re-platform its e-commerce sites in fiscal 2016, as it continues to improve its planning and allocation methodologies and e-commerce platform. The Company's real estate strategy includes increased focus on the Company's two key maternity apparel brands with strategic phase-out and elimination of certain non-core brands and business relationships. During the six months ended July 30, 2016 and August 1, 2015 the Company incurred \$671,000 and \$1,324,000, respectively, of charges related to these management and organizational changes.

During the fourth quarter of fiscal 2015, the Company announced that it had received an unsolicited, non-binding preliminary merger proposal from Orchestra-Prémaman S.A. ("Orchestra"), a France-based retailer of children's wear. On March 15, 2016 the Company entered into a non-disclosure agreement with Orchestra and agreed to exchange information and engage in discussions with Orchestra in response to their communications. During the six months ended July 30, 2016 the Company incurred \$873,000 of charges related to the proposal for a business combination.

In September 2013 the Company announced plans to relocate its corporate headquarters and distribution operations from Philadelphia, Pennsylvania to southern New Jersey. The Company completed the relocation of its corporate headquarters to Moorestown, New Jersey in January 2015 and completed the relocation of its distribution operations to Florence, New Jersey in August 2015. During the six months ended August 1, 2015 the Company recorded \$2,094,000 of charges related to the preparation for occupancy of and relocation to its new distribution facility.

During the six months ended August 1, 2015 the Company incurred \$27,000 of charges related to its change to a retail calendar-based fiscal year.

A summary of the charges incurred in connection with the management and organizational changes, proposed business combination, facilities relocations and fiscal year change is as follows (in thousands):

Three Months		Six Months	
Ended		Ended	
July	August	July	August
30,	1,	30,	1,
2016	2015	2016	2015

Edgar Filing: Destination Maternity Corp - Form 10-Q

Management and Organizational Changes				
Non-core brand contract termination	\$220	\$—	\$545	\$—
Severance and related benefits	3	152	121	242
Consulting fees	—	371	5	1,082
Total management and organizational changes	223	523	671	1,324
Proposed Business Combination				
Legal and other professional fees	652	—	873	—
Facilities Relocations				
Pre-opening rent expense on new distribution facility	—	796	—	1,615
Accelerated depreciation and amortization expense	—	93	—	233
Other	—	198	—	246
Total facilities relocations	—	1,087	—	2,094
Fiscal Year Change				
Systems modifications	—	27	—	27
Total other charges	\$875	\$1,637	\$1,544	\$3,445

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

10. GOVERNMENT INCENTIVES

In September 2013 the Company announced its plans to relocate its corporate headquarters and distribution operations from Philadelphia, Pennsylvania to southern New Jersey (the "Project"). The Company completed the relocation of its corporate headquarters in January 2015 and completed the relocation of its distribution operations in August 2015. To partially offset the costs of these relocations, the Board of the New Jersey Economic Development Authority ("NJEDA") approved the Company for an incentive package of up to \$40,000,000 in benefits under the Grow New Jersey Assistance Program ("Grow NJ") in the form of transferrable income tax credits over a ten-year period from the State of New Jersey. The Company's Grow NJ award required a minimum capital investment of \$20,000,000 with the total potential award being equal to the total eligible capital investment in the Project and subject to an overall award limit of \$40,000,000. The award provides annually over a ten-year period up to \$7,000 per eligible new full-time job, as defined under Grow NJ, with a requirement that at least 100 eligible jobs were created and subject to an annual award limit of \$4,000,000.

In September 2015 the Company confirmed to NJEDA that it had submitted all documentation required to qualify for the Company's Grow NJ award, including certification of over 600 eligible jobs and over \$50,000,000 in capital investment, including building construction costs of the landlord for the Company's newly constructed distribution center in Florence, New Jersey. The Grow NJ award will be earned on an annual basis over the ten-year period, subject to the \$4,000,000 annual award limit, and requires an annual compliance report that includes certification of average annual employment figures after the end of each fiscal year. After the end of the ten-year Grow NJ award earnings period there is a five-year compliance period during which the Company must maintain the average of its annual eligible jobs certified during the preceding ten years or a pro-rata amount up to one-tenth of the previously awarded income tax credits would be subject to recapture and repayment to the State of New Jersey annually during the five-year compliance period. The Company believes the likelihood of any recapture and repayment is remote.

The annual benefit from the Grow NJ award available to the Company is expected to significantly exceed the Company's annual income tax liability to the State of New Jersey. In order to maximize the realizable value of the incentive package, in December 2013 the Company entered into an agreement with a third party to sell 75% or more of the annual income tax credits awarded to the Company. The Company recognizes its Grow NJ award on an annual basis for each fiscal year based on the realizable value of the award earned and expected to be received, primarily from the sale of the income tax credits, net of any associated costs. The Grow NJ award is reflected in the Company's consolidated financial statements as a reduction to the costs incurred by the Company in connection with the relocations. For fiscal 2015 the Company's Grow NJ award of \$3,600,000 (net of valuation allowance) was recognized during the third and fourth quarters of fiscal 2015, which represented the measurement period for the Company's fiscal 2015 required average employment certification. In May 2016 the Company received \$3,600,000 cash proceeds, net of costs, from the receipt and subsequent sale of the \$4,000,000 tax credit certificate earned for fiscal 2015.

During the three and six months ended July 30, 2016 the Company recognized \$867,000 and \$1,767,000, respectively, of cost reduction related to the Grow NJ award, of which \$867,000 and \$1,693,000, respectively, is included in the Consolidated Statements of Operations, including reductions of cost of goods sold of \$625,000 and \$1,199,000, respectively, and reductions of selling, general and administrative expenses of \$242,000 and \$494,000, respectively. Additionally \$822,000 and \$748,000 is included in the Consolidated Balance Sheets as of July 30, 2016 and January

30, 2016, respectively, as a reduction to overhead in inventory. A corresponding deferred tax asset of \$1,091,000, net of valuation allowance, and net of federal and state income tax effect, is included in the Consolidated Balance Sheet in short-term deferred income taxes, and is expected be converted to a receivable and collected in fiscal 2017 upon sale of the income tax credits.

11. INCOME TAXES

As of July 30, 2016 the Company had \$999,000 of unrecognized tax benefits related to uncertain income tax positions, including accrued interest and penalties of \$392,000. The Company records interest and penalties related to unrecognized tax benefits in its income tax provision. If recognized, the portion of the liabilities for unrecognized tax benefits that would impact the Company's effective tax rate was \$744,000, net of federal benefit.

During the 12 months subsequent to July 30, 2016 it is reasonably possible that the gross unrecognized tax benefits could potentially decrease by \$142,000 (of which \$102,000 would affect the effective tax rate, net of federal expense (benefit) for uncertain tax positions, including the continued effect of interest on unrecognized tax benefits and limitations on certain potential tax credits, offset by the effect of expiring statutes of limitations and settlements.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

The Company's United States Federal income tax returns for years ended September 30, 2012 and thereafter remain subject to examination by the United States Internal Revenue Service ("IRS"). The Company also files tax returns in Canada, India, Kuwait and numerous United States state jurisdictions, which have varying statutes of limitations. Generally, Canadian tax returns for tax years ended September 30, 2008 and thereafter, Indian tax returns for tax years ended March 31, 2010 and thereafter, Kuwaiti tax returns for tax years ended January 30, 2015 and thereafter, and United States state tax returns for tax years ended September 30, 2011 and thereafter, depending upon the jurisdiction, remain subject to examination. However, the statutes of limitations on certain of the Company's United States state tax returns remain open for years prior to fiscal 2011.

12. EQUITY AWARD PLANS

The Compensation Committee of the Company's Board of Directors established performance goals for the award of performance-based RSUs for the Company's executive officers, under the Amended and Restated Destination Maternity Corporation 2005 Equity Incentive Plan, in each of April 2016 (the "Fiscal 2016 Awards") and April 2015 (the "Fiscal 2015 Awards"). The RSUs earned, if any, under the awards will be based on the Company's cumulative operating income, as defined in the applicable award agreement ("RSU Operating Income") for a specified three-year period ("Performance Period"). The grant of any RSUs under these awards will generally be further contingent on the continued employment of the executive officers with the Company through the dates on which the shares in respect of these RSUs, if any, are issued following the end of the applicable Performance Periods, as well as the achievement of certain minimum levels of RSU 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 record date. The additional RSUs, if any, will be earned on the same terms as the original RSUs.

On August 1, 2016 RSUs with the same terms and conditions as the Fiscal 2016 Awards were awarded as an inducement grant, in connection with the hiring of the Company's new Executive Vice President & Chief Financial Officer.

