NEIMAN MARCUS GROUP INC
Form 424B3
December 07, 2006

PROSPECTUS SUPPLEMENT
(To Prospectus dated August 21, 2006)

Filed Pursuant to Rule 424(b)(3)
Registration No. 333-136297

The Neiman Marcus Group, Inc.

7.125% Senior Debentures due 2028

Recent Developments

We have attached to this prospectus supplement the Quarterly Report on Form 10-Q of Neiman Marcus, Inc. for the period ended October 28, 2006. The attached information updates and supplements The Neiman Marcus Group, Inc. s Prospectus dated August 21, 2006.

You should carefully consider the risk factors beginning on page 15 of the Prospectus before investing.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

This prospectus will be used by Credit Suisse Securities (USA) LLC in connection with offers and sales in market-making transactions at certain negotiated prices related to prevailing market prices. Credit Suisse Securities (USA) LLC has advised us that it is currently making a market in the securities; however, it is not obligated to do so and may stop at any time. Credit Suisse Securities (USA) LLC may act as principal or agent in any such transaction. We will not receive the proceeds of the sale of the securities but will bear the expenses of registration. See Plan of Distribution in the Prospectus.

Credit Suisse

December 6, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended October 28, 2006

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file no. 333-133184-12

Neiman Marcus, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**20-3509435** (I.R.S. Employer Identification No.)
1618 Main Street **Dallas, Texas** (Address of principal executive offices)	**75201** (Zip code)

Registrant s telephone number, including area code: **(214) 743-7600**

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

There were 1,012,264 shares of the registrant s common stock, par value $.01 per share, outstanding at October 28, 2006.

NEIMAN MARCUS, INC.

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NEIMAN MARCUS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands, except shares)	October 28, 2006 (Successor)	July 29, 2006 (Successor)	October 29, 2005 (Successor)
ASSETS			
Current assets:			
Cash and cash equivalents	$ 159,430	$ 223,740	$ 191,532
Reserved cash			134,734
Accounts receivable	46,207	30,164	23,115
Merchandise inventories	971,302	793,621	959,103
Deferred income taxes	33,232	31,503	16,074
Other current assets	42,696	40,211	78,706
Current assets of discontinued operations	16,354	16,617	39,843
Total current assets	1,269,221	1,135,856	1,443,107
Property and equipment, net	1,038,138	1,030,279	1,095,403
Customer lists, net	518,068	531,632	421,186
Favorable lease commitments, net	460,727	465,197	385,201
Trademarks	1,621,788	1,621,788	1,696,846
Goodwill	1,605,140	1,605,140	1,685,083
Debt issuance costs	94,797	97,537	108,028
Other assets	14,994	27,786	11,145
Non-current assets of discontinued operations	79,297	92,746	140,416
Total assets	$ 6,702,170	$ 6,607,961	$ 6,986,415
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$ 320,212	$ 300,439	$ 335,097
Accrued liabilities	431,295	377,968	322,374
Notes payable and current maturities of long-term liabilities	4,179	3,887	200
Senior notes due 2008			134,734
Current liabilities of discontinued operations	28,565	16,764	35,580
Total current liabilities	784,251	699,058	827,985
Long-term liabilities:			
Asset-based revolving credit facility			150,000
Senior secured term loan facility	1,875,000	1,875,000	1,975,000
Senior debentures due 2028	120,760	120,711	120,565
Senior notes	700,000	700,000	700,000
Senior subordinated notes	500,000	500,000	500,000
Deferred real estate credits, net	29,326	27,316	808
Deferred income taxes	1,031,959	1,048,925	1,106,419
Other long-term liabilities	192,939	190,195	169,018
Non-current liabilities of discontinued operations	12,735	12,775	13,188
Total long-term liabilities	4,462,719	4,474,922	4,734,998
Minority interest in discontinued operations	5,993	6,314	11,751
Common stock (par value $0.01 per share, issued 1,012,264 shares)	10	10	10
Additional paid-in capital	1,406,741	1,405,373	1,401,420
Accumulated other comprehensive income (loss)	2,772	9,829	(598)
Retained earnings	39,684	12,455	10,849
Total shareholders equity	1,449,207	1,427,667	1,411,681
Total liabilities and shareholders equity	$ 6,702,170	$ 6,607,961	$ 6,986,415

See Notes to Condensed Consolidated Financial Statements.

