

Destination Maternity Corp
Form 10-Q
September 10, 2018

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 August 04, 2018

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)

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(856) 291-9700

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, smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(1) of the Exchange Act

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 — 14,622,264 shares outstanding as of August 31, 2018

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

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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)

	August 4, 2018	February 3, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,317	\$ 1,635
Trade receivables, net	6,837	6,692
Inventories	67,753	71,256
Prepaid expenses and other current assets	11,043	11,522
Total current assets	86,950	91,105
Property and equipment, net of accumulated depreciation and amortization of \$103,299 and \$98,024	59,177	66,146
Other assets:		
Deferred line of credit financing costs, net of accumulated amortization of \$875 and \$829	405	450
Other intangible assets, net of accumulated amortization of \$938 and \$907	879	953
Deferred income taxes	4,241	2,829
Other non-current assets	1,087	1,099
Total other assets	6,612	5,331
Total assets	\$ 152,739	\$ 162,582
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit borrowings	\$ 7,300	\$ 8,000
Current portion of long-term debt	4,881	4,780
Accounts payable	24,497	30,949
Accrued expenses and other current liabilities	33,402	31,661
Total current liabilities	70,080	75,390
Long-term debt	23,802	23,809
Deferred rent and other non-current liabilities	21,442	22,715
Total liabilities	115,324	121,914
Commitments and contingencies (Note 15)		

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Stockholders' equity:

Preferred stock, 1,656,381 shares authorized, none outstanding	—	—
Common stock, \$.01 par value; 20,000,000 shares authorized, 14,805,049 and		
14,684,117 shares issued and outstanding	148	147
Additional paid-in capital	107,420	106,865
Accumulated deficit	(70,081)	(66,274)
Accumulated other comprehensive loss	(72)	(70)
Total stockholders' equity	37,415	40,668
Total liabilities and stockholders' equity	\$ 152,739	\$ 162,582

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		Six Months Ended	
	Ended		August 4,	July 29,
	August 4,	July 29,	August 4,	July 29,
	2018	2017	2018	2017
Net sales	\$96,395	\$98,280	\$199,622	\$204,706
Cost of goods sold	46,530	46,227	94,354	94,714
Gross profit	49,865	52,053	105,268	109,992
Selling, general and administrative expenses	50,095	52,806	101,952	108,455
Store closing, asset impairment and asset disposal expenses	672	1,120	1,641	2,638
Other charges, net	1,923	(171)	3,073	646
Operating loss	(2,825)	(1,702)	(1,398)	(1,747)
Interest expense, net	1,144	979	2,301	1,983
Loss before income taxes	(3,969)	(2,681)	(3,699)	(3,730)
Income tax provision	56	93	112	186
Net loss	\$(4,025)	\$(2,774)	\$(3,811)	\$(3,916)
Net loss per share— Basic	\$(0.29)	\$(0.20)	\$(0.28)	\$(0.28)
Average shares outstanding— Basic	13,823	13,793	13,831	13,771
Net loss per share— Diluted	\$(0.29)	\$(0.20)	\$(0.28)	\$(0.28)
Average shares outstanding— Diluted	13,823	13,793	13,831	13,771

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 August 4, July 29, 2018 2017		Six Months Ended August 4, July 29, 2018 2017	
Net loss	\$ (4,025)	\$ (2,774)	\$ (3,811)	\$ (3,916)
Foreign currency translation adjustments	(2)	—	(2)	2
Comprehensive loss	\$ (4,027)	\$ (2,774)	\$ (3,813)	\$ (3,914)

The accompanying notes are an integral part of these consolidated financial statements.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(unaudited)

	Common Stock		Additional	Accumulated	Accumulated	
	Number	Amount			Other	Total
	of		Paid-in	Deficit	Loss	
	Shares	Amount	Capital	Deficit	Loss	Total
Balance as of February 3, 2018	14,684	\$ 147	\$ 106,865	\$ (66,274)	\$ (70)	\$ 40,668
Net loss	—	—	—	(3,811)	—	(3,811)
Foreign currency translation adjustments	—	—	—	—	(2)	(2)
Dividends forfeited	—	—	—	4	—	4
Stock-based compensation	443	4	580	—	—	584
Exercise of stock options, net	—	—	1	—	—	1
Repurchase and retirement of common stock	(322)	(3)	(26)	—	—	(29)
Balance as of August 4, 2018	14,805	\$ 148	\$ 107,420	\$ (70,081)	\$ (72)	\$ 37,415
Balance as of January 28, 2017	14,010	\$ 140	\$ 105,775	\$ (44,693)	\$ (72)	\$ 61,150
Net loss	—	—	—	(3,916)	—	(3,916)
Foreign currency translation adjustments	—	—	—	—	2	2
Dividends forfeited	—	—	—	4	—	4
Stock-based compensation	(15)	—	830	—	—	830
Repurchase and retirement of common stock	(9)	—	(37)	—	—	(37)
Balance as of July 29, 2017	13,986	\$ 140	\$ 106,568	\$ (48,605)	\$ (70)	\$ 58,033

The accompanying notes are an integral part of these consolidated financial statements.

