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Destination Maternity Corp
Form 10-Q
December 07, 2017

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 October 28, 2017

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)
232 Strawbridge Drive

Moorestown, New Jersey
(Address of principal executive offices)

13-3045573
(IRS Employer

Identification No.)

08057

(Zip code)

(856) 291-9700

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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 — 14,609,385 shares outstanding as of December 1, 2017

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)

October 28, 2017 January 28, 2017

ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,217	\$ 2,859
Trade receivables, net	6,901	5,683
Inventories	73,936	69,040
Prepaid expenses and other current assets	6,420	9,464
Total current assets	89,474	87,046
Property and equipment, net of accumulated depreciation and amortization of \$99,865 and \$97,461	72,232	83,029
Other assets:		
Deferred line of credit financing costs, net of accumulated amortization of \$800 and \$717	380	456
Other intangible assets, net of accumulated amortization of \$884 and \$810	1,011	1,092
Deferred income taxes	2,155	3,251
Other non-current assets	1,172	1,113
Total other assets	4,718	5,912
Total assets	\$ 166,424	\$ 175,987
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit borrowings	\$ 8,200	\$ 4,600
Current portion of long-term debt	8,173	6,948
Accounts payable	18,121	17,656
Accrued expenses and other current liabilities	33,242	31,359
Total current liabilities	67,736	60,563
Long-term debt	25,190	31,485
Deferred rent and other non-current liabilities	22,957	22,789
Total liabilities	115,883	114,837
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Preferred stock, 1,656,381 shares authorized:	—	—

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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, 14,610,827 and 14,010,417 shares issued and outstanding	146	140
Additional paid-in capital	106,582	105,775
Accumulated deficit	(56,117)	(44,693)
Accumulated other comprehensive loss	(70)	(72)
Total stockholders' equity	50,541	61,150
Total liabilities and stockholders' equity	\$ 166,424	\$ 175,987

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

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DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Nine Months Ended	
	October 28, 2017	October 29, 2016	October 28, 2017	October 29, 2016
Net sales	\$96,354	\$102,582	\$301,060	\$333,541
Cost of goods sold	45,453	48,294	140,167	157,151
Gross profit	50,901	54,288	160,893	176,390
Selling, general and administrative expenses	53,234	54,573	161,689	169,967
Store closing, asset impairment and asset disposal expenses	1,011	724	3,649	1,772
Other charges, net	3,100	459	3,746	2,003
Operating income (loss)	(6,444)	(1,468)	(8,191)	2,648
Interest expense, net	1,006	981	2,989	2,606
Income (loss) before income taxes	(7,450)	(2,449)	(11,180)	42
Income tax provision (benefit)	73	(943)	259	16
Net income (loss)	\$(7,523)	\$(1,506)	\$(11,439)	\$26
Net income (loss) per share— Basic	\$(0.55)	\$(0.11)	\$(0.83)	\$0.00
Average shares outstanding— Basic	13,800	13,702	13,777	13,696
Net income (loss) per share— Diluted	\$(0.55)	\$(0.11)	\$(0.83)	\$0.00
Average shares outstanding— Diluted	13,800	13,702	13,777	13,705

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		Nine Months Ended	
	October 28, 2017	October 29, 2016	October 28, 2017	October 29, 2016
Net income (loss)	\$ (7,523)	\$ (1,506)	\$ (11,439)	\$ 26
Foreign currency translation adjustments	—	—	2	1
Comprehensive income (loss)	\$ (7,523)	\$ (1,506)	\$ (11,437)	\$ 27

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

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DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(unaudited)

	Common Stock			Accumulated		
	Number of Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Other Comprehensive Loss	Total
Balance as of January 28, 2017	14,010	\$ 140	\$ 105,775	\$ (44,693)	\$ (72)	\$ 61,150
Net loss	—	—	—	(11,439)	—	(11,439)
Foreign currency translation adjustments	—	—	—	—	2	2
Dividends forfeited	—	—	—	15	—	15
Stock-based compensation	616	6	852	—	—	858
Repurchase and retirement of common stock	(15)	—	(45)	—	—	(45)
Balance as of October 28, 2017	14,611	\$ 146	\$ 106,582	\$ (56,117)	\$ (70)	\$ 50,541
Balance as of January 30, 2016	13,825	\$ 138	\$ 104,784	\$ (11,951)	\$ (73)	\$ 92,898
Net income	—	—	—	26	—	26
Foreign currency translation adjustments	—	—	—	—	1	1
Dividends forfeited	—	—	—	17	—	17
Stock-based compensation	194	2	1,271	—	—	1,273
Exercise of stock options, net	1	—	3	—	—	3
Tax benefit shortfall from stock options and restricted stock	—	—	(604)	—	—	(604)
Repurchase and retirement of common stock	(3)	—	(21)	—	—	(21)
Balance as of October 29, 2016	14,017	\$ 140	\$ 105,433	\$ (11,908)	\$ (72)	\$ 93,593