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NEIMAN MARCUS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(UNAUDITED)

(in thousands)	**Thirteen weeks ended October 28, 2006 (Successor)**	**Four weeks ended October 29, 2005 (Successor)**	**Nine weeks ended October 1, 2005 (Predecessor)**
Revenues	$ 1,039,211	$ 313,812	$ 632,372
Cost of goods sold including buying and occupancy costs (excluding depreciation)	606,778	191,528	371,542
Selling, general and administrative expenses (excluding depreciation)	247,530	77,263	155,632
Income from credit card operations	(16,371)	(3,785)	(7,818)
Depreciation expense	33,175	9,322	19,209
Amortization of customer lists	13,564	3,249	
Amortization of favorable lease commitments	4,470	1,559	
Transaction and other costs			23,544
Other income	(4,210)		
Operating earnings	154,275	34,676	70,263
Interest expense (income), net	68,818	17,254	(910)
Earnings from continuing operations before income taxes	85,457	17,422	71,173
Income taxes	34,002	6,790	26,226
Earnings from continuing operations	51,455	10,632	44,947
(Loss) earnings from discontinued operations, net of taxes	(24,226)	217	(793)
Net earnings	$ 27,229	$ 10,849	$ 44,154

See Notes to Condensed Consolidated Financial Statements.

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NEIMAN MARCUS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(in thousands)	**Thirteen weeks ended October 28, 2006 (Successor)**	**Four weeks ended October 29, 2005 (Successor)**	**Nine weeks ended October 1, 2005 (Predecessor)**
CASH FLOWS - OPERATING ACTIVITIES			
Net earnings	$ 27,229	$ 10,849	$ 44,154
Loss (earnings) from discontinued operations	24,226	(217)	793
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation expense	33,175	9,322	19,209
Amortization of debt issue costs	3,498	1,091	96
Amortization of customer lists and favorable lease commitments	18,034	4,808	
Non-cash charges related to step-up in carrying value of inventory		7,481	
Stock-based compensation charges	1,365		19,968
Deferred income taxes	(13,801)	(12,409)	(6,921)
Other, primarily costs related to defined benefit pension plans	5,768	12,893	(4,621)
	99,494	33,818	72,678
Changes in operating assets and liabilities:			
Increase in accounts receivable	(16,043)	(921)	(7,779)
Increase in merchandise inventories	(178,076)	(26,943)	(172,924)
(Increase) decrease in other current assets	(2,485)	1,077	6,898
Increase in other assets	(929)		(2,274)
Increase in accounts payable and accrued liabilities	74,287	11,594	122,608
Payment of deferred compensation and stock-based awards		(12,901)	
Increase in deferred real estate credits	2,428	2,389	4,326
Net cash (used for) provided by continuing operating activities	(21,324)	8,113	23,533
Net cash provided by (used for) discontinued operations	1,059	1,273	(4,098)
Net cash (used for) provided by operating activities	(20,265)	9,386	19,435
CASH FLOWS INVESTING ACTIVITIES			
Capital expenditures	(41,419)	(21,996)	(25,575)
Acquisition of The Neiman Marcus Group, Inc.		(5,152,939)	
Increase in reserved cash		(134,734)	
Net cash used for continuing investing activities	(41,419)	(5,309,669)	(25,575)
Net cash used for discontinued operations	(136)	(1,015)	(736)
Net cash used for investing activities	(41,555)	(5,310,684)	(26,311)
CASH FLOWS FINANCING ACTIVITIES			
Repayment of borrowings	(809)		
Borrowings under asset-based revolving credit facility		150,000	
Borrowings under senior term loan facility		1,975,000	
Borrowings of senior notes and subordinated debt		1,200,000	
Debt issuance costs paid	(758)	(102,854)	
Cash equity contributions		1,427,739	
Cash dividends paid			(7,346)
Net cash (used for) provided by continuing financing activities	(1,567)	4,649,885	(7,346)
Net cash (used for) provided by discontinued operations	(925)	(750)	5,000
Net cash (used for) provided by financing activities	(2,492)	4,649,135	(2,346)
CASH AND CASH EQUIVALENTS			
Decrease during the period	(64,312)	(652,163)	(9,222)
Beginning balance	224,763	844,260	853,482
Ending balance	160,451	192,097	844,260
Less cash and cash equivalents of discontinued operations	1,021	565	1,056
Ending balance of continuing operations	$ 159,430	$ 191,532	$ 843,204

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(in thousands)	Thirteen weeks ended October 28, 2006 (Successor)	Four weeks ended October 29, 2005 (Successor)	Nine weeks ended October 1, 2005 (Predecessor)
Supplemental Schedule of Cash Flow Information			
Cash paid (received) during the period for:			
Interest	$ 78,308	$ 3,541	$ 134
Income taxes	$ 11,024	$ 275	$ 10,693
Noncash activities:			
Equity contribution from Holding	$	$ 25,000	$
Equity contribution from management shareholders	$	$ 17,891	$
Reduction in equity for deemed dividend to management shareholders	$	$ 69,200	$
Additions to property and equipment	$ 822	$	$

See Notes to Condensed Consolidated Financial Statements.