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DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended August 4, July 29, 2018 2017	
Operating Activities		
Net loss	\$(3,811)	\$(3,916)
Adjustments to reconcile net loss to net cash provided		
by operating activities:		
Depreciation and amortization	7,961	8,888
Stock-based compensation expense	584	830
Loss on impairment of long-lived assets	1,519	2,446
Loss on disposal of assets	68	116
Grow NJ award benefit	(1,412)	1,815
Amortization of deferred financing costs	336	235
Changes in assets and liabilities:		
Decrease (increase) in:		
Trade receivables	(145)	(221)
Inventories	3,503	(719)
Prepaid expenses and other current assets	479	1,962
Other non-current assets	12	(44)
Decrease in:		
Accounts payable, accrued expenses and other current liabilities	(1,831)	(2,965)
Deferred rent and other non-current liabilities	(1,417)	(179)
Net cash provided by operating activities	5,846	8,248
Investing Activities		
Capital expenditures	(2,579)	(3,611)
Additions to intangible assets	—	(18)
Net cash used in investing activities	(2,579)	(3,629)
Financing Activities		
Decrease in cash overdraft	(2,657)	(1,342)
Decrease in line of credit borrowings	(700)	(400)
Proceeds from long-term debt	2,500	3,401
Repayment of long-term debt	(2,537)	(6,673)
Deferred financing costs paid	(160)	(268)
Withholding taxes on stock-based compensation paid in connection		
with repurchase of common stock	(29)	(37)

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Proceeds from exercise of stock options	—	—
Net cash used in financing activities	(3,583)	(5,319)
Effect of exchange rate changes on cash and cash equivalents	(2)	2
Net Decrease in Cash and Cash Equivalents	(318)	(698)
Cash and Cash Equivalents, Beginning of Period	1,635	2,859
Cash and Cash Equivalents, End of Period	\$1,317	\$2,161
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$1,965	\$1,751
Cash (received) paid for income taxes	\$118	\$(4,294)

The accompanying notes are an integral part of these consolidated financial statements.

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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 August 4, 2018 and July 29, 2017 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 February 3, 2018 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. Certain prior year amounts have been reclassified to conform to the current year presentation.

The Company operates on a 52/53-week fiscal year ending on the Saturday nearest January 31 of each year. References to the Company's fiscal 2018 refer to the 52-week fiscal year, or periods within such fiscal year, which began February 4, 2018 and will end February 2, 2019. References to the Company's fiscal 2017 refer to the 53-week fiscal year, or periods within such fiscal year, which began January 29, 2017 and ended February 3, 2018.

2. EARNINGS PER SHARE ("EPS") AND 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 lapse of restrictions on restricted stock and deferred stock unit awards, and from shares of common stock resulting from the assumed exercise of outstanding stock options. Common shares issuable in connection with the award of performance-based restricted stock units ("RSUs") are excluded from the calculation of EPS until the RSUs' performance conditions are achieved and the shares in respect of the RSUs become issuable (see Note 13).

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

Three Months Ended	
August 4, 2018	July 29, 2017

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	Net Loss	Shares	EPS	Net Loss	Shares	EPS
Basic and Diluted EPS	\$(4,025)	13,823	\$(0.29)	\$(2,774)	13,793	\$(0.20)

	Six Months Ended August 4, 2018			July 29, 2017		
	Net Loss	Shares	EPS	Net Loss	Shares	EPS
Basic and Diluted EPS	\$(3,811)	13,831	\$(0.28)	\$(3,916)	13,771	\$(0.28)

In addition to performance-based RSUs, for the three and six months ended August 4, 2018 stock options and unvested restricted stock totaling approximately 538,000 and 983,000 shares, respectively, were excluded from the calculation of Diluted EPS as their effect would have been antidilutive. Stock options and unvested restricted stock totaling approximately 1,696,000 and 1,142,000 shares of the Company's common stock were outstanding as of August 4, 2018 and July 29, 2017, respectively, but were not included in the computation of Diluted EPS for the three and six months ended August 4, 2018 and July 29, 2017 due to the Company's net loss. Had the Company reported a profit for the three and six months ended August 4, 2018 and for the three months ended July 29, 2017 the weighted average number of dilutive shares outstanding for computation of Diluted EPS would have been approximately 14,284,000, 14,124,000, 13,814,000 and 13,795,000 shares, respectively.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

During the six months ended August 4, 2018 and July 29, 2017, \$4,000 and \$4,000, respectively, 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 August 4, 2018, and February 3, 2018 the Company's trade receivables were net of allowance for doubtful accounts of \$166,000 and \$166,000, respectively.