The following table sets forth the aggregate minimum, target and maximum RSUs, excluding RSUs from dividends declared, that may be earned by the executive officers for each fiscal year award cycle.

Awards	Performance Period	Minimum RSUs	Target RSUs	Maximum RSUs
Fiscal 2016 Awards (1)	January 31, 2016 to February 3, 2018	13,698	54,789	82,185
Fiscal 2015 Awards	February 2, 2015 to January 28, 2017	15,218	30,436	45,655

(1) Includes RSUs under an inducement grant dated August 1, 2016.

Fiscal 2015 Awards include the prorated number of RSUs that may be earned by the Company's former President and exclude RSUs forfeited by the Company's former Executive Vice President and Chief Financial Officer. During the fiscal year ended September 30, 2014 the Company determined that the awards for the three-year Performance Periods ending September 30, 2016 and 2015 were unlikely to be earned, even at the minimum level. The Company's Executive Vice President & Chief Administrative Officer would be entitled to the fair value associated with 3,374 RSUs awarded for the three-year Performance Period ending September 30, 2016 in the event of a change in control, as defined in the executive's employment agreement, prior to October 1, 2016.

During the six months ended July 30, 2016 and August 1, 2015 certain vesting restricted stock awards were net-share settled by the Company such that the Company withheld shares of the Company's common stock, which had a fair market value equivalent to the minimum statutory obligation for the applicable income and employment taxes for the awards, and the Company remitted the cash value to the appropriate taxing authorities. The total shares withheld, which were 2,351 and 3,699 shares, respectively, during the six months ended July 30, 2016 and August 1, 2015, 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 \$18,000 and \$57,000 for the six months ended July 30, 2016 and August 1, 2015, respectively.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

13. RECENT ACCOUNTING PRONOUNCEMENTS

a. Adopted

In April 2015 the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The Company adopted ASU No. 2015-03 effective January 31, 2016 and accordingly, the deferred financing costs related to the Company’s Term Loan are reflected as a direct deduction from the Term Loan liability. The adoption of ASU No. 2015-03 did not have any impact on the Company’s net consolidated financial position, results of operations or cash flows. The Company continues to classify deferred financing costs related to its Credit Facility within other assets in the Consolidated Balance Sheets in accordance with the optional disclosure provisions in ASU No. 2015-15, Interest - Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements.

b. Proposed

In March 2016 the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. ASU No. 2016-09 affects all entities that issue share-based payment awards to their employees. ASU No. 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows, including recognizing all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement rather than in additional paid-in capital. ASU No. 2016-09 is effective for financial statements issued for annual reporting periods beginning after December 15, 2016 and interim periods within those years. Earlier application is permitted. The impact from adoption of the new requirements of ASU No. 2016-09 on the Company’s consolidated financial position or results of operations has not yet been determined.

In February 2016 the FASB issued ASU No. 2016-02, Leases (Topic 842). ASU No. 2016-02 affects any entity that enters into a lease (as that term is defined in the ASU) and its guidance supersedes Topic 840, Leases. As it substantively relates to the Company, ASU No. 2016-02 requires lessees to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position. For finance leases, lessees are required to recognize interest on the lease liability separately from amortization of the right-of-use asset in the statement of comprehensive income and to classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows. For operating leases, lessees are required to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis, and to classify all cash payments within operating activities in the statement of cash flows. In transition, lessees are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. ASU No. 2016-02 is effective for financial statements issued for annual reporting periods beginning after December 15, 2018 and interim periods within those years. Earlier application is permitted. The impact from adoption of the new requirements of ASU No. 2016-02 on the Company’s consolidated financial position or results of operations has not yet been determined.

Edgar Filing: Destination Maternity Corp - Form 10-Q

In November 2015 the FASB issued ASU No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. To simplify the presentation of deferred income taxes, ASU No. 2015-17 requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. ASU No. 2015-17 is effective for financial statements issued for annual reporting periods beginning after December 15, 2016 and interim periods within those years. Earlier application is permitted. Because this guidance impacts presentation only, the adoption of the new requirements of ASU 2015-17 will not have any impact on the Company's net consolidated financial position or results of operations.

In July 2015 the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. ASU No. 2015-11 requires entities to measure inventory at the lower of cost and net realizable value. ASU No. 2015-11 is effective for financial statements issued for annual reporting periods beginning after December 15, 2016 and interim periods within those years. Earlier application is permitted. Application of the new requirements of ASU No. 2015-11 is not expected to have a material impact on the Company's consolidated financial position or results of operations.

In May 2014 the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2014-09 requires an entity to recognize revenue for the amount of consideration to which it expects to be entitled for the transfer of promised goods or services to customers. Additionally, ASU No. 2014-09 requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. The standard will replace most existing

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

revenue recognition guidance in generally accepted accounting principles in the United States (“GAAP”) when it becomes effective. ASU No. 2014-09 is effective for financial statements issued for annual reporting periods beginning after December 15, 2016 and interim periods within those years. In August 2015 the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date which deferred the effective date of ASU No. 2014-09 by one year, making the guidance effective for fiscal years beginning after December 15, 2017. Early adoption will be permitted, but not earlier than the original effective date for annual and interim periods. The impact from adoption of the new requirements of ASU No. 2014-09 on the Company’s consolidated financial position or results of operations has not yet been determined.

14. COMMITMENTS AND CONTINGENCIES

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

15. SEGMENT AND ENTERPRISE WIDE DISCLOSURES

Operating Segment. For purposes of the disclosure requirements for segments of a business enterprise, the Company has determined that its business is comprised of one operating segment: the design, manufacture and sale of maternity apparel and related accessories. While the Company offers a wide range of products for sale, the substantial portion of its products are initially distributed through the same distribution facilities, many of the Company’s products are manufactured at common contract manufacturer production facilities, the Company’s products are marketed through a common marketing department, and these products are sold to a similar customer base consisting of expectant mothers.

Geographic Information. Geographic revenue information is allocated based on the country in which the products or services are sold, and in the case of international franchise revenues, on the location of the customer. Information concerning the Company’s operations by geographic area was as follows (in thousands):

Three Months Ended		Six Months Ended	
July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015

Edgar Filing: Destination Maternity Corp - Form 10-Q

Net Sales to Unaffiliated Customers				
United States	\$99,985	\$112,044	\$216,271	\$244,966
Foreign	6,544	7,262	14,688	15,952

July 30, January
 2016 30,
 2016

Long-Lived Assets		
United States	\$88,048	\$90,338
Foreign	2,875	3,483

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

16. INTEREST EXPENSE, NET

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

	Three Months Ended		Six Months Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Interest expense	\$974	\$350	\$1,626	\$780
Interest income	(1)	(6)	(1)	(7)
Interest expense, net	\$973	\$344	\$1,625	\$773

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

We operate on a fiscal year ending on the Saturday nearest January 31 of each year. References in this discussion to our fiscal 2016 refer to the fiscal year, or periods within such fiscal year, which began January 31, 2016 and will end January 28, 2017. References to our fiscal 2015 refer to the fiscal year, or periods within such fiscal year, which began February 1, 2015 and ended January 30, 2016.

Overview

We are the leading designer and retailer of maternity apparel in the United States with 1,227 retail locations, including 526 stores in the United States, Canada and Puerto Rico, and 701 leased departments located within department stores and baby specialty stores throughout the United States, in Puerto Rico and in England. We also sell merchandise on the Internet, primarily through our brand-specific websites, motherhood.com and apeainthepod.com, as well as through our destinationmaternity.com website. We have store franchise and product supply relationships in the Middle East, South Korea, Mexico, Israel and India. As of July 30, 2016 we have 237 international franchised locations, including 21 stand-alone stores operated under one of our retail nameplates and 216 shop-in-shop locations.

In assessing the performance of our business, we consider a variety of operational and financial measures. The key measures for determining how our business is performing are net income (loss) determined in accordance with GAAP ("net income (loss)") and the corresponding net income (loss), or earnings (loss) per share (diluted), net income (loss) before certain charges or credits, when applicable, such as other charges, loss on extinguishment of debt, and certain infrequent income tax adjustments ("adjusted net income (loss)") and the corresponding earnings (loss) per share (diluted), Adjusted EBITDA (defined below), Adjusted EBITDA before other charges, net sales, and comparable sales. Adjusted EBITDA represents operating income (loss) before deduction for the following non-cash charges: 1) depreciation and amortization expense, 2) loss on impairment of tangible and intangible assets, 3) loss (gain) on disposal of assets, and 4) stock-based compensation expense.