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)

	Nine Months Ended	
	October	October
	28, 2017	29, 2016
Operating Activities		
Net income (loss)	\$(11,439)	\$26
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	13,259	13,583
Stock-based compensation expense	858	1,273
Loss on impairment of long-lived assets	3,267	1,406
Loss on disposal of assets	283	289
Grow NJ award benefit	1,096	1,138
Deferred income tax benefit	—	(463)
Amortization of deferred financing costs	375	231
Changes in assets and liabilities:		
Decrease (increase) in:		
Trade receivables	(1,218)	1,713
Inventories	(4,896)	(1,023)
Prepaid expenses and other current assets	3,110	(394)
Other non-current assets	(59)	1
Increase (decrease) in:		
Accounts payable, accrued expenses and other current liabilities	2,474	(12,185)
Deferred rent and other non-current liabilities	23	(569)
Net cash provided by operating activities	7,133	5,026
Investing Activities		
Capital expenditures	(5,484)	(9,616)
Proceeds from sale of property and equipment	—	2
Additions to intangible assets	(18)	(72)
Net cash used in investing activities	(5,502)	(9,686)
Financing Activities		
Decrease in cash overdraft	(461)	(544)
Increase (decrease) in line of credit borrowings	3,600	(21,900)
Proceeds from long-term debt	3,401	32,000
Repayment of long-term debt	(8,493)	(2,964)
Deferred financing costs paid	(277)	(1,275)
Withholding taxes on stock-based compensation paid in connection with repurchase of common stock	(45)	(21)
Proceeds from exercise of stock options	—	3
Net cash (used in) provided by financing activities	(2,275)	5,299

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Effect of exchange rate changes on cash and cash equivalents	2	1
Net (Decrease) Increase in Cash and Cash Equivalents	(642)	640
Cash and Cash Equivalents, Beginning of Period	2,859	2,116
Cash and Cash Equivalents, End of Period	\$2,217	\$2,756
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$2,640	\$2,140
Cash (received) paid for income taxes	\$(4,240)	\$252

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 nine months ended October 28, 2017 and October 29, 2016 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 28, 2017 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 2017 refer to the 53-week fiscal year, or periods within such fiscal year, which began January 29, 2017 and will end February 3, 2018. References to the Company's fiscal 2016 refer to the 52-week fiscal year, or periods within such fiscal year, which began January 31, 2016 and ended January 28, 2017.

On December 19, 2016 the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Orchestra-Prémaman S.A. ("Orchestra"), a société anonyme organized under the laws of France, and US OP Corporation, a Delaware corporation and a wholly-owned subsidiary of Orchestra, to complete a proposed business combination (the "Merger"). On July 27, 2017 the Company, Orchestra, and certain other affiliates of Orchestra entered into a Termination Agreement (the "Termination Agreement") pursuant to which the parties agreed to terminate the Merger Agreement and various ancillary agreements entered into in connection with and in contemplation of the Merger.

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 12).

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

	Three Months Ended October 28, 2017			October 29, 2016		
	Net Loss	Shares	EPS	Net Loss	Shares	EPS
Basic and Diluted EPS	\$(7,523)	13,800	\$(0.55)	\$(1,506)	13,702	\$(0.11)

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DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

	Nine Months Ended October 28, 2017			October 29, 2016		
	Net Loss	Shares	EPS	Net Income	Shares	EPS
Basic EPS	\$(11,439)	13,777	\$(0.83)	\$26	13,696	\$0.00
Incremental shares from the assumed exercise of outstanding stock options	—	—		—	—	
Incremental shares from the assumed lapse of restrictions on restricted stock and deferred stock unit awards	—	—		—	9	
Diluted EPS	\$(11,439)	13,777	\$(0.83)	\$26	13,705	\$0.00

In addition to performance-based RSUs, for the nine months ended October 29, 2016 stock options and unvested restricted stock totaling approximately 1,063,000 shares were excluded from the calculation of Diluted EPS as their effect would have been antidilutive. Stock options, unvested restricted stock and unvested deferred stock units totaling approximately 1,604,000 and 1,270,000 shares of the Company's common stock were outstanding as of October 28, 2017 and October 29, 2016, respectively, but were not included in the computation of Diluted EPS for the three and nine months ended October 28, 2017 and for the three months ended October 29, 2016 due to the Company's net loss. Had the Company reported a profit for the three and nine months ended October 28, 2017 and for the three months ended October 29, 2016 the weighted average number of dilutive shares outstanding for computation of Diluted EPS would have been approximately 13,811,000, 13,797,000 and 13,721,000 shares, respectively.