4. INVENTORIES

Inventories were comprised of the following (in thousands):

	August 4, 2018	February 3, 2018
Finished goods	\$ 67,245	\$ 70,687
Work-in-progress	266	182
Raw materials	242	387
	\$ 67,753	\$ 71,256

5. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

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

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	August 4, 2018	February 3, 2018
Employee compensation and benefits	\$ 7,260	\$ 7,133
Accrued expenses	5,603	3,244
Insurance, primarily self-insurance reserves	4,721	5,048
Deferred rent	3,066	3,211
Sales and use taxes	2,929	2,638
Gift certificates and store credits	2,829	3,385
Product return reserve	2,017	2,799
Deferred revenue	1,922	1,001
Audit and legal	862	714
Accrued property and equipment additions	384	218
Other	1,809	2,270
	\$ 33,402	\$ 31,661

6. LINE OF CREDIT

After completion of a debt refinancing on February 1, 2018 the Company has in place a \$50,000,000 senior secured revolving credit facility (the "Credit Facility"), which was amended and restated in connection with the issuance of the Company's \$25,000,000 Term Loan (see Note 7). The Company's previous \$70,000,000 Credit Facility had been in place since March 25, 2016. In connection with the Term Loan financing the maturity date of the Credit Facility was extended to January 31, 2023 and certain availability reserves were reduced or eliminated. Proceeds from advances under the Credit Facility, subject to certain restrictions, may be used to provide financing for working capital, letters of credit, capital expenditures, and other general corporate purposes.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

The Credit Facility contains various affirmative and negative covenants and representations and warranties including the requirement that the Company maintain Excess Availability (as defined in the related Credit Agreement) of more than the greater of 10% of the Combined Loan Caps (as defined in the related Credit Agreement) and \$7,000,000. 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 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 0.50% or 2) a LIBOR rate plus 1.0%. The Company also pays an unused line fee under the Credit Facility of 0.25% per annum.

Any amounts outstanding under the Credit Facility may be accelerated and become due and payable immediately and all loan and letter of credit commitments thereunder may be terminated upon an event of default and expiration of any applicable cure period. Events of default include: 1) nonpayment of obligations due under the subject loan agreement and related loan documents, 2) cross-defaults to other indebtedness and documents, 3) failure to perform any covenant or agreement contained in the subject loan agreement, 4) material misrepresentations, 5) failure to pay, or certain other defaults under, other material indebtedness of the Company, 6) certain bankruptcy or insolvency events, 7) a change of control, 8) indictments of the Company or senior management in a material forfeiture action, 9) default under certain material contracts to the extent such termination or default has or could reasonably be expected to have a material adverse effect, and 10) customary ERISA defaults, among others.

In connection with the original execution and subsequent amendments of the Credit Facility, the Company incurred deferred financing costs of \$1,280,000 including \$107,000 paid in fiscal 2017. These deferred financing costs are being amortized over the term of the Credit Facility agreement and are included in "interest expense, net" in the consolidated statements of operations.

As of August 4, 2018, the Company had \$7,300,000 in outstanding borrowings under the Credit Facility, \$7,327,000 in letters of credit and \$19,044,000 of availability based on the Company's Borrowing Base formula and availability reserve requirements. As of July 29, 2017, the Company had \$4,200,000 in outstanding borrowings under the previous Credit Facility, \$5,827,000 in letters of credit and \$14,851,000 of availability. For the three months ended August 4, 2018 and July 29, 2017 borrowings had a weighted interest rate of 4.13% and 3.70% per annum, respectively. For the six months ended August 4, 2018 and July 29, 2017 borrowings had a weighted interest rate of 3.97% and 3.31% per annum, respectively. During the six months ended August 4, 2018 and July 29, 2017 the Company's average levels of direct borrowings were \$16,356,000 and \$8,451,000, respectively, and the Company's maximum borrowings were \$27,400,000 and \$15,700,000, respectively.

7. LONG-TERM DEBT

On February 1, 2018 (the "Closing Date") the Company entered into a Term Loan Credit Agreement (the "Term Loan Agreement") which provides for a term loan of up to \$25,000,000 and matures on January 31, 2023 (the "Term Loan"). On the Closing Date the Company borrowed \$22,500,000 net of fees against the Term Loan and used the

proceeds, in addition to \$3,600,000 borrowed under its Credit Facility (see Note 6) to pay off the \$22,999,000 balance of the Company's then existing term loan (the "Prior Term Loan") and \$3,226,000 of fees and interest associated with the refinancing transaction. The Term Loan provided for an additional loan of \$2,500,000 which could be borrowed at the Company's discretion within a period of 45 days after delivery to the lender of the Company's first quarter fiscal 2018 financial statements and satisfaction of certain other requirements. The Company met these requirements and borrowed the additional \$2,500,000 on July, 16 2018. There is a minimum excess availability requirement of the greater of 10% of the Combined Loan Cap, as defined in the Term Loan Agreement, or \$7,000,000.