Comparable sales figures represent sales at retail locations (which does not include licensed brand or international franchise relationships) that have been in operation by us for at least 13 full months, as well as Internet sales. Our comparable sales figures generally do not include: 1) retail locations which change location type or format, 2) retail locations which are expanded, contracted or relocated if the square footage of the retail location has changed by 20% or more, or, if in the judgment of management, such expansion, contraction or relocation materially alters the comparability of the retail location (either with respect to the manner of its operation or otherwise), 3) in the case of relocations only, retail locations which are not in the same immediate geographical vicinity (such as, without limitation, the same mall, the same part of a mall, or the same street) after the relocation, (4) retail locations that have temporarily closed for any reason for 30 days or more, or 5) retail locations which, in the judgment of management, have undergone other significant changes which materially alter the comparability of the retail location (either with respect to the manner of its operation or otherwise) (such as, for example only, in the case of closure of retail locations in connection with the cessation of a leased department relationship where the manner of operation of such retail location has been materially altered prior to closure, or in the case of construction in, on or near a retail location, which significantly interferes with the customer traffic, visibility or operation of a retail location). There may be variations in the way in which other retailers calculate comparable sales. As a result, data in this quarterly report regarding our comparable sales may not be comparable to similar data made available by other retailers. Beginning with the first quarter of fiscal 2016 we made certain adjustments to our definition of comparable sales including, most notably, (a) extending the period that a retail location is required to be in operation before being included in comparable sales from "at least 12 full months at the beginning of a period" to "at least 13 full months"; and (b) expressly providing that retail locations which are closed temporarily for 30 days or more will generally be excluded from comparable sales. We made these changes because we believe the new formulation is more typical of that used by other specialty retailers. In addition, comparable sales as determined under the revised definition will allow for easier reconciliation of monthly, quarterly and annual reporting. We have not restated prior period comparable sales figures

because the changes would not be material in the aggregate considering the relatively minor changes to the definition.

Presented below is a summary of our results for the second quarter and first six months of fiscal 2016 with regard to each of the key measures noted above:

Second Quarter Fiscal 2016 Financial Results

Net loss for the second quarter of fiscal 2016 was \$2.5 million, or \$0.18 per share (diluted), compared to net loss of \$2.7 million, or \$0.20 per share (diluted), for second quarter of fiscal 2015.

Net loss for the second quarter of fiscal 2016 includes other charges of 1) \$0.1 million, net of tax, or \$0.01 per share (diluted), related to management and organizational changes and 2) \$0.4 million, net of tax, or \$0.03 per share (diluted), related to a proposed business combination. Net loss for the second quarter of fiscal 2015 includes other charges of 1) \$0.3 million, net of tax,

17

or \$0.02 per share (diluted), related to management and organizational changes and 2) \$0.7 million, net of tax, or \$0.05 per share (diluted), related to the relocations of our headquarters and distribution facilities.

Adjusted net loss for the second quarter of fiscal 2016 was \$2.0 million, or \$0.14 per share (diluted), compared to the comparably adjusted net loss for the second quarter of fiscal 2015 of \$1.7 million, or \$0.12 per share (diluted).

Adjusted EBITDA was \$2.4 million for the second quarter of fiscal 2016, an increase of 153.7% compared to \$0.9 million of Adjusted EBITDA for the second quarter of fiscal 2015.

Adjusted EBITDA before other charges was \$3.3 million for the second quarter of fiscal 2016, an increase of 31.1% compared to \$2.5 million of Adjusted EBITDA before other charges for the second quarter of fiscal 2015.

Net sales for the second quarter of fiscal 2016 decreased 10.7% to \$106.5 million from \$119.3 million for the second quarter of fiscal 2015.

Comparable sales for the second quarter of fiscal 2016 decreased 2.7% compared to a comparable sales increase of 2.0% for the second quarter of fiscal 2015.

First Six Months of Fiscal 2016 Financial Results

Net income for the first six months of fiscal 2016 was \$1.5 million, or \$0.11 per share (diluted), compared to net loss of \$0.1 million, or \$0.01 per share (diluted), for the first six months of fiscal 2015.

Net income for the first six months of fiscal 2016 includes other charges of 1) \$0.4 million, net of tax, or \$0.03 per share (diluted), related to management and organizational changes and 1) \$0.5 million, net of tax, or \$0.04 per share (diluted), related to a proposed business combination. Net loss for the first six months of fiscal 2015 includes other charges of 1) \$0.8 million, net of tax, or \$0.06 per share (diluted), related to management and organizational changes and 2) \$1.3 million, net of tax, or \$0.10 per share (diluted), related to the relocations of our headquarters and distribution facilities.

Adjusted net income for the first six months of fiscal 2016 was \$2.5 million, or \$0.18 per share (diluted), compared to the comparably adjusted net income for the first six months of fiscal 2015 of \$2.0 million, or \$0.15 per share (diluted). Adjusted EBITDA was \$15.0 million for the first six months of fiscal 2016, an increase of 32.5% compared to \$11.3 million of Adjusted EBITDA for the first six months of fiscal 2015.

Adjusted EBITDA before other charges was \$16.5 million for the first six months of fiscal 2016, an increase of 13.8% compared to \$14.5 million of Adjusted EBITDA before other charges for the first six months of fiscal 2015.

Net sales for the first six months of fiscal 2016 decreased 11.5% to \$231.0 million from \$260.9 million for the first six months of fiscal 2015.

Comparable sales for the first six months of fiscal 2016 decreased 4.2% compared to a comparable sales increase of 0.2% for the first six months of fiscal 2015.

Leased Department and Licensed Relationships

As previously announced, in an effort to direct resources to the highest return opportunities and further optimize real estate while reducing costs, we discontinued our Two Hearts[®] Maternity by Destination Maternity[®] line, thus ending our relationship with Sears[®] in June 2016, resulting in the closure of 475 leased departments within Sears stores during the first six months of fiscal 2016. In addition, our leased department relationship with Gordmans ended in March 2016 and we closed 100 leased departments within Gordmans stores. We have also decided to phase out production of our Oh Baby by Motherhood[®] line during fiscal 2016 after being informed that Kohl's has elected to scale back and ultimately discontinue its exclusive license with us for this line in early fiscal 2017. Even after the end of these relationships, we remain well positioned to service the needs of our customers through our own stores, as well as through our other leased departments and our various websites.

Results of Operations

The following table sets forth certain operating data as a percentage of net sales and as a percentage change for the three and six months ended July 30, 2016 and August 1, 2015:

	% of Net Sales (1)						% Change Period to Period	
	Three Months Ended		Six Months Ended		Favorable (Unfavorable)		Three	Six
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015	Months Ended	Months Ended	July 30, 2016 vs. August 1, 2015	July 30, 2016 vs. August 1, 2015
Net sales	100.0%	100.0 %	100.0%	100.0 %			(10.7)%	(11.5)%
Cost of goods sold (2)	48.5	53.6	47.1	51.4			19.2	18.9
Gross profit	51.5	46.4	52.9	48.6			(0.9)	(3.6)
Selling, general and administrative expenses (3)	53.1	51.7	50.0	48.2			8.1	8.2
Store closing, asset impairment and asset disposal expenses (income)	0.4	(3.3)	0.5	(1.1)			(111.2)	(135.6)
Other charges	0.8	1.4	0.7	1.3			46.5	55.2
Operating income (loss)	(2.9)	(3.4)	1.8	0.2			22.7	672.2
Interest expense, net	0.9	0.3	0.7	0.3			(182.8)	(110.2)
Income (loss) before income taxes	(3.8)	(3.7)	1.1	(0.1)			6.5	1,137.9
Income tax (benefit) provision	(1.5)	(1.4)	0.4	(0.0)			(6.5)	(1,131.2)
Net income (loss)	(2.4)%	(2.2)%	0.7 %	(0.1)%			6.5 %	1,142.2 %

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

(2) "Cost of goods sold" includes merchandise costs (including customs duty expenses), expenses related to inventory shrinkage, product related corporate expenses (including expenses related to our payroll, benefit costs and operating expenses of our buying departments), inventory reserves (including lower of cost or market reserves), inbound freight charges, purchasing and receiving costs, inspection costs, distribution center costs (including occupancy expenses and equipment depreciation), internal transfer costs, and the other costs of our distribution network, partially offset by the allocable amount of our Grow NJ benefit in fiscal 2016.

(3) "Selling, general and administrative expenses" includes advertising and marketing expenses, corporate administrative expenses, corporate headquarters occupancy expenses, store expenses (including store payroll and store occupancy expenses), and store opening expenses, partially offset by the allocable amount of our Grow NJ benefit in fiscal 2016.

The following tables set forth certain information concerning the number of our retail locations and international franchised locations for the periods indicated. Retail locations include stores and maternity apparel leased departments and exclude locations where Kohl's sells our products under an exclusive product and license agreement, and international franchised locations.