During the nine months ended October 28, 2017 and October 29, 2016 \$15,000 and \$17,000, 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 October 28, 2017 and January 28, 2017 the Company's trade receivables were net of allowance for doubtful accounts of \$166,000 and \$163,000, respectively.

4. INVENTORIES

Inventories were comprised of the following (in thousands):

	October 28, 2017	January 28, 2017
Finished goods	\$73,347	\$68,346
Work-in-progress	237	212
Raw materials	352	482
	\$73,936	\$69,040

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

5. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

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

	October 28, 2017	January 28, 2017
Employee compensation and benefits	\$8,198	\$6,754
Insurance, primarily self-insurance reserves	5,539	5,421
Deferred rent	3,279	3,507
Gift certificates and store credits	2,675	4,305
Sales and use taxes	2,492	2,591
Product return reserve	2,264	1,615
Accounting and legal	1,192	1,276
Accrued property and equipment additions	653	316
Income taxes payable	319	12
Other	6,631	5,562
	\$33,242	\$31,359

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 \$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. In connection with the Term Loan financing the maturity date of the Credit Facility was extended from August 25, 2020 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. Effective December 19, 2016 the Company's Credit Facility lender consented to the Merger and the Credit Facility was amended to require a \$10,000,000 EBITDA Reserve (as defined in the related Credit Facility agreement) against availability under the Credit Facility. Effective April 7, 2017 the Credit facility was further amended to allow the Company to enter into certain equipment financing arrangements, on the condition that a portion of the proceeds of such financing be applied as a prepayment of the Term Loan (see Note 7). The amendment also provided for an additional reserve of \$5,000,000 against availability under the Credit Facility that will be reduced dollar for dollar for prepayments of the Term Loan in accordance with the amendment. On June 6, 2017 \$3,401,000 of proceeds from an equipment financing transaction (see Note 7) were used to prepay a portion of the Company's Term Loan and to reduce the required additional reserve

to \$1,599,000.

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, as amended on April 7, 2017, 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 Combined Loan Cap (as defined in the Credit Facility agreement) or \$10,000,000. 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 \$1,179,000. 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 October 28, 2017 the Company had \$8,200,000 in outstanding borrowings under the Credit Facility and \$7,327,000 in letters of credit, with \$12,531,000 of availability under the Credit Facility based on the Company's Borrowing Base formula and availability reserve requirements. As of October 29, 2016 the Company had \$6,500,000 in outstanding borrowings under the Credit

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

Facility and \$5,827,000 in letters of credit, with \$31,717,000 of availability under the Credit Facility based on the Company's Borrowing Base formula and minimum Excess Availability requirement. For the three months ended October 28, 2017 and October 29, 2016 Tranche A borrowings had a weighted interest rate of 3.87% and 4.00%, respectively, per annum. For the nine months ended October 28, 2017 and October 29, 2016 Tranche A borrowings had a weighted interest rate of 3.51% and 2.83%, respectively, per annum. For the nine months ended October 29, 2016 Tranche A-1 borrowings had a weighted interest rate of 3.43% per annum. During the nine months ended October 28, 2017 and October 29, 2016 the Company's average level of direct borrowings under the Credit Facility was \$8,707,000 and \$12,150,000, respectively, and the Company's maximum borrowings at any time were \$15,700,000 and \$42,700,000, 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 25, 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. Effective December 19, 2016 the Company's Term Loan lenders consented to the Merger and the Term Loan Agreement was amended to change the definition of Consolidated EBITDA (see below) to allow the Company to add back certain transaction costs relating to the Merger and modified the financial covenant limiting capital expenditures (see below). Effective April 7, 2017 the Term Loan Agreement was further amended to allow the Company to enter into certain equipment financing arrangements, on the condition that a portion of the proceeds of such financing be applied as a prepayment of the Term Loan. The April 7, 2017 Term Loan Agreement amendment also provided for an additional reserve of \$5,000,000 against availability under the Credit Facility that will be reduced dollar for dollar for prepayments of the Term Loan in accordance with the amendment (see Note 6) and eliminated the covenant requiring maintenance of a minimum level of Consolidated EBITDA (see below). On June 6, 2017 \$3,401,000 of proceeds from an equipment financing transaction (see below) were used to prepay a portion of the Company's Term Loan and to reduce the required additional reserve to \$1,599,000.