The interest rate on the Term Loan is equal to a LIBOR rate plus 9.0%. The Company is required to make minimum repayments of the principal amount of the Term Loan in quarterly installments of \$312,500 which commenced on July 31, 2018, 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 and subject to a prepayment premium as follows: 1) if the prepayment occurs on or prior to the second anniversary of the Closing Date, the greater of a) interest on the prepayment that would otherwise have been paid with the 24 month period following the Closing Date minus actual interest payments made through the prepayment date and b) 2% of the prepayment and 2) 2% of the prepayment amount if paid between the second and 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.

On March 25, 2016 the Company entered into a Term Loan Agreement Credit Agreement (the "Prior Term Loan Agreement") for the Company's \$32,000,000 Prior Term Loan that had a maturity date of March 25, 2021. The proceeds of the Prior Term Loan were used to repay a portion of the indebtedness that was outstanding under the Company's credit facility at that time. The interest rate on the Prior Term Loan was equal to a LIBOR rate (with a 1.0% LIBOR floor) plus 7.5%. The Company was required to make minimum repayments of the principal amount in quarterly installments of \$800,000 with the remaining outstanding balance payable on the maturity date. As amended on December 19, 2016 and April 7, 2017, the Prior Term Loan Agreement contained various minimum excess availability requirements including \$5,000,000 against availability under the Company Credit Facility that was reduced dollar for dollar for prepayments of the Prior Term Loan, and an amount equal to the greater of 10% of the Combined Loan Cap (as defined in the Credit Facility Agreement) or \$10,000,000.

In connection with the execution of the Term Loan Agreement, the Prior Term Loan Agreement and subsequent amendments, the Company incurred deferred financing costs of \$4,557,000. Of this amount, the unamortized balance of \$1,542,000 in deferred financing costs incurred in connection with the Prior Term Loan were written off upon entering into the Term Loan and charged to loss on extinguishment of debt in the Company consolidated statements of operations. There were \$2,460,000 of deferred financing costs incurred in connection with the Term Loan. These deferred financing costs are reflected as a direct deduction from the Term Loan liability in the consolidated balance sheets and are being amortized over the term of the Term Loan Agreement. The amortization is included in "interest expense, net" in the consolidated statements of operations.

As of August 4, 2018, and July 29, 2017 there was \$24,688,000 and \$25,399,000, respectively, of principal outstanding under the Term Loan and Prior Term Loan.

As of August 4, 2018, and July 29, 2017 there was \$4,510,000 and \$7,816,000, 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. Any amounts outstanding under the equipment note may be accelerated and become due and payable immediately upon an event of default and expiration of any applicable cure period. The specified events of default are substantially the same as those in the Credit Facility agreement (see Note 6).

On June 6, 2017 the Company received \$3,401,000 in proceeds from a three-year financing arrangement in the form of a sale and leaseback for certain furniture, fixtures and software. Monthly payments under the leaseback arrangement are \$123,000 for the first 24 months and \$48,000 for months 25 to 36. At the end of the leaseback term, the Company has the option to extend the lease for an additional year or to repurchase the financed property for a price to be agreed. All of the proceeds from the transaction were used to prepay a portion of the Company's Term

Loan. As of August 4, 2018, there was \$1,988,000 of principal outstanding under this financing arrangement.

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

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DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

At both August 4, 2018 and February 3, 2018, 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 August 4, 2018 and February 3, 2018, the Company had \$7,300,000 and \$8,000,000, 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 9.00%. 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 notes 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.

9. NET SALES

The following disaggregates the Company's net sales by major source (in thousands):

	Three Months		Six Months Ended	
	Ended August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Retail stores	\$58,641	\$62,492	\$121,629	\$132,338
Leased departments	9,892	10,897	19,881	22,460
Total retail locations	68,533	73,389	141,510	154,798
Ecommerce	23,003	19,238	48,485	37,076
Marketing partnerships	4,191	4,180	8,126	8,530
Wholesale and franchise	668	1,473	1,501	4,302
Total other charges, net	\$96,395	\$98,280	\$199,622	\$204,706

The Company's performance obligations consist primarily of transferring control of merchandise to customers. Retail and ecommerce sales are recognized upon transfer of control, which occurs when merchandise is taken at point-of-sale for a retail transaction or upon receipt of shipment for an ecommerce transaction. Sales are reported net of returns and sales taxes. Shipping and handling fees billed to customers are recognized in net sales when control of the underlying merchandise is transferred to the customer.

The Company earns revenue through a variety of marketing partnership programs utilizing the Company's opt-in customer database and various in-store marketing initiatives focused on baby and parent-related products and services. Revenue from these activities is recognized when the goods or services are provided.