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NEIMAN MARCUS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Basis of Presentation

On April 22, 2005, Neiman Marcus, Inc., formerly Newton Acquisition, Inc. (the Company), and its wholly-owned subsidiary, Newton Acquisition Merger Sub, Inc. (Merger Sub), were formed and incorporated in the state of Delaware. On April 29, 2005, the Company received subscriptions for 900 shares of its common stock from Newton Holding, LLC (Holding) in exchange for a capital contribution of $900 and Merger Sub issued 900 shares of its common stock to the Company in exchange for a capital contribution of $900. Holding, the Company and Merger Sub were formed by investment funds affiliated with Texas Pacific Group and Warburg Pincus LLC (the Sponsors) for the purpose of acquiring The Neiman Marcus Group, Inc. (NMG). The equity subscriptions were subsequently funded by the Sponsors.

The acquisition of NMG was completed on October 6, 2005 through the merger of Merger Sub with and into NMG, with NMG being the surviving entity (the Acquisition). Subsequent to the Acquisition, NMG is a subsidiary of the Company, which is controlled by Holding. The Acquisition was recorded as of October 1, 2005, the beginning of our October accounting period.

In connection with the acquisition of NMG, Holding made an aggregate cash equity contribution of $1,420.0 million and a noncash equity contribution of $25.0 million to the Company in exchange for the Company issuing 999,100 shares of its common stock to Holding. In addition, certain members of executive management of the Company made cash equity contributions aggregating $7.7 million and noncash equity contributions, consisting of shares of common stock and common stock options in NMG, aggregating $17.9 million in exchange for 12,264 shares of common stock in the Company.

Prior to the Acquisition, the Company had no independent assets or operations. After the Acquisition, the Company represents the Successor to NMG since the Company s sole asset is its investment in NMG and its operations consist solely of the operating activities of NMG as well as costs incurred by the Company related to its investment in NMG. For periods prior to the Acquisition, NMG is deemed to be the predecessor to the Company. As a result, for periods prior to the Transactions, the financial statements of the Company consist of the financial statements of NMG for such periods. The accompanying consolidated statements of earnings and cash flows present our results of operations and cash flows for the periods preceding the Acquisition (Predecessor) and the periods succeeding the Acquisition (Successor), respectively. All references to we and our relate to the Company for periods subsequent to the Transactions and to NMG for periods prior to the Transactions.

Our fiscal year ends on the Saturday closest to July 31. All references to the first quarter of fiscal year 2007 relate to the thirteen weeks ended October 28, 2006 (Successor). All references to the first quarter of fiscal year 2006 relate to the combined period comprised of four weeks ended October 29, 2005 (Successor) and the nine weeks ended October 1, 2005 (Predecessor).

We have prepared the accompanying unaudited condensed consolidated financial statements in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, these financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Therefore, these financial statements should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended July 29, 2006.

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly our financial position, results of operations and cash flows for the applicable interim periods. The results of operations for these periods are not necessarily comparable to, or indicative of, results of any other interim period or for the fiscal year as a whole.

We are required to make estimates and assumptions about future events in preparing financial statements in conformity with generally accepted accounting principles. These estimates and assumptions affect the amounts of assets, liabilities, revenues and expenses and the disclosure of gain and loss contingencies at the date of the unaudited condensed consolidated financial statements. While we believe that our past estimates and assumptions have been materially accurate, our current estimates are subject to change if different assumptions as to the outcome of future events were made. We evaluate our estimates and judgments on an ongoing basis and predicate those estimates and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances. We make adjustments to our assumptions and judgments when facts and circumstances dictate. Since future events and their effects cannot be determined with absolute certainty, actual results may differ from the estimates used in preparing the accompanying unaudited condensed consolidated financial statements.

We believe the following critical accounting policies, among others, encompass the more significant judgments and estimates used in the preparation of our financial statements:

- Recognition of revenues;
- Valuation of merchandise inventories, including determination of original retail values, recognition of markdowns and vendor allowances, estimation of inventory shrinkage, and determination of cost of goods sold;
- Determination of impairment of long-lived assets;
- Recognition of advertising and catalog costs;
- Measurement of liabilities related to our loyalty programs;
- Recognition of income taxes;
- Measurement of accruals for litigation, general liability, workers compensation and health insurance, short-term disability, pension and postretirement health care benefits; and
- Allocation of the price paid to acquire the Company to our assets and liabilities as of the date of the Acquisition (as more fully described in Note 3).

A detailed description of our critical accounting policies is included in our Annual Report on Form 10-K for the fiscal year ended July 29, 2006.