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, as

amended on April 7, 2017, requires the Company to maintain Excess Availability (as defined in the related Credit Facility agreement) equal to the greater of 10% of the Combined Loan Cap (as defined in the related Credit Facility agreement) or \$10,000,000. Prior to the April 7, 2017 Term Loan Agreement amendment, the Company was required to maintain specified levels of quarterly Consolidated EBITDA (as defined in the related Term Loan Agreement). For all periods prior to the elimination of the Consolidated EBITDA covenant, the Company's Consolidated EBITDA exceeded the Consolidated EBITDA requirements under the Term Loan Agreement. The December 19, 2016 Term Loan Agreement amendment prohibits the Company from making capital expenditures (net of tenant allowances) in excess of a specified amount in any period of four fiscal quarters (subject to carryforward of 50% of any underutilization). The limitation on capital expenditures ranges from \$16,000,000 for the four fiscal quarters ended on January 28, 2017 to \$10,500,000 for the four fiscal quarters ending on February 3, 2018, and increases to \$17,000,000 for the four fiscal quarters ending on May 5, 2018 and thereafter. For the four fiscal quarters ended on October 28, 2017 the Company's net capital expenditures did not exceed the \$13,000,000 limit. Any amounts outstanding under the Term Loan may be accelerated and become due and payable immediately upon an event of default and expiration of any applicable cure period. In connection with the execution of the Term Loan Agreement and subsequent amendments, the Company incurred deferred financing costs of \$1,527,000. 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 statements of operations.

As of October 28, 2017 and January 28, 2017 there was \$24,599,000 and \$30,400,000, respectively, of principal outstanding under the Term Loan.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

As of October 28, 2017 and January 28, 2017 there was \$7,064,000 and \$9,302,000, respectively, of principal 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.

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 financing arrangement 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 October 28, 2017 there was \$2,947,000 of principal outstanding under the 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

At both October 28, 2017 and January 28, 2017 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 October 28, 2017 and January 28, 2017 the Company had \$8,200,000 and \$4,600,000, 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 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. OTHER CHARGES, NET

In an effort to enhance the Company's competitive position, in late fiscal 2014 the Company commenced a program to actively focus on improving its business processes, key management personnel and planning resources. These efforts have been increasingly challenged by a number of external factors and industry trends, including the overall weakness in the women's specialty apparel retail space as well as declining mall-based traffic. In order to address these challenges, the Company has acted to best position itself for profitable, long-term growth, with a focus on improving inventory management, driving sales productivity, optimizing real estate, expanding its online presence and controlling costs. Among other efforts, the Company conducted a comprehensive evaluation of its key apparel brands and business relationships, resulting in strategic phase-outs and the elimination of certain non-core brands. Management time and resources expended during late fiscal 2016 and the first half of fiscal 2017 to complete the Merger had a negative impact on the execution of the Company's operations and its transformation plans. After termination of the Merger the Company has taken actions focused on preserving and creating value for its stockholders. The Company retained a leading consulting

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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firm to review its costs and business strategy in order to implement an organizational transformation. The Company is in the process of executing a transition of its Chief Executive Officer (“CEO”) having announced on September 7, 2017 the appointment of B. Allen Weinstein, a member of the Company’s Board since 2010, as interim Chief Executive Officer (“Interim CEO”) and the resignation of Anthony M. Romano as its Chief Executive Officer & President (“Former CEO”). 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 nine months ended October 28, 2017 and October 29, 2016 the Company recognized \$2,633,000 and \$707,000, respectively, of net 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 the Company’s largest shareholder, Orchestra, a France-based retailer of children’s wear. On December 19, 2016 the Company entered into the Merger Agreement. During the second quarter of fiscal 2017 the parties determined that it was in the best interests of their respective stockholders to terminate the Merger. On July 27, 2017 the Company, Orchestra, and certain other affiliates of Orchestra entered into 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, with a net amount of \$1,000,000 paid to the Company on July 31, 2017. During the nine months ended October 28, 2017 and October 29, 2016 the Company incurred \$1,113,000 and \$1,296,000, respectively, of net charges related to the Merger, including \$426,000 of charges in the third quarter of fiscal 2017 related to a contested proxy solicitation initiated by Orchestra.