Sales of product to the Company's wholesale customers and international franchisees are recognized upon transfer of control which is primarily when product is shipped. Franchise fees are recorded by the Company when all material services have been performed or in the case of royalties earned on sales of product, in the period when the franchisee sells product to their retail customer.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

10. OTHER CHARGES, NET

In the first quarter of fiscal 2018 the Company received notification from a stockholder group (the “Stockholder Group”), of the nomination of a slate of alternative nominees for election to the Company’s Board of Directors at the Annual Meeting of Stockholders that was held on May 23, 2018 (the “Proxy Solicitation”). At the Company’s 2018 Annual Meeting of Stockholders held on May 23, 2018, the Company’s stockholders replaced the incumbent board in its entirety and elected Holly N. Alden, Christopher B. Morgan, Marla A. Ryan and Anne-Charlotte Windal as the Company’s new Board of Directors. During the six months ended August 4, 2018 the Company incurred \$2,142,000 of charges related to the Proxy Solicitation, including \$1,256,000 during the three months ended August 4, 2018, primarily to reimburse a member of the Stockholder Group for amounts incurred to nominate the slate of alternative directors as part of a mutual release agreement entered into with such member of the Stockholder Group.

During the fourth quarter of fiscal 2015 the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with the Company’s largest shareholder, Orchestra, a France-based retailer of children’s wear, to complete a proposed business combination (“the Proposed Merger”). During the second quarter of fiscal 2017 the parties determined that it was in the best interest of their respective stockholders to terminate the Merger and on July 27, 2017, the Company, Orchestra, and certain other affiliates of Orchestra entered into a Termination Agreement (the “Termination Agreement”). In connection with the Termination Agreement, Orchestra and the Company agreed to reimburse each other for certain costs incurred in connection with their effort to implement the Merger Agreement. During the six months ended July 29, 2017 the Company incurred \$649,000 of charges related to the proposed merger.

Over the last several years the Company has engaged in a series of management and organizational changes and, in connection therewith, retained consulting firms to review its costs and business strategy associated with such management and organizational changes. The Company’s Board of Directors authorized changes to the Company’s chief executive function including the resignation of Anthony M. Romano as the Company’s Chief Executive Officer and President, the September 17, 2017 appointment of B. Allen Weinstein, an independent member of the Company’s Board since 2010, as Interim Chief Executive Officer replacing Mr. Romano, the January 2, 2018 appointment of Melissa Payner-Gregor, an independent member of the Company’s Board since 2009, as Interim Chief Executive Officer replacing Mr. Weinstein and the May 23, 2018 appointment of Marla Ryan as Chief Executive Officer replacing Ms. Payner-Gregor. Ronald Masciantonio, the Company’s Chief Administrative Officer, resigned from his position on June 4, 2018. David Stern, the Company’s former Chief Financial Officer departed the Company effective at the close of business on August 10, 2018. The Company also paid one-time retention bonuses with service conditions to certain key management personnel which are being recorded over the service period, while reducing its overall headcount to create a more efficient and effective operating structure. During the three and six months ended August 4, 2018 and July 29, 2017 the Company incurred \$667,000, (\$6,000), \$931,000 and (\$3,000), respectively, of charges related to these management and organizational changes.

A summary of the net charges incurred in connection with the proxy solicitation and proposed merger and the management and organizational changes is as follows (in thousands):

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	Three Months Ended		Six Months Ended	
	July	July	July	July
	August 429, 2018	August 429, 2017	August 429, 2018	August 429, 2017
Proxy Solicitation and Proposed Merger				
Proxy solicitation	\$1,256	\$—	\$2,142	\$—
Proposed merger	—	(165)	—	649
Total proxy solicitation and proposed merger	1,256	(165)	2,142	649
Management and Organizational Changes				
Severance and related benefits	633	(6)	885	(3)
Consulting fees	34	—	46	—
Total management and organizational changes	667	(6)	931	(3)
Total other charges, net	\$1,923	\$(171)	\$3,073	\$646

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

11. GOVERNMENT INCENTIVES

In fiscal 2015 the Company completed the relocation of its corporate headquarters and distribution operations from Philadelphia, Pennsylvania to southern New Jersey. 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 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 be created and subject to an annual award limit of \$4,000,000.

The Grow NJ award 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. The expected realizable amount of the Grow NJ award is included in the consolidated balance sheet in deferred income taxes. As of August 4, 2018, the Company had recorded a deferred tax asset of \$2,829,000 related to the NJ Grow award earned in fiscal 2017, the cash proceeds of which it expects to receive in the third quarter of fiscal 2018. In April 2017, the Company received \$3,251,000 cash proceeds, net of costs, from the receipt and subsequent sale of the \$3,612,000 tax credit certificate earned for fiscal 2016. During the three and six months ended August 4, 2018, the Company recognized the cost reduction related to the Grow NJ award in the amount of \$710,000 and \$1,285,000, respectively, as compared to the three and six months ended July 29, 2017 in which the Company recognized \$718,000 and \$1,436,000 respectively.