Three Months Ended

Edgar Filing: Destination Maternity Corp - Form 10-Q

Retail Locations (1)	July 30, 2016			August 1, 2015		
	Stores	Leased Departments	Total Retail Locations	Stores	Leased Departments	Total Retail Locations
Beginning of period	530	957	1,487	557	1,311	1,868
Opened	3	2	5	3	7	10
Closed (2)	(7)	(258)	(265)	(8)	(5)	(13)
End of period	526	701	1,227	552	1,313	1,865

19

Edgar Filing: Destination Maternity Corp - Form 10-Q

Retail Locations (1)	Six Months Ended July 30, 2016			August 1, 2015		
	Stores	Leased Departments	Total Retail Locations	Stores	Leased Departments	Total Retail Locations
Beginning of period	536	1,279	1,815	564	1,311	1,875
Opened	6	3	9	11	12	23
Closed (2)	(16)	(581)	(597)	(23)	(10)	(33)
End of period	526	701	1,227	552	1,313	1,865

(1) Excludes locations where Kohl's sells our products under an exclusive product and license agreement, and international franchised locations.

(2) During the three and six months ended July 30, 2016 we closed 253 and 475, respectively, leased departments within Sears stores. During the six months ended July 30, 2016, we closed 100 leased departments within Gordmans stores.

International Franchised Locations (1)	Three Months Ended July 30, 2016			August 1, 2015		
	Stores	Shop-in- Shop Locations	Total International Franchised Locations	Stores	Shop-in- Shop Locations	Total International Franchised Locations
Beginning of period	23	180	203	24	104	128
Opened	1	37	38	3	20	23
Closed	(3)	(1)	(4)	(1)	(2)	(3)
End of period	21	216	237	26	122	148

International Franchised Locations (1)	Six Months Ended July 30, 2016			August 1, 2015		
	Stores	Shop-in- Shop Locations	Total International Franchised Locations	Stores	Shop-in- Shop Locations	Total International Franchised Locations
Beginning of period	25	168	193	23	62	85
Opened	1	50	51	4	62	66
Closed	(5)	(2)	(7)	(1)	(2)	(3)
End of period	21	216	237	26	122	148

(1) As of July 30, 2016 our merchandise is offered in 109 shop-in-shops in Mexico. During June 2015 we commenced our expansion into Israel. As of July 30, 2016 our merchandise is offered in 40 shop-in-shops and two franchise stores in Israel. In June 2016 we commenced our expansion into India. As of July 30, 2016 our merchandise is offered in 31 shop-in-shops in India.

Edgar Filing: Destination Maternity Corp - Form 10-Q

Three Months Ended July 30, 2016 and August 1, 2015

Net Sales. Our net sales for the second quarter of fiscal 2016 decreased by 10.7%, or \$12.8 million, to \$106.5 million from \$119.3 million for the three months ended August 1, 2015. Comparable sales for the second quarter of fiscal 2016 decreased 2.7% compared to a comparable sales increase of 2.0% for the second quarter of fiscal 2015. The decrease in total reported sales for the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 resulted primarily from the decrease in comparable sales and decreased sales related to the Company's continued efforts to close underperforming stores (see our discussion in Item 1. Business Overview of our Annual Report on Form 10-K for the year ended January 30, 2016 regarding closing underperforming stores), and decreased leased department and licensed sales, reflecting the effect of the wind down of the Kohl's, Sears and Gordmans relationships. The primary drivers of the comparable sales decrease were lower transactions and lower unit sales due to decreased store traffic, partially offset by an increase in our average selling prices.

Gross Profit. Our gross profit for the second quarter of fiscal 2016 decreased by 0.9%, or \$0.5 million, to \$54.8 million from \$55.3 million for the second quarter of fiscal 2015, and our gross profit as a percentage of net sales (gross margin) for the second quarter of fiscal 2016 was 51.5% compared to 46.4% for the second quarter of fiscal 2015. The decrease in gross profit for the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 was primarily due to our lower sales volume as a result of the

factors discussed above. The year-over-year increase in gross margin reflects less price promotion and markdown activity as a result of better managed inventory, and lower levels of excess current season and aged merchandise. During the second quarter of fiscal 2016 higher occupancy and depreciation expenses from our relocations were substantially offset by lower employment costs and benefit from our Grow NJ award, which we began to recognize during the second half of fiscal 2015. In fiscal 2016 and beyond the Grow NJ benefit is expected to partially offset our relocation related costs on an annual basis.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses for the second quarter of fiscal 2016 decreased by 8.1%, or \$5.0 million, to \$56.6 million from \$61.6 million for the second quarter of fiscal 2015. As a percentage of net sales, selling, general and administrative expenses increased to 53.1% for the second quarter of fiscal 2016 from 51.7% for the second quarter of fiscal 2015. This decrease in expense for the quarter reflects cost reductions resulting from our continued closure of underperforming stores and other headcount reductions, as well as lower marketing and advertising expense. The increase in expense percentage for the three month period reflects the unfavorable leverage from our decreased sales due to the relatively fixed nature of much of our expenses.

Store Closing, Asset Impairment and Asset Disposal Expenses (Income). For the second quarter of fiscal 2016 we had \$0.4 million of expense from store closings, asset impairments and asset disposals compared to \$4.0 million of income for the second quarter of fiscal 2015. During the second quarter of fiscal 2015 we received \$4.1 million from the landlord as incentive for an early termination of a store lease.

Other Charges. In the second quarter of fiscal 2016 we incurred other charges of \$0.9 million related to management and organizational changes and a proposed business combination. Other charges related to management and organizational changes were \$0.2 million, primarily for costs to terminate a non-core apparel brand relationship. Other charges related to a proposed business combination were \$0.7 million, primarily for legal and advisory fees. In the second quarter of fiscal 2015 we incurred other charges of \$1.6 million related to management and organizational changes and the relocations of our headquarters and distribution operations. Other charges related to management and organizational changes were \$0.5 million, primarily for consulting fees, and to a lesser extent, severance and other benefits in connection with the replacement of certain key management personnel and some reductions in headcount. Other charges related to our relocations of our corporate headquarters and distribution operations from Philadelphia, Pennsylvania to southern New Jersey were approximately \$1.1 million, primarily for pre-opening rent expense for the new distribution center, and to a lesser extent, accelerated depreciation.

Operating Income (Loss). We had an operating loss of \$3.1 million for the second quarter of fiscal 2016 compared to an operating loss of \$4.0 million for the second quarter of fiscal 2015, which included the \$4.1 million incentive for an early termination of a store lease. Excluding the year-over-year effect of the early lease termination incentive in fiscal 2015 our operating loss was reduced by \$5.0 million, which reflects our 8.1% reduction in selling, general and administrative expenses, increases in our average selling prices and gross margin from better inventory management, and lower other charges. These improvements more than offset our lower gross profit as a result of the decline in sales volume.

Interest Expense, Net. Our net interest expense for the second quarter of fiscal 2016 increased to \$1.0 million from \$0.3 million for the second quarter of fiscal 2015. This increase was due to interest expense on outstanding borrowings on our Term Loan during the second quarter of fiscal 2016, partially offset by a reduction in the principal balance due under our equipment note and lower average borrowings under our Credit Facility during the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015.

Income Tax (Benefit) Provision. For the three months ended July 30, 2016 and August 1, 2015 our effective tax benefit rate was 38.5%. Our effective tax benefit rate was higher than the statutory federal tax rate of 35% primarily

due to state income tax benefits, net of federal expense.

Net Income (Loss). Net loss for the second quarter of fiscal 2016 was \$2.5 million, or \$0.18 per share (diluted), compared to net loss of \$2.7 million, or \$0.20 per share (diluted), for the second quarter of fiscal 2015. Net loss for the second quarter of fiscal 2016 includes other charges of \$0.1 million, net of tax, related to management and organizational changes and \$0.4 million, net of tax, related to a proposed business combination. Net loss for the second quarter of fiscal 2015 includes other charges of \$0.3 million, net of tax, related to management and organizational changes, and \$0.7 million, net of tax, related to the relocations of our headquarters and distribution facilities, and the fiscal year change.

Our average diluted shares outstanding of 13.7 million for the second quarter of fiscal 2016 were slightly higher than the 13.6 million average diluted shares outstanding for the second quarter of fiscal 2015. We had higher shares outstanding in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 primarily as a result of stock option exercises and restricted stock awards.