The Termination Agreement also terminated certain ancillary agreements between the Company and a wholly-owned subsidiary of Orchestra, under which the Company provided real estate and construction project consulting services, and offered for purchase infant and childrenswear merchandise for sale in certain of the Company’s stores. For the first nine months of fiscal 2017 the Company recognized \$44,000 of revenue under such agreements.

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

	Three Months Ended		Nine Months Ended	
	October 28, 2017	October 29, 2016	October 28, 2017	October 29, 2016
Management and Organizational Changes				
Former CEO separation benefits	\$1,364	\$ —	\$1,364	\$ —
Other severance and related benefits	754	36	751	157
Pro-rata retention bonuses	21	—	21	—
Consulting and other fees	497	—	497	5

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Non-core brand contract terminations	—	—	—	545
Total management and organizational changes	2,636	36	2,633	707
Proposed Business Combination				
Legal and other fees	464	423	2,113	1,296
Net reimbursement for certain costs incurred	—	—	(1,000)	—
Total proposed business combination	464	423	1,113	1,296
Total other charges, net	\$3,100	\$ 459	\$3,746	\$ 2,003

10. GOVERNMENT INCENTIVES

In 2015 the Company completed the relocation of its corporate headquarters and distribution operations from Philadelphia, Pennsylvania to southern New Jersey (the “Project”). 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.

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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. The expected realizable amount of the Grow NJ award is included in the consolidated balance sheet in deferred income taxes. In April 2017 and May 2016 the Company received \$3,251,000 and \$3,600,000 cash proceeds, net of costs, from the receipt and subsequent sale of the \$3,621,000 and \$4,000,000 tax credit certificates earned for fiscal 2016 and fiscal 2015, respectively. During the three and nine months ended October 28, 2017 the Company recognized \$718,000 and \$2,155,000, respectively, of cost reduction related to the Grow NJ award, of which \$675,000 and \$2,152,000, respectively, is included in the consolidated statements of operations, including reductions of cost of goods sold of \$476,000 and \$1,554,000, respectively, and reductions of selling, general and administrative expenses of \$199,000 and \$598,000, respectively. During the three and nine months ended October 29, 2016 the Company recognized \$695,000 and \$2,462,000, respectively, of cost reduction related to the Grow NJ award, of which \$670,000 and \$2,363,000, respectively, is included in the consolidated statements of operations, including reductions of cost of goods sold of \$476,000 and \$1,675,000, respectively, and reductions of selling, general and administrative expenses of \$194,000 and \$688,000, respectively. Additionally, \$813,000 and \$810,000, is included in the consolidated balance sheets as of October 28, 2017 and January 28, 2017, respectively, as a reduction to overhead in inventory.

11. INCOME TAXES

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. The evaluation includes the consideration of all available evidence, both positive and negative, regarding historical operating results including recent years with reported losses, the estimated timing of future reversals of existing taxable temporary differences, estimated future taxable income exclusive of reversing temporary differences and carryforwards, and potential tax planning strategies which may be employed to prevent an operating loss or tax credit carryforward from expiring unused. 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. The three-year cumulative loss constituted significant negative evidence, limiting the Company's ability to consider other positive evidence, such as the Company's projections for future growth. Consequently, the Company's consolidated balance sheets as of October 28, 2017 and January 28, 2017 include a valuation allowance of \$32,110,000 and \$27,758,000, respectively, against substantially all of its deferred tax assets. The establishment of this valuation allowance has no effect on the Company's ability to utilize the deferred tax assets to offset future taxable income, if generated. As required by generally accepted accounting principles in the United States ("GAAP"), the Company will continue to assess the likelihood that the deferred tax assets will be realizable in the future and, accordingly, the valuation allowance was increased by a non-cash charge to income tax expense of \$4,352,000 in the first nine months of fiscal 2017. The tax benefits relating to any reversal of the valuation allowance on the net deferred tax assets in a future period will be recognized as a reduction of future income tax expense in that period.

As of October 28, 2017 the Company had \$788,000 of unrecognized tax benefits related to uncertain income tax positions, including accrued interest and penalties of \$361,000. 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 \$570,000, net of federal benefit.

During the 12 months subsequent to October 28, 2017 it is reasonably possible that the gross unrecognized tax benefits could potentially decrease by approximately \$392,000 (of which \$277,000 would affect the effective tax rate, net of federal expense) for uncertain tax positions, primarily from the effect of expiring statutes of limitations, partially offset by the continued effect of interest on unrecognized tax benefits.