12. INCOME TAXES

The U.S. Tax Cuts and Jobs Act of 2017 (the “TCJA”) was signed into law on December 22, 2017. The TCJA included a number of changes to the U.S. corporate income tax including a reduction of the corporate income tax rate from 35% to 21% for tax years beginning after December 31, 2017. For fiscal 2018 the Company’s effective federal tax rate is 21%. For fiscal 2017 the Company used a blended effective tax rate of 33.7% which represented the prorated

percentage from the TCJA's January 1, 2018 effective date and the Company's February 3, 2018 fiscal year-end.

Accounting Standards Codification ("ASC") Topic 740, Income Taxes, requires that a valuation allowance be recorded to reduce deferred tax assets when it is more likely than not that the tax benefit of the deferred tax assets will not be realized. In situations where a three-year cumulative loss condition exists, accounting standards limit the ability to consider projections of future results as positive evidence to assess the realizability of deferred tax assets. In fiscal 2016 the Company's financial results reflected a three-year cumulative loss. Consequently, in fiscal 2016 the Company recorded a non-cash charge as a valuation allowance against substantially all of its deferred tax assets. Three-year cumulative losses have continued in fiscal 2017 and fiscal 2018, consequently the Company continues to record a valuation allowance against its deferred tax assets.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

13. 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 August 2016 and April 2016 (collectively the "Fiscal 2016 Awards"). The RSUs earned, if any, under the awards will be based on the Company's cumulative adjusted EBITDA, as defined in the applicable award agreement ("RSU Adjusted EBITDA") 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 Adjusted EBITDA in the final fiscal year of each applicable Performance Period. The additional RSUs, if any, will be earned on the same terms as the original RSUs.

The following table sets forth the aggregate minimum, target and maximum RSUs, 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	January 31, 2016 to February 2, 2019	13,698	54,789	82,815

During fiscal 2016 the Company determined that the Fiscal 2016 Awards and Fiscal 2015 Awards were unlikely to be earned, even at the minimum level.

During the six months ended August 4, 2018 and July 29, 2017, 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 in connection with the tax obligations, which were approximately 9,000 and 9,000 shares, respectively, during the six months ended August 4, 2018 and July 29, 2017, 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 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 \$29,000 and \$37,000 for the six months ended August 4, 2018 and July 29, 2017, respectively.

14. RECENT ACCOUNTING PRONOUNCEMENTS AND CHANGE IN ACCOUNTING PRINCIPLE

a. Newly Adopted Accounting Pronouncements

In May 2017 the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. ASU 2017-09 provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. ASU No. 2017-09 is effective for financial statements issued for annual reporting periods beginning after December 15, 2017 and interim periods within those years. Earlier application is permitted. The Company adopted ASU No. 2017-09 effective February 4, 2018 and the adoption did not have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

In October 2016 the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. ASU No. 2016-16 amends the accounting for income taxes and requires the recognition of the income tax consequences of an intercompany asset transfer, other than transfers of inventory, when the transfer occurs. For intercompany transfers of inventory, the income tax effects will continue to be deferred until the inventory has been sold to a third party. ASU No. 2016-16 is effective for financial statements issued for annual reporting periods beginning after December 15, 2017 and interim periods within those years, using a modified retrospective application method through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Earlier application is permitted. The Company adopted ASU No. 2016-16 effective February 4, 2018 and the adoption did not have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

In August 2016 the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. ASU No. 2016-15 clarifies and provides guidance on eight specific cash flow classification issues and is intended to reduce existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU No. 2016-15 is effective for annual reporting periods beginning after December 15, 2017 and interim periods within those years. Earlier application is permitted, provided that all of the amendments are adopted in the same period. The Company adopted ASU No. 2016-15 effective February 4, 2018 and the adoption did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

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 replaced most existing revenue recognition guidance in GAAP when it became 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.

Management adopted this guidance on February 3, 2018 using the modified retrospective approach. This ASU required that sales return reserves be presented on a gross basis as a refund liability and an asset for recovery and that the asset be reported separate from inventory on the Company's consolidated balance sheet. Prior to the adoption of this ASU the Company had recorded its sales return reserve on a gross basis with the asset for recovery recorded as a component of inventory. The impact of adoption on the Company's consolidated balance sheet as of August 4, 2018 is as follows:

(in thousands)	As Reported	Excluding ASU 2014-09	
		Effect	Effect
Inventories	\$ 67,753	\$ (948)	68,701
Prepaid expenses and other current assets	11,043	948	10,095

There was no impact from adoption on the Company's consolidated statements of operations or consolidated statements of cash flow.

b. Not Yet Adopted

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 Company is currently evaluating the provisions of this standard and assessing its existing lease portfolio in order to determine the impact on its accounting systems, processes and internal controls over financial reporting. While the Company is still evaluating this standard, given the significant number of leases the Company is party to, the Company expects this standard will have a material impact on the Company's consolidated financial statements. The standard will have no impact on our debt-covenant compliance under our current agreements.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

15. 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.