Edgar Filing: Destination Maternity Corp - Form 10-Q

Following is a reconciliation of net loss and net loss per share (diluted) (“Diluted EPS”) to adjusted net loss and adjusted Diluted EPS for the three months ended July 30, 2016 and August 1, 2015 (in thousands, except per share amounts):

	Three Months Ended			August 1, 2015		
	July 30, 2016		Diluted EPS	Net		Diluted EPS
	Net Loss	Diluted Shares		Loss	Shares	
As reported	\$(2,509)	13,700	\$(0.18)	\$(2,682)	13,585	\$(0.20)
Other charges for management and organizational changes	223	—		523	—	
Other charges for proposed business combination	652	—		—	—	
Other charges for relocations	—	—		1,087	—	
Other charges for fiscal year change	—	—		27	—	
Income tax effect of other charges (1) (2)	(334)	—		(638)	—	
As adjusted	\$(1,968)	13,700	\$(0.14)	\$(1,683)	13,585	\$(0.12)

(1) For the second quarter of fiscal 2016 income tax effect of other charges includes \$85 related to management and organizational changes and \$249 related to a proposed business combination, which represent the differences in income tax benefit calculated with and without the specified pretax expense.

(2) For the second quarter of fiscal 2015 income tax effect of other charges includes \$206 related to management and organizational changes, \$422 related to relocations and \$10 related to the fiscal year change, which represent the differences in income tax benefit calculated with and without the specified pretax expense.

Following is a reconciliation of net loss to Adjusted EBITDA and Adjusted EBITDA before other charges for the second quarter of fiscal 2016 and 2015 (in thousands):

	Three Months Ended	
	July 30, 2016	August 1, 2015
Net loss	\$(2,509)	\$(2,682)
Add: income tax benefit	(1,570)	(1,680)
Add: interest expense, net	973	344
Operating loss	(3,106)	(4,018)
Add: depreciation and amortization expense	4,541	4,129
Add: loss on impairment of long-lived assets	322	262
Add: loss (gain) on disposal of assets	113	(140)
Add: stock-based compensation expense	510	705
Adjusted EBITDA	2,380	938
Add: other charges for management and organizational changes	223	523
Add: other charges for proposed business combination	652	—
Add: other charges for relocations (1)	—	994
Add: other charges for fiscal year change	—	27
Adjusted EBITDA before other charges	\$3,255	\$2,482

(1) For the second quarter of fiscal 2015 other charges for relocations excludes accelerated depreciation expense of \$93 (included in depreciation and amortization expense above).

Six Months Ended July 30, 2016 and August 1, 2015

Net Sales. Our net sales for the first six months of fiscal 2016 decreased by 11.5%, or approximately \$29.9 million, to \$231.0 million from \$260.9 million for the first six months of fiscal 2015. Comparable sales for the first six months of fiscal 2016 decreased 4.2% compared to a comparable sales increase of 0.2% for the first six months of fiscal 2015. The decrease in total reported sales for the first six months of fiscal 2016 compared to the first six months of fiscal 2015 resulted primarily from the decrease in comparable sales and decreased sales related to the Company's continued efforts to close underperforming stores, and decreased leased department and licensed sales, reflecting the effect of the wind down of the Kohl's, Sears and Gordmans relationships. The primary drivers of the comparable sales decrease were lower transactions and lower unit sales due to decreased store traffic, partially offset by an increase in our average selling prices.

Gross Profit. Our gross profit for the first six months of fiscal 2016 decreased by 3.6%, or \$4.6 million, to \$122.1 million from \$126.7 million for the first six months of fiscal 2015, and our gross margin for the first six months of fiscal 2016 was 52.9% compared to 48.6% for the first six months of fiscal 2015. The decrease in gross profit for the first six months of fiscal 2016 compared to the first six months of fiscal 2015 was primarily due to our lower sales volume as a result of the factors discussed above. The year-over-year increase in gross margin reflects less price promotion and markdown activity as a result of better managed inventory, and lower levels of excess current season and aged merchandise. During the first six months of fiscal 2016 higher occupancy and depreciation expenses from our relocations were substantially offset by lower employment costs and benefit from our Grow NJ award, which we began to recognize during the second half of fiscal 2015.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses for the first six months of fiscal 2016 decreased by 8.2%, or \$10.3 million, to \$115.4 million from \$125.7 million for the first six months of fiscal 2015. As a percentage of net sales, selling, general and administrative expenses increased to 50.0% for the first six months of fiscal 2016 from 48.2% for the first six months of fiscal 2015. This decrease in expense for the six month period reflects cost reductions resulting from our continued closure of underperforming stores and other headcount reductions, as well as lower marketing and advertising expense. The increase in expense percentage for the six month period reflects the unfavorable leverage from our decreased sales due to the relatively fixed nature of much of our expenses.

Store Closing, Asset Impairment and Asset Disposal Expenses (Income). For the first six months of fiscal 2016 we had \$1.0 million of expense from store closings, asset impairments and asset disposals compared to \$2.9 million of income for the first six months of fiscal 2015. During the first six months of fiscal 2015 we received \$4.1 million from the landlord as incentive for an early termination of a store lease.

Other Charges. In the first six months of fiscal 2016 we incurred other charges of \$1.5 million primarily related to management and organizational changes and a proposed business combination. Other charges related to management and organizational changes were approximately \$0.6 million, primarily for costs to terminate non-core apparel brand relationships, and to a lesser extent, severance and other benefits. Other changes related to a proposed business combination were \$0.9 million, primarily for legal and advisory fees. In the first six months of fiscal 2015 we incurred other charges of \$3.4 million related to management and organizational changes, and the relocations of our headquarters and distribution operations. Other charges related to management and organizational changes were \$1.3 million, primarily for consulting fees, and to a lesser extent, severance and other benefits in connection with the replacement of certain key management personnel and some reductions in headcount. Other charges related to our relocations were \$2.1 million, primarily for pre-opening rent expense for the new distribution center and to a lesser extent, accelerated depreciation.

Operating Income (Loss). We had operating income of \$4.1 million for the first six months of fiscal 2016 compared to operating income of \$0.5 million for the first six months of fiscal 2015, which included the \$4.1 million incentive for an early termination of a store lease. Excluding the year-over-year effect of the early lease termination incentive in fiscal 2015 our operating income increased by \$7.7 million, which reflects our 8.2% reduction in selling, general and administrative expenses increases in our average selling prices and gross margin from better inventory management, and lower other charges. These improvements more than offset our lower gross profit as a result of the decline in sales volume.

Interest Expense, Net. Our net interest expense for the first six months of fiscal 2016 increased to \$1.6 million from \$0.8 million for the first six months of fiscal 2015. This increase was due to interest expense incurred on our Term Loan during the first six months of fiscal 2016, partially offset by a reduction in the principal balance due under our equipment note and lower average borrowings under our Credit Facility during the first six months of fiscal 2016 compared to the first six months of fiscal 2015.

Income Tax (Benefit) Provision. For the six months ended July 30, 2016 our effective tax rate was 38.5%. For the six months ended August 1, 2015 our effective tax benefit rate was 38.8%. Our effective tax rate for the six months ended July 30, 2016 and August 1, 2015 was higher than the statutory federal tax rate of 35% primarily due to state income tax benefits, net of federal expense.

Net Income (Loss). Net income for the first six months of fiscal 2016 was \$1.5 million, or \$0.11 per share (diluted), compared to a net loss of \$0.1 million, or \$0.01 per share (diluted), for the first six months of fiscal 2015. Net income for the first six months of fiscal 2016 includes other charges of \$0.4 million, net of tax, related to management and organizational changes and \$0.5 million, net of tax, related to a proposed business combination. Net loss for the first six months of fiscal 2015 includes other charges of \$0.8 million, net of tax, related to management and organizational changes, and \$1.3 million, net of tax, related to the relocations of our headquarters and distribution facilities, and the fiscal year change.

Our average diluted shares outstanding of 13.7 million for the first six months of fiscal 2016 were slightly higher than the 13.6 million average diluted shares outstanding for the first six months of fiscal 2015. We had higher shares outstanding in the first six months of fiscal 2016 compared to the first six months of fiscal 2015 as a result of stock option exercises and restricted stock awards.

Edgar Filing: Destination Maternity Corp - Form 10-Q

Following is a reconciliation of net income (loss) and Diluted EPS to adjusted net income and adjusted Diluted EPS for the six months ended July 30, 2016 and August 1, 2015 (in thousands, except per share amounts):

	Six Months Ended			August 1, 2015		
	July 30, 2016			Net		
	Net Income	Diluted Shares	Diluted EPS	Income (Loss)	Diluted Shares	Diluted EPS
As reported	\$1,532	13,697	\$ 0.11	\$(147)	13,583	\$(0.01)
Other charges for management and organizational changes	671	—		1,324	—	
Other charges for proposed business combination	873	—		—	—	
Other charges for relocations	—	—		2,094	—	
Other charges for fiscal year change	—	—		27	—	
Income tax effect of other charges (1) (2)	(590)	—		(1,319)	—	
Dilutive impact of outstanding stock options and restricted stock eliminated due to net loss	—	—		—	33	
As adjusted	\$2,486	13,697	\$ 0.18	\$1,979	13,616	\$ 0.15

(1) For the six months ended July 30, 2016 income tax effect of other charges includes \$256 related to management and organizational changes and \$334 related to a proposed business combination, which represent the differences in income tax provision calculated with and without the specified pretax expense.