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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. 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, and United States state tax returns for tax years ended September 30, 2012 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 2012.

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 August 2016 and April 2016 (collectively 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 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	10,484	41,936	62,904
Fiscal 2015 Awards	February 1, 2015 to February 3, 2018	13,918	27,836	41,754

Fiscal 2016 and 2015 Awards include the prorated number of RSUs that may be earned by the Company's Former CEO and former President and exclude RSUs forfeited by the Company's former Executive Vice President & Chief Financial Officer. 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 nine months ended October 28, 2017 and October 29, 2016 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 15,000 and 3,000 shares, respectively, during the nine months ended October 28, 2017 and October 29, 2016, 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 \$45,000 and \$21,000 for the nine months ended October 28, 2017 and October 29, 2016, respectively.

13. RECENT ACCOUNTING PRONOUNCEMENTS AND CHANGE IN ACCOUNTING PRINCIPLE

a. Newly Adopted Accounting Pronouncements

In March 2016 the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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. The Company adopted ASU No. 2016-09 effective January 29, 2017 and the adoption did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

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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. The Company adopted ASU No. 2015-17 effective January 29, 2017 and applied the required reclassifications on a retrospective basis. Accordingly, in the consolidated balance sheet as of January 28, 2017, \$3,251,000 of deferred tax assets were reclassified from current assets to other assets. The adoption of ASU No. 2015-17 did not have any impact on the Company's net consolidated financial position, results of operations or cash flows.

In July 2015 the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. ASU No. 2015-11 changes the measurement principle for inventory from the lower of cost or market to the lower of cost and net realizable value. The Company adopted ASU No. 2015-11 effective January 29, 2017 and the adoption did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

b. Proposed Accounting Pronouncements

In May 2017 the FASB issued ASU No. 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. ASU No. 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 impact from adoption of the new requirements of ASU No. 2017-09 on the Company's consolidated financial position or results of operations has not yet been determined.

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 impact from adoption of the new requirements of ASU No. 2016-16 on the Company's consolidated financial position or results of operations has not yet been determined.

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 adoption of the new requirements of ASU No. 2016-15 will not have any impact on the Company's net consolidated financial position or results of operations.

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. 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 balance sheets from the recognition of right-of-use assets and related liabilities but does not expect it to have a material impact on the consolidated statements 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

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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 Company is currently evaluating the impact of ASU No. 2014-09, and based on the nature and timing of a predominant amount of its revenues which are from store point-of-sale and e-commerce transactions, implementation is not expected to materially impact the Company's consolidated financial statements. Additionally, the Company continues to evaluate whether there will be any impact to its contract-based revenues under ASU No. 2014-09, as well as the overall presentation of required disclosures. The Company will adopt ASU No. 2014-09 on February 4, 2018 and expects to utilize the modified retrospective approach, which requires a cumulative adjustment to retained earnings.

c. Change in Accounting Principle

The Company sells gift cards to its customers in its retail stores, through its websites and through select third parties. The portion of gift cards sold to customers which are never redeemed is commonly referred to as gift card breakage. Prior to fiscal 2017 the Company recognized revenue from gift card breakage after it determined that any legal obligation to report and remit the value associated with abandoned property had been satisfied. The Company has accumulated a significant amount of historical data from its past gift card transactions, allowing it to reasonably and objectively determine the pattern of gift card redemptions and a related estimated gift card breakage rate. In the first quarter of fiscal 2017 the Company elected to record revenue from gift card breakage over the period of, and in proportion to, the actual redemptions of gift cards based on the Company's historical breakage. The Company believes this method is preferable as it better reflects the gift card earnings process resulting in the recognition of gift card breakage income over the period of gift card redemptions (i.e., over the performance period).

The Company determined that this accounting change represented 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 the Company recognized \$764,000 of revenue as a cumulative adjustment for the accounting change.

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		Nine Months Ended	
	October 28, 2017	October 29, 2016	October 28, 2017	October 29, 2016
Net Sales				
United States	\$90,584	\$95,610	\$283,676	\$311,881
Foreign	5,770	6,972	17,384	21,660

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	October 28, 2017	January 28, 2017
Long-Lived Assets		
United States	\$72,232	\$81,811
Foreign	1,011	2,310

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		Nine Months Ended	
	October 28, 2017	October 29, 2016	October 28, 2017	October 29, 2016
Interest expense	\$1,006	\$ 982	\$2,991	\$2,608
Interest income	—	(1)	(2)	(2)
Interest expense, net	\$1,006	\$ 981	\$2,989	\$2,606

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 2017 refer to the 53-week fiscal year, or periods within such fiscal year, which began January 29, 2017 and will end February 3, 2018. References to our fiscal 2016 refer to the 52-week fiscal year, or periods within such fiscal year, which began January 31, 2016 and ended January 28, 2017.