16. 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	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Net Sales				
United States	\$91,800	\$92,663	\$190,052	\$193,092
Foreign	4,595	5,617	9,571	11,614

	August 4, 2018	February 3, 2018
Long-Lived Assets		
United States	\$ 58,629	\$ 65,456
Foreign	1,427	1,643

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

17. INTEREST EXPENSE, NET

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

	Three Months Ended		Six Months Ended	
	July August 2018	July August 2017	July August 2018	July August 2017
Interest expense	\$ 1,145	\$ 980	\$ 2,303	\$ 1,985
Interest income	(1)	(1)	(2)	(2)
Interest expense, net	\$ 1,144	\$ 979	\$ 2,301	\$ 1,983

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

We operate on a 52/53-week fiscal year ending on the Saturday nearest January 31 of each year. References in this discussion to our fiscal 2018 refer to the 52-week fiscal year, or periods within such fiscal year, which began February 4, 2018 and will end February 2, 2019. References to our fiscal 2017 refer to the 53-week fiscal year, or periods within such fiscal year, which began January 29, 2017 and ended February 3, 2018.

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, 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 through equity and debt 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.

Overview

We are the leading designer and retailer of maternity apparel in the United States with 1,114 retail locations, including 480 stores in the United States, Canada and Puerto Rico, and 634 leased departments located within department stores

and baby specialty stores throughout North America. We also sell merchandise on the Internet, primarily through our Motherhood.com, APeaInThePod.com and Destinationmaternity.com websites. We also sell our merchandise through our Canadian website, MotherhoodCanada.ca, through Amazon.com in the United States, and through websites of certain of our retail partners, including Macys.com. We have store franchise and product supply relationships in the Middle East, South Korea, Mexico, Israel and India. As of August 4, 2018, we have 188 international franchised locations, including 11 stand-alone stores operated under one of our retail nameplates and 177 shop-in-shop locations.

Proxy Solicitation

In the first quarter of fiscal 2018 we received notification from a stockholder group (“the Stockholder Group”), of the nomination of a slate of alternative nominees for election to our Board of Directors at the Annual Meeting of Stockholders that was held on May 23, 2018 (the “Proxy Solicitation”). At our 2018 Annual Meeting of Stockholders held on May 23, 2018, the Company’s stockholders replaced the incumbent board in its entirety and elected Holly N. Alden, Christopher B. Morgan, Marla A. Ryan and Anne-Charlotte Windal as our new Board of Directors. During the six months ended August 4, 2018 we incurred \$2.1 million of charges related to the Proxy Solicitation, including \$1.3 million during the three months ended August 4, 2018, primarily to reimburse a member of the Stockholder Group for amounts incurred to nominate the slate of alternative directors as part of a mutual release agreement entered into with such member of the Stockholder Group.

Proposed Merger

On December 19, 2016 we entered into the Merger Agreement with Orchestra. Despite substantial and sustained efforts by both parties, and in light of the challenges of satisfying applicable securities regulations in France and in the U.S., particularly in connection with the completion of the registration and listing of Orchestra securities in the U.S., the parties determined that it was in the best interests of their respective stockholders to terminate the Merger Agreement. Accordingly, on July 27, 2017 we, Orchestra, and certain other affiliates of Orchestra entered into a Termination Agreement pursuant to which the parties agreed to terminate the Merger Agreement. We and Orchestra agreed to reimburse each other for certain costs incurred in connection with their effort to implement the Merger Agreement, with a net amount of \$1.0 million paid to us on July 31, 2017. During the six months ended July 29, 2017 we recognized \$0.6 million of charges related to the Termination of Merger.

Management and Organizational Changes

We have engaged in a series of management and organizational changes over the last several years. Through these actions, we are attempting to identify further opportunities to become more profitable in the near future, by increasing both revenue and gross margins while reducing expenses.

During the six months ended August 4, 2018 and July 29, 2017 we recognized \$0.9 million of expenses and \$3 thousand of income, respectively, of charges related to management and organizational changes.

Change in Accounting Principle

During the first quarter of fiscal 2017 we changed the way we account for recording revenue from gift cards sold to retail customers that were never redeemed, commonly referred to as breakage. We determined that this accounting change represents a change in accounting estimate effected by a change in accounting principle. In accordance with the requirements of ASC Topic 250 related to such accounting changes, during the first quarter of fiscal 2017 we recognized \$0.8 million of revenue as a cumulative adjustment for the accounting change.

Presented below is a summary of our results for the second quarter and first six months of fiscal 2018 with regard to each of the key measures noted below:

Presentation of Financial Information

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). Comparable sales exclude the 53rd week of sales for 53-week fiscal years. In the 52-week fiscal year subsequent to a 53-week fiscal year, we exclude the sales in the non-comparable week from the comparable sales calculation. 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.

Use of Non-GAAP Measures

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 on disposal of assets, and 4) stock-based compensation expense.