(2) For the six months ended August 1, 2015 income tax effect of other charges includes \$507 related to management and organizational changes, \$802 related to relocations and \$10 related to the fiscal year change, which represent the differences in income tax (benefit) provision calculated with and without the specified pretax expense.

Following is a reconciliation of net income (loss) to Adjusted EBITDA and Adjusted EBITDA before other charges for the six months ended July 30, 2016 and August 1, 2015 (in thousands):

	Six Months Ended	
	July 30, 2016	August 1, 2015
Net income (loss)	\$1,532	\$(147)
Add: income tax provision (benefit)	959	(93)
Add: interest expense, net	1,625	773
Operating income	4,116	533
Add: depreciation and amortization expense	8,927	8,139
Add: loss on impairment of long-lived assets	733	1,054
Add: loss on disposal of assets	215	14
Add: stock-based compensation expense	968	1,552
Adjusted EBITDA	14,959	11,292
Add: other charges for management and organizational changes	671	1,324
Add: other charges for proposed business combination	873	—
Add: other charges for relocations (1)	—	1,861

Edgar Filing: Destination Maternity Corp - Form 10-Q

Add: other charges for fiscal year change	—	27
Adjusted EBITDA before other charges	\$16,503	\$14,504

(1) For the six months ended August 1, 2015 other charges for relocations excludes accelerated depreciation expense of \$233 (included in depreciation and amortization expense above).

Regulation G Disclosures

Management's Discussion and Analysis of Financial Condition and Results of Operations contains non-GAAP financial measures within the meaning of the SEC's Regulation G, including: 1) Adjusted net income (loss), 2) Adjusted net income (loss) per share (diluted), 3) Adjusted EBITDA (operating income (loss) before deduction for the following non-cash charges: (i) depreciation and amortization expense, (ii) loss on impairment of tangible and intangible assets, (iii) loss (gain) on disposal of assets, and (iv) stock-based compensation expense), and 4) Adjusted EBITDA before other charges.

Our management believes that each of these non-GAAP financial measures provides useful information about the Company's results of operations and/or financial position to both investors and management. Each non-GAAP financial measure is provided because management believes it is an important measure of financial performance used in the retail industry to measure operating results, to determine the value of companies within the industry and to define standards for borrowing from institutional lenders. We use each of these non-GAAP financial measures as a measure of the performance of the Company. In addition, certain of the Company's cash and equity incentive compensation plans are based on our level of achievement of Adjusted EBITDA before other charges, and our Term Loan provides for achievement of specified minimum levels of "Consolidated EBITDA," which is substantially identical to our non-GAAP financial measure of Adjusted EBITDA before other charges (except that for purposes of the Term Loan, the amount of extraordinary, unusual or non-recurring items that may be excluded is limited as provided in the Term Loan).

We provide these various non-GAAP financial measures to investors to assist them in performing their analysis of our historical operating results. Each of these non-GAAP financial measures reflects a measure of the Company's operating results before consideration of certain charges and consequently, none of these measures should be construed as an alternative to net income (loss) or operating income (loss) as an indicator of the Company's operating performance, as determined in accordance with GAAP. We may calculate each of these non-GAAP financial measures differently than other companies.

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

Seasonality

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

Liquidity and Capital Resources

Our cash needs have primarily been for 1) capital expenditures, including (i) leasehold improvements, fixtures and equipment for new stores, store relocations and remodels of our existing stores, (ii) material handling equipment and leasehold improvements for the relocations of our distribution operations and corporate headquarters, respectively, and (iii) investment in information systems and technology, 2) debt service, including principal prepayments, 3) quarterly cash dividends, and 4) working capital, including inventory to support our business. We have historically financed our capital requirements from cash flows from operations, borrowings under our credit facilities or available cash balances.

Cash and cash equivalents increased by \$0.6 million during the first six months of fiscal 2016 compared to an increase of \$1.1 million for the first six months of fiscal 2015.

Cash provided by operations was \$5.3 million for the first six months of fiscal 2016, a decrease of \$2.0 million from the \$7.3 million in cash provided by operations for the first six months of fiscal 2015. This decrease in cash provided by operations versus the prior year was primarily the result of the effect of net working capital and other asset/liability changes that used \$8.9 million of cash in the first six months of fiscal 2016 compared to \$3.4 million of cash used in the first six months of fiscal 2015, partially offset by our increase in net income and the \$3.6 million cash proceeds received from the sale of our Grow NJ tax credit. The \$5.5 million year-over-year increase in use of cash from net working capital and other asset/liability changes was primarily the result of 1) a larger year-over-year decrease in accounts payable and accrued expenses in the first six months of fiscal 2016 compared to the fiscal 2015 period, reflecting timing of vendor and payroll related payments (\$6.4 million), and 2) a decrease in prepaid expenses and other current assets in the first six months of fiscal 2015, primarily reflecting receipt of \$4.0 million of tenant construction allowances for our new headquarters facility, partially offset by a decrease in trade receivables in the first six months of fiscal 2016 compared to an increase in the comparable fiscal 2015 period, reflecting timing of collections and lower outstanding receivables for our leased and licensed businesses. Our working capital changes, quarterly net income (loss) and cash flow adjustments may fluctuate significantly and net cash provided by or used in operating activities for any interim period is not necessarily indicative of the results that may be achieved for a full fiscal year.

During the first six months of fiscal 2016 we received \$32.0 million from our Term Loan, which we used to repay a portion of the outstanding indebtedness under the Credit Facility and to pay financing costs of the Term Loan. Cash from operations and net incremental borrowings under our Credit Facility and our Term Loan, which were approximately \$4.0 million, were used to provide cash for capital expenditures, monthly payments on our capital equipment loan and to slightly increase available cash. For the first six months of fiscal 2016 we spent \$6.8 million on capital expenditures, including \$4.3 million for leasehold improvements, fixtures and equipment for new store facilities, as well as improvements to existing stores, and \$2.5 million primarily for our information systems. We expect to use borrowings under our Credit Facility to fund a portion of our capital requirements from time to time during the remainder of fiscal 2016.

Our inventory carrying value of \$70.5 million as of July 30, 2016 has declined 4.1% from the comparable prior year amount as a result of our efforts to clear our stores of excess and out-of-season merchandise. Overall unit inventory is 8% down on a year-over-year basis. During the first six months of fiscal 2016 we continued to adjust our approach to balancing inventory and pricing decisions in a demand-constrained retail environment and remained cautious not to take deep markdowns too early. This helped us achieve a 430 basis point improvement in gross margin rate during the first six months of fiscal 2016 versus the comparable period of fiscal 2015. However, we did sell less units driven by fewer transactions as a result of decreased store traffic. We continue to evaluate alternative liquidation approaches to optimize our cash return on the disposal of excess and out-of-season merchandise.

During the first six months of fiscal 2015 we used \$21.0 million from borrowings on our Credit Facility and cash provided by operations to pay for capital expenditures, to pay our quarterly cash dividend, to make monthly payments on our capital equipment loan and to increase available cash. For the first six months of fiscal 2015 we spent \$18.9 million on capital expenditures, including \$9.6 million for leasehold improvements, fixtures and equipment for new store facilities, as well as improvements to existing stores, \$8.3 million related to the relocations of our corporate headquarters and distribution operations, and \$1.0 million for our information systems. In the first six months of fiscal 2015 we paid \$5.5 million for our quarterly cash dividend.

On March 25, 2016, we entered into a Term Loan Agreement for a \$32.0 million Term Loan due March 21, 2021, the proceeds of which were received on March 26, 2016 and were used to repay a portion of the outstanding indebtedness under our existing Credit Facility. The interest rate on the Term Loan is equal to a LIBOR rate (with a 1.00% LIBOR floor) plus 7.50%. We are required to make minimum repayments of the principal amount of the Term Loan in quarterly installments of \$0.8 million each, with the remaining outstanding balance payable on the maturity date.