Overview

We are the leading designer and retailer of maternity apparel in the United States with 1,147 retail locations, including 501 stores in the United States, Canada and Puerto Rico, and 646 leased departments located within department stores and baby specialty stores throughout North America. 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 October 28, 2017 we have 208 international franchised locations, including 16 stand-alone stores operated under one of our retail nameplates and 192 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 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). 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.

Termination of Planned Merger

On December 19, 2016 we entered into the Merger Agreement, pursuant to which, subject to the satisfaction or waiver of certain conditions, a subsidiary of Orchestra would merge with and into the Company, with the Company surviving

as a wholly-owned subsidiary of Orchestra. Despite substantial and sustained efforts by both parties since execution of the Merger Agreement, and in light of the challenges of satisfying applicable securities regulations in France and in the U.S. as well as the uncertainty as to whether those regulatory requirements could be satisfied without unreasonable effort and expense, particularly in connection with the completion of the registration and listing of Orchestra securities in the U.S., where such securities previously have not been publicly traded, the parties determined that it was in the best interests of their respective stockholders to terminate the Merger Agreement. Accordingly, on July 27, 2017 the Company, Orchestra, and certain other affiliates of Orchestra entered into a Termination Agreement pursuant to which the parties agreed to terminate the Merger Agreement and various ancillary agreements entered into in connection with and in contemplation of the Merger. Orchestra and the Company 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 the Company on July 31, 2017. Orchestra and its affiliates last reported they continue to own 1.9 million shares of the outstanding common stock of Destination Maternity.

During the first nine months of fiscal 2017 and fiscal 2016 we recognized \$1.1 million and \$1.3 million, respectively, of charges related to the Merger, including \$0.4 million of charges in the third quarter of fiscal 2017 related to a contested proxy solicitation initiated by Orchestra.

Turnaround Plan

While we have succeeded in maintaining our leadership position within this specialty retail sector, in an effort to enhance our competitive position, in late fiscal 2014 we commenced a program, which we sometimes refer to as our “turnaround plan” or “turnaround” to actively focus on improving our business processes, key management personnel and planning resources. These efforts became increasingly challenged by a number of external factors and industry trends, including the overall weakness in the women's specialty apparel retail space as well as declining mall-based traffic. These challenges have led to a slower pace of progress than originally planned, resulting in a decline in net sales from fiscal 2016 and underperformance to 2017 expectations.

In order to address the challenges that we and other retailers are facing, we have taken decisive action to best position us for profitable, long-term growth, with a focus on improving inventory management, driving sales productivity, optimizing real estate, expanding our online presence and controlling costs. Among other efforts, we conducted a comprehensive evaluation of our key apparel brands and business relationships, resulting in strategic phase-outs and the elimination of certain non-core brands.

During late fiscal 2016 and the first half of fiscal 2017 we incurred significant expenses and expended substantial management time, attention and energy in seeking to complete the Merger. Those expenditures, although made in pursuit of a transaction we believed would be in the best interest of our stockholders, nevertheless had a negative impact on the execution of our operations and turnaround plan. After termination of the Merger we have taken actions focused on preserving and creating value for our stockholders. We retained a leading consulting firm to review our costs and business strategy in order to implement an organizational transformation. We are in the process of executing a CEO transition having announced on September 7, 2017 the appointment of B. Allen Weinstein, a member of our Board since 2010, as Interim CEO and the resignation of Anthony M. Romano as our Former CEO. We also paid one-time retention bonuses with service conditions to certain key management personnel, while reducing our overall headcount to create a more efficient and effective operating structure. Through these actions we are identifying further opportunities to improve profitability, by growing both top line and gross margins while reducing expenses. We expect this transformation to yield approximately \$10 to \$11 million per year in annualized expense savings primarily starting in fiscal 2018.

During the first nine months of fiscal 2017 and fiscal 2016 we recognized \$2.6 million and \$0.7 million, respectively, of charges related to our turnaround plan.