Our management believes that each of the non-GAAP financial measures presented by us provides useful information about our 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 our performance. In addition, certain of our cash and equity incentive compensation plans are based on our level of achievement of Adjusted EBITDA before other charges, which is substantially identical to our non-GAAP financial measure of Adjusted EBITDA before certain other deductions.

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 our 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 our operating performance, or as an alternative to cash flows from operating activities as a measure of our liquidity, 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 in this Quarterly Report.

Second Quarter Fiscal 2018 Financial Results

Net loss for the second quarter of fiscal 2018 was \$4.0 million, or \$0.29 per share (diluted), compared to net loss of \$2.8 million, or \$0.20 per share (diluted), for the second quarter of fiscal 2017.

Net loss for the second quarter of fiscal 2018 includes a \$1.4 million, net of tax, charge related to the Proxy Solicitation and organizational changes and a \$1.0 million, non-cash income tax charge related to the change in valuation allowance against net deferred tax assets. Net loss for the second quarter of fiscal 2017 includes a \$1.1 million, non-cash income tax charge related to a change in the valuation allowance against net deferred tax assets and other income of \$0.1 million, net of tax, related to the Proposed Merger, which was terminated on July 27, 2017.

Adjusted net loss for the second quarter of fiscal 2018 was \$1.6 million, or \$0.11 per share (diluted), compared to the comparably adjusted net loss for the second quarter of fiscal 2017 of \$1.8 million, or \$0.13 per share (diluted).

Adjusted EBITDA was \$2.0 million for the second quarter of fiscal 2018, a decrease of 52.4% compared to \$4.3 million of Adjusted EBITDA for the second quarter of fiscal 2017.

Adjusted EBITDA before other charges was \$4.0 million for the second quarter of fiscal 2018, a decrease of 3.4% compared to \$4.1 million of Adjusted EBITDA before other charges for the second quarter of fiscal 2017.

Net sales for the second quarter of fiscal 2018 decreased 1.9% to \$96.4 million from \$98.3 million for the second quarter of fiscal 2017.

Comparable sales for the second quarter of fiscal 2018 increased 1.2% compared to a comparable sales decrease of 3.4% for the second quarter of fiscal 2017.

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First Six Months of Fiscal 2018 Financial Results

Net loss for the first six months of fiscal 2018 was \$3.8 million, or \$0.28 per share (diluted), compared to a net loss of \$3.9 million, or \$0.28 per share (diluted), for the first six months of fiscal 2017.

Net loss for the first six months of fiscal 2018 includes a 2.3 million, net of tax, charge related to Proxy Solicitation and organizational changes and a \$0.9 million, non-cash income tax charge related to a change in the valuation allowance against net deferred tax assets. Net loss for the first six months of fiscal 2017 includes a \$1.5 million, non-cash income tax charge related to a change in the valuation allowance against net deferred tax assets, revenue of \$0.5 million, net of tax, related to a cumulative adjustment for change in accounting principle, and other charges of \$0.4 million, net of tax, related to the Proposed Merger.

Adjusted net loss for the first six months of fiscal 2018 was \$0.5 million, or \$0.04 per share (diluted), compared to the comparably adjusted net loss for the first six months of fiscal 2017 of \$2.5 million, or \$0.18 per share (diluted).

Adjusted EBITDA was \$8.7 million for the first six months of fiscal 2018, a decrease of 17.1% compared to \$10.5 million of Adjusted EBITDA for the first six months of fiscal 2017.

Adjusted EBITDA before other charges and effect of change in accounting principle was \$11.8 million for the first six months of fiscal 2018, an increase of 13.4% compared to \$10.4 million of Adjusted EBITDA before other charges for the first six months of fiscal 2017.

Net sales for the first six months of fiscal 2018 decreased 2.5% to 199.6 million from \$204.7 million for the first six months of fiscal 2017.

Comparable sales for the first six months of fiscal 2018 increased 0.5% compared to a comparable sales decrease of 5.5% for the first six months of fiscal 2017.

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 August 4, 2018 and July 29, 2017:

	% of Net Sales (1)				% Change Period to	
	Three Months Ended		Six Months Ended		Period Favorable	
					(Unfavorable)	
					Three Months	Six Months
	Three Months Ended	July August 4, 2018	July August 4, 2017	Six Months Ended	July August 4, 2018	July August 4, 2017
				2018 vs. 2017	2018 vs. 2017	
Net sales	100.0%	100.0%	100.0%	100.0%	(1.9)%	(2.5)%
Cost of goods sold (2)	48.3	47.0	47.3	46.3	(0.7)	0.4
Gross profit	51.7	53.0	52.7	53.7	(4.2)	(4.3)
Selling, general and administrative expenses (3)	52.0	53.7	51.1	53.0	5.1	6.0
Store closing, asset impairment and asset disposal	0.7	1.1	0.8	1.3	40.0	37.8

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expenses						
Other charges, net	2.0	(0.2)	1.5	0.3	(1,224.6)	(375.7)