Additionally, the Term Loan can be prepaid at our option subject to certain restrictions, in part or in whole at any time, subject to the payment of a prepayment premium as follows: 1) 3% on or prior to the first anniversary of the closing date, 2) 2% from the first anniversary to the second anniversary of the closing date, and 3) 1% after the second anniversary but on or prior to the third anniversary of the closing date. Under the Term Loan Agreement we are required to maintain Excess Availability (as defined in the related Credit Facility agreement) equal to the greater of 10% of the Loan Cap (as defined in the related Credit Facility agreement) or \$5.0 million. In addition, we are required to maintain Consolidated EBITDA (as defined in the related Term Loan Agreement) in an amount not less than the levels specified for each period in the Term Loan Agreement. For the first six months of fiscal 2016 our consolidated EBITDA exceeded the Consolidated EBITDA requirement of \$9.5 million. The Consolidated EBITDA requirement for the nine months ending October 29, 2016 is \$12.6 million, and the Consolidated EBITDA requirement for the 12 months ending January 28, 2017 is \$19.0 million. The Term Loan Agreement thereafter provides for a Consolidated EBITDA requirement for the four trailing fiscal quarters that increases from this level to \$30.0 million for the four fiscal quarters ending on February 1, 2020 and thereafter. We expect to continue to remain in compliance with the Consolidated EBITDA covenant and do not expect such continued compliance will have a materially adverse impact on our operations, our ability to invest in the business, or otherwise cause us to require additional fundraising through the sale of equity or debt.

Edgar Filing: Destination Maternity Corp - Form 10-Q

We are prohibited from making capital expenditures (net of tenant allowances) in excess of \$17.0 million in any period of four fiscal quarters (subject to carry-forward of 50% of any underutilization). The Term Loan Agreement also prohibits the payment of dividends or share repurchases by us for three years. The Term Loan is secured by a security interest in substantially all of our assets, including accounts receivable, inventory, equipment, letter of credit rights, cash, intellectual property and other intangibles, and certain other assets. The security interest granted to the Term Lenders is, in certain respects, subordinate to the security interest granted to the Credit Facility Lender.

After completion of our debt refinancing on March 26, 2016 we have a \$70.0 million Credit Facility, which was amended and restated in connection with the issuance of our new \$32.0 million Term Loan. Previously the Credit Facility was \$76.0 million and consisted of two tranches: 1) a senior secured revolving credit and letter of credit facility of up to \$70.0 million (“Tranche A”) and 2) a senior secured first-in, last-out revolving credit facility of up to \$6.0 million (“Tranche A-1”). On March 26, 2016 proceeds from the Term Loan were used to repay a portion of the outstanding indebtedness under the Credit Facility, including repayment of the entire balance outstanding under Tranche A-1, which was then terminated. We originally entered into a five-year \$61.0 million Credit Facility on November 1, 2012. In accordance with the terms of the Credit Facility, effective June 3, 2015 our permitted borrowings under Tranche A of the Credit Facility were increased by \$15.0 million at our request. Effective August 25, 2015 the Credit Facility

was amended to reflect the increase to Tranche A permitted borrowings and to extend the maturity date to August 25, 2020 from November 1, 2017. In connection with the Term Loan financing the maturity date of the Credit Facility was further extended to March 25, 2021. Proceeds from advances under the Credit Facility, with certain restrictions, may be used to provide financing for working capital, letters of credit, capital expenditures and other general corporate purposes. Under the Credit Facility, we are required to maintain minimum Excess Availability (as defined in the related Credit Facility agreement) equal to the greater of 10% of the Loan Cap (as defined in the Credit Facility agreement) or \$5.0 million. The Credit Facility is secured by a security interest in our trade receivables, inventory, letter of credit rights, cash, intangibles and certain other assets.

As of July 30, 2016 we had \$1.7 million of borrowings under the Credit Facility and \$6.2 million in letters of credit, with \$34.5 million of availability under our Credit Facility based on our Borrowing Base formula and minimum Excess Availability requirement. As of August 1, 2015 we had \$21.0 million of borrowings under the Credit Facility (\$15.0 million from Tranche A and \$6.0 million from Tranche A-1) and \$6.3 million in letters of credit, with \$27.7 million of availability under our Credit Facility based on our Borrowing Base formula and minimum Excess Availability requirement. For the first six months of fiscal 2016 and 2015 Tranche A borrowings had a weighted interest rate of 2.54% and 2.91% per annum, respectively, and Tranche A-1 borrowings had a weighted interest rate of 3.43% and 4.10% per annum, respectively. During the first six months of fiscal 2016 and 2015 our average level of direct borrowings was \$15.0 and \$21.7 million, respectively, and our maximum borrowings at any time were \$42.7 million and \$31.8 million, respectively.

As of July 30, 2016 there was \$10.8 million outstanding under a five-year equipment financing arrangement with our Credit Facility bank. The equipment note bears annual interest at 3.38%, with payments of \$0.3 million (including interest) due monthly through December 2019. The equipment note is collateralized by substantially all of the material handling equipment at our distribution facility in Florence, New Jersey.

During the six months ended August 1, 2015 we paid cash dividends of \$5.5 million (or \$0.40 per share). In March 2016, in connection with our debt refinancing, our Board of Directors agreed to suspend the quarterly dividend.

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

Facilities Relocations

In September 2013 we announced our plans to relocate our corporate headquarters and distribution operations from Philadelphia, Pennsylvania to southern New Jersey. We completed the relocation of our corporate headquarters in January 2015 and we completed the relocation of our distribution operations in August 2015. We had cumulative capital expenditures associated with these relocations of \$40 million, with nearly \$4 million of this amount offset by construction allowance contributions from the landlord for our new headquarters building. We previously received \$15 million of capital equipment financing through our Credit Facility bank to partially fund the material handling equipment in the new distribution facility. To partially offset the costs of these relocations, the Board of the NJEDA approved us for an incentive package of up to \$40 million in benefits under Grow NJ in the form of transferrable income tax credits over a ten-year period from the State of New Jersey. The annual benefit amount available to us is expected to significantly exceed our annual income tax liability to New Jersey. In order to maximize the realizable value of our incentive package, in December 2013 we entered into an agreement with a third party to sell 75% or more of the annual income tax credits awarded to us. In May 2016 NJEDA delivered our initial \$4.0 million tax credit certificate that was earned for fiscal 2015. We subsequently realized \$3.6 million cash proceeds, net of costs, from the sale of the full \$4.0 million of tax credits to the third party under our December 2013 agreement.

Critical Accounting Policies and Estimates

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. These generally accepted accounting principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our consolidated financial statements and the reported amounts of net sales and expenses during the reporting period. Our critical accounting policies are described in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the year ended January 30, 2016. As of July 30, 2016 there were no material changes in, or additions to, our critical accounting policies or in the assumptions or estimates we used to prepare the financial information appearing in this report.

27

Recent Accounting Pronouncements

Adopted

In April 2015 the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. ASU No. 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. We adopted ASU 2015-03 effective January 31, 2016 and accordingly, the deferred financing costs related to our Term Loan are reflected as a direct deduction from the Term Loan liability. The adoption of ASU No. 2015-03 did not have any impact on our net consolidated financial position, results of operations or cash flows. We continue to classify deferred financing costs related to our Credit Facility within other assets in the Consolidated Balance Sheets in accordance with the optional disclosure provisions in ASU No. 2015-15, Interest - Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements.

Proposed

In March 2016 the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. ASU No. 2016-09 affects all entities that issue share-based payment awards to their employees. ASU No. 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows, including recognizing all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement rather than in additional paid-in capital. ASU No. 2016-09 is effective for financial statements issued for annual reporting periods beginning after December 15, 2016 and interim periods within those years. Earlier application is permitted. The impact from adoption of the new requirements of ASU No. 2016-09 on our consolidated financial position or results of operations has not yet been determined.

In February 2016 the FASB issued ASU No. 2016-02, Leases (Topic 842). ASU No. 2016-02 affects any entity that enters into a lease (as that term is defined in the ASU) and its guidance supersedes Topic 840, Leases. As it substantively relates to the Company, ASU No. 2016-02 requires lessees to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position. For finance leases, lessees are required to recognize interest on the lease liability separately from amortization of the right-of-use asset in the statement of comprehensive income and to classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows. For operating leases, lessees are required to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis, and to classify all cash payments within operating activities in the statement of cash flows. In transition, lessees are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. ASU No. 2016-02 is effective for financial statements issued for annual reporting periods beginning after December 15, 2018 and interim periods within those years. Earlier application is permitted. The impact from adoption of the new requirements of ASU No. 2016-02 on our consolidated financial position or results of operations has not yet been determined.

In November 2015 the FASB issued ASU No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. To simplify the presentation of deferred income taxes, ASU No. 2015-17 requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. ASU No. 2015-17 is effective for financial statements issued for annual reporting periods beginning after December 15, 2016 and interim periods within those years. Earlier application is permitted. Because this guidance impacts presentation only, the adoption of the new requirements of ASU 2015-17 will not have any impact on our net consolidated financial position

or results of operations.