Change in Accounting Principle

We sell gift cards to our customers in our retail stores, through our websites and through select third parties. The portion of gift cards sold to customers which are never redeemed is commonly referred to as gift card breakage. Prior to fiscal 2017 we recognized revenue from gift card breakage after we determined that any legal obligation to report and remit the value associated with abandoned property had been satisfied. We have accumulated a significant amount of historical data from our past gift card transactions, allowing us to reasonably and objectively determine the pattern of gift card redemptions and a related estimated gift card breakage rate. In the first quarter of fiscal 2017 we elected to record revenue from gift card breakage over the period of, and in proportion to, the actual redemptions of gift cards based on our historical breakage. We believe this method is preferable as it better reflects the gift card earnings process resulting in the recognition of gift card breakage income over the period of gift card redemptions (i.e., over the performance period).

We determined that this accounting change represented 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.

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 fiscal 2016. In addition, our leased department relationship with Gordmans ended in March 2016, resulting in the closure of 100 leased departments within Gordmans stores. We also phased out production of our Oh Baby by Motherhood® line during fiscal 2016 after being informed that Kohl's elected to scale back and ultimately discontinue its exclusive license with us for this line. Our license agreement with Kohl's ended in February 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.

Presented below is a summary of our results for the third quarter and first nine months of fiscal 2017 with regard to each of the key measures noted above:

Third Quarter Fiscal 2017 Financial Results

Net loss for the third quarter of fiscal 2017 was \$7.5 million, or \$0.55 per share (diluted), compared to net loss of \$1.5 million, or \$0.11 per share (diluted), for the third quarter of fiscal 2016.

Net loss for the third quarter of fiscal 2017 includes a \$2.9 million non-cash income tax charge related to a change in the valuation allowance against net deferred tax assets and other charges of \$1.9 million, net of tax, or \$0.14 per share (diluted), primarily related to management and organizational changes. Net loss for the third quarter of fiscal 2016 includes other charges of \$0.3 million, net of tax, or \$0.02 per share (diluted), primarily related to the now terminated Merger.

Adjusted net loss for the third quarter of fiscal 2017 was \$2.7 million, or \$0.20 per share (diluted), compared to the comparably adjusted net loss for the third quarter of fiscal 2016 of \$1.2 million, or \$0.09 per share (diluted).

Adjusted EBITDA was \$(1.1) million for the third quarter of fiscal 2017, compared to \$4.2 million of Adjusted EBITDA for the third quarter of fiscal 2016.

Adjusted EBITDA before other charges was \$2.0 million for the third quarter of fiscal 2017, a decrease of 56.5% compared to \$4.7 million of Adjusted EBITDA before other charges for the third quarter of fiscal 2016.

Net sales for the third quarter of fiscal 2017 decreased 6.1% to \$96.4 million from \$102.6 million for the third quarter of fiscal 2016.

Comparable sales for the third quarter of fiscal 2017 increased 1.1% compared to a comparable sales decrease of 5.2% for the third quarter of fiscal 2016.

First Nine Months of Fiscal 2017 Financial Results

Net loss for the first nine months of fiscal 2017 was \$11.4 million, or \$0.83 per share (diluted), compared to net income of \$26,000, or \$0.00 per share (diluted), for the first nine months of fiscal 2016.

Net loss for the first nine months of fiscal 2017 includes a \$4.4 million, non-cash income tax charge related to a change in the valuation allowance against net deferred tax assets, other charges of \$2.3 million, net of tax, or \$0.17 per share (diluted), related to management and organizational changes, and the now terminated Merger, and revenue of \$0.5 million, net of tax, or \$0.03 per share (diluted), related to a cumulative adjustment for change in accounting principle. Net income for the first nine 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 2) \$0.8 million, net of tax, or \$0.06 per share (diluted), related to the now terminated Merger.

Adjusted net loss for the first nine months of fiscal 2017 was \$5.2 million, or \$0.38 per share (diluted), compared to the comparably adjusted net income for the first nine months of fiscal 2016 of \$1.3 million, or \$0.09 per share (diluted).

Adjusted EBITDA was \$9.5 million for the first nine months of fiscal 2017, a decrease of 50.6% compared to \$19.2 million of Adjusted EBITDA for the first nine months of fiscal 2016.

Adjusted EBITDA before other charges and effect of change in accounting principle was \$12.5 million for the first nine months of fiscal 2017, a decrease of 41.2% compared to \$21.2 million of Adjusted EBITDA before other charges for the first nine months of fiscal 2016.

Net sales for the first nine months of fiscal 2017 decreased 9.7% to \$301.1 million from \$333.5 million for the first nine months of fiscal 2016.