In July 2015 the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. ASU No. 2015-11 requires entities to measure inventory at the lower of cost and net realizable value. ASU No. 2015-11 is effective for financial statements issued for annual reporting periods beginning after December 15, 2016 and interim periods within those years. Earlier application is permitted. Application of the new requirements of ASU No. 2015-11 is not expected to have a material impact on our consolidated financial position or results of operations.

In May 2014 the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2014-09 requires an entity to recognize revenue for the amount of consideration to which it expects to be entitled for the transfer of promised goods or services to customers. Additionally, ASU No. 2014-09 requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. The standard will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU No. 2014-09 is effective for financial statements issued for annual reporting periods beginning after December 15, 2016 and interim periods within those years. In August 2015 the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date which deferred the effective date of ASU No. 2014-09 by one year, making the guidance effective for fiscal years beginning after December 15, 2017. Early

adoption will be permitted, but not earlier than the original effective date for annual and interim periods. The impact from adoption of the new requirements of ASU No. 2014-09 on our consolidated financial position or results of operations has not yet been determined.

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. The following factors, among others, in some cases have affected and in the future 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 strength or weakness of the retail industry in general and of apparel purchases in particular, our ability to successfully manage our various business initiatives, our ability to successfully pursue, complete and manage any strategic transaction and related matters, adverse effects on the market price of our common stock and on our operating results because of a failure to complete any strategic transaction, failure to realize any benefits of any proposed strategic transaction, the success of our international business and its expansion, our ability to successfully manage, retain and expand our leased department and international franchise relationships and marketing partnerships, future sales trends in our various sales channels, unusual weather patterns, changes in consumer spending patterns, raw material price increases, overall economic conditions and other factors affecting consumer confidence, demographics and other macroeconomic factors that may impact the level of spending for maternity apparel (such as fluctuations in pregnancy rates and birth rates), expense savings initiatives, our ability to anticipate and respond to fashion trends and consumer preferences, unanticipated fluctuations in our operating results, the impact of competition and fluctuations in the price, availability and quality of raw materials and contracted products, availability of suitable store locations, continued availability of capital and financing, our ability to hire, develop and retain senior management and sales associates, our ability to develop and source merchandise, our ability to receive production from foreign sources on a timely basis, our compliance with applicable financial and other covenants under our financing arrangements, potential debt prepayments, the trading liquidity of our common stock, changes in market interest rates, our compliance with certain tax incentive and abatement programs, war or acts of terrorism and other factors referenced in our Annual Report on Form 10-K, including those set forth under the caption "Risk Factors."

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Edgar Filing: Destination Maternity Corp - Form 10-Q

As of July 30, 2016 we had cash and cash equivalents of \$2.8 million. Our cash equivalents consist of investments in money market funds that bear interest at variable rates. A change in market interest rates earned on our investments impacts the interest income and cash flows, but does not materially impact the fair market value of the financial instruments. Due to the low balance, average maturity and conservative nature of our investment portfolio, we believe a sudden change in interest rates would not have a material effect on the value of our investment portfolio. The impact on our future interest income resulting from changes in investment yields will depend largely on the gross amount of our investment portfolio at that time. However, based upon the conservative nature of our investment portfolio and current experience, we do not believe a decrease in investment yields would have a material negative effect on our interest income.

As of July 30, 2016 the components of our debt portfolio were the \$32.0 million Term Loan, the \$10.8 million equipment note and the \$70.0 million Credit Facility. Each of the components of our debt portfolio are denominated in United States dollars. The fair value of the debt portfolio is referred to as the “debt value.” The equipment note bears interest at a fixed rate of 3.38%. Although a change in market interest rates would not affect the interest incurred or cash flow related to this fixed rate portion of the debt portfolio, the debt value would be affected.

The Term Loan carries a variable interest rate that is tied to market indices with a minimum annual rate of 8.50%. The sensitivity analysis as it relates to this portion of our debt portfolio assumes an instantaneous 100 basis point move in interest rates above and below the minimum threshold, with all other variables held constant. The debt value of the Term Loan is approximately \$32.0 million. A 100 basis point increase in market interest rates above the minimum threshold would result in additional annual interest expense on the Term Loan of approximately \$0.3 million. A 100 basis point decline in market interest rates below the minimum threshold would have no effect on our annual interest expense on the Term Loan.

Our Credit Facility has variable interest rates that are tied to market indices. As of July 30, 2016 we had \$1.7 million of direct borrowings and \$6.2 million of letters of credit outstanding under our Credit Facility. As of July 30, 2016 Tranche A borrowings under the Credit Facility would have resulted in interest at a rate between 2.00% and 4.00% per annum. Interest on any future borrowings under the Credit Facility would, to the extent of outstanding borrowings, be affected by changes in market interest rates. A change in market interest rates on the variable rate portion of our debt portfolio would impact the interest expense incurred and cash flows.

The sensitivity analysis as it relates to the fixed rate portion of our debt portfolio assumes an instantaneous 100 basis point move in interest rates from their levels as of July 30, 2016, with all other variables held constant. A 100 basis point increase in market interest rates would result in a decrease in the value of the debt by approximately \$0.2 million as of July 30, 2016. A 100 basis point decline in market interest rates would cause the debt value to increase by approximately \$0.2 million as of July 30, 2016.

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

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that are filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed under the Exchange Act is accumulated and communicated to our management on a timely basis to allow decisions regarding required disclosure. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of July 30, 2016. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that as of July 30, 2016 these controls and procedures were effective.

Internal Control over Financial Reporting

There have been no changes in internal control over financial reporting identified in connection with the foregoing evaluation that occurred during the fiscal quarter ended July 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are named as a defendant in legal actions arising from our normal business activities. 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 1A. Risk Factors

In addition to the other information set forth in this Form 10-Q, you should carefully consider the factors discussed in Part I, Item 1A “Risk Factors” of our Form 10-K for the year ended January 30, 2016. The risks described in our Form 10-K are not the only risks that we face. Additional risks not presently known to us or that we do not currently consider significant may also have an adverse effect on us. If any of the risks actually occur, our business, results of operations, cash flows or financial condition could suffer.

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

The following table provides information about purchases by us during the three month period May 1, 2016 to June 30, 2016 of equity securities that are registered by us pursuant to Section 12 of the Exchange Act:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program (2)	Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program (2)
May 1 to May 28, 2016	50	\$ 6.97	—	\$ 10,000,000
May 29 to July 2, 2016	419	\$ 6.20	—	\$ 10,000,000
July 3 to July 30, 2016	—	\$ —	—	\$ 10,000,000
Total	469	\$ 6.28	—	\$ 10,000,000

(1) Represents shares reacquired directly from certain employees to satisfy income tax withholding obligations for such employees in connection with restricted stock awards that vested during the period.

(2) Our Board of Directors has approved a program to repurchase up to \$10.0 million of our outstanding common stock. Under the program, we may repurchase shares from time to time through solicited or unsolicited transactions in the open market or in negotiated or other transactions. In July 2014 our Board of Directors extended our authorized stock repurchase program from July 31, 2014 to July 31, 2016. No shares have been repurchased under this program as of July 30, 2016. Our new Term Loan Agreement, effective March 25, 2016, prohibits share repurchases for three years.

Item 6. Exhibits

Exhibit No.	Description
*1.01	Conflict Minerals Report for the Year Ended December 31, 2015 (Exhibit 1.01 to the Company's Specialized Disclosure Report on Form SD dated May 31, 2016)
†*10.1	Transaction Bonus Agreement, dated May 31, 2016, by and between the Company and Anthony M. Romano (Exhibit 10.1 to the Company's Current Report on Form 8-K dated May 31, 2016 (the "May 31, 2016 Form 8-K"))
†*10.2	Transaction Bonus and Retention Agreement, dated May 31, 2016, by and between the Company and Ronald J. Masciantonio (Exhibit 10.2 to the May 31, 2016 Form 8-K)
†*10.3	Amended and Restated Executive Employment Agreement, dated May 31, 2016, by and between the Company and Ronald J. Masciantonio (Exhibit 10.3 to the May 31, 2016 Form 8-K)
31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Executive Vice President & Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Executive Vice President & Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

*Incorporated by reference

†Management contract or compensatory plan or arrangement

Signatures

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

Destination Maternity Corporation

Date: August 25, 2016 By: /s/ Anthony M. Romano
Anthony M. Romano
Chief Executive Officer & President

Date: August 25, 2016 By: /s/ David Stern
David Stern
Executive Vice President &
Chief Financial Officer

INDEX OF EXHIBITS FILED WITH
FORM 10-Q OF DESTINATION MATERNITY CORPORATION
FOR THE QUARTER ENDED JULY 30, 2016

Exhibit No.	Description
31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Executive Vice President & Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Executive Vice President & Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document