Recent Accounting Pronouncements. In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that we recognize in our consolidated financial statements the impact of a tax position, if that position is more likely than not of being sustained upon examination, based on the technical merits of the position. We will be required to implement the provisions of FIN 48 no later than the first quarter of fiscal year 2008. We have not yet evaluated the impact, if any, of adopting FIN 48 on our consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 (SAB 108). SAB 108 addresses the process and diversity in practice of quantifying financial statement misstatements resulting in the potential build up of improper amounts on the balance sheet. We will be required to adopt the provisions of SAB 108 no later than the fourth quarter of fiscal year 2007. We currently do not believe that the adoption of SAB 108 will have a material impact on our consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (FAS 157), which provides guidance for using fair value to measure certain assets and liabilities. FAS 157 will apply whenever another standard requires or permits assets or liabilities to be measured at fair value. The standard does not expand the use of fair value to any new circumstances. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, or our fiscal year ending August 1, 2009. We have not yet evaluated the impact, if any, of adopting FAS 157 on our consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Benefit Plans (FAS 158). FAS 158 requires employers to report a postretirement benefit asset for plans that are overfunded and a postretirement benefit liability for plans that are underfunded. Deferred plan costs and income are required to be reported in accumulated other comprehensive income (OCI), net of tax effects, until they are amortized. We will be required to adopt the provisions of FAS 158 no later than the fourth quarter of fiscal year 2007. We have not yet evaluated the impact, if any, of adopting FAS 158 on our consolidated financial statements.

2. The Transactions

As discussed in Note 1, the Acquisition was completed on October 6, 2005 and was financed by:

- Borrowings under a senior secured asset-based revolving credit facility (Asset-Based Revolving Credit Facility) and a secured term loan credit facility (Senior Secured Term Loan Facility) (collectively, the Secured Credit Facilities);

- the issuance of 9.0%/9.75% senior notes due 2015 (Senior Notes);

- the issuance of 10.375% senior subordinated notes due 2015 (Senior Subordinated Notes); and

- equity investments funded by direct and indirect equity investments from the Sponsors, co-investors and management.

The Acquisition occurred simultaneously with:

- the closing of the financing transactions and equity investments described above;

- the call for redemption of, the deposit into a segregated account of the estimated amount of the redemption payment related to, and the ratable provision of security pursuant to the terms thereof, for our 6.65% senior notes due 2008 (2008 Notes);

- the ratable provision of security to our 7.125% senior debentures due 2028 (2028 Debentures) pursuant to the terms thereof; and

- the termination of a previous $350 million unsecured revolving credit agreement (Credit Agreement).

We refer to the above transactions, the Acquisition and our payment of any costs related to these transactions collectively herein as the Transactions.

Transaction and Other Costs. During the period from July 30, 2005 to October 1, 2005, the Predecessor expensed $23.5 million in connection with the Transactions. These costs consisted primarily of $4.5 million of accounting, investment banking, legal and other costs associated with the Transactions and a $19.0 million non-cash charge for stock compensation resulting from the accelerated vesting of Predecessor stock options and restricted stock in connection with the Acquisition.

Carryover Basis Adjustment for Management Shareholders. Executive management participants held certain equity interests, including stock options, in the Predecessor prior to the Transactions and continue to hold equity interests in the Company, representing indirect equity interests in the Successor after the Transactions. In accordance with the provisions of Emerging Issues Task Force No. 88-16, Basis in Leveraged Buyout Transactions, the basis of executive management s indirect interests in the Successor after the Transactions is carried over at the basis of their interests in the Predecessor prior to the Transactions. The carryover basis of such interests less the net cash received by the management participants represents a deemed dividend of $69.2 million to the management participants and has been recognized as a reduction to shareholders equity.

3. Purchase Accounting

We accounted for the Acquisition in accordance with the provisions of Statement of Financial Accounting Standards No. 141 Business Combinations (SFAS No. 141), whereby the purchase price paid to effect the Acquisition was allocated to state the acquired assets and liabilities at fair value. The Acquisition and the allocation of the purchase price were recorded as of October 1, 2005, the beginning of our October accounting period. The purchase price was approximately $5,461.7 million. The sources and uses of funds in connection with the Transactions and the redemption of our 2008 Notes are summarized below (in millions):

Sources	
Asset-Based Revolving Credit Facility	$ 150.0
Secured Term Loan Facility	1,975.0
Senior Notes	700.0
Senior Subordinated Notes	500.0
Cash on hand	666.1
Equity contribution cash	1,427.7
Equity contribution non-cash	42.9
Total sources	$ 5,461.7
Uses	
Consideration paid to stockholders (including non-cash management rollover of $17.9 million)	$ 5,110.8
Transaction costs (including non-cash items of $18.8 million)	82.3
Redemption of existing 2008 Notes	134.7
Debt issuance costs (including non-cash items of $6.3 million)	109.2
Payment of deferred compensation obligations and other accrued liabilities	24.7
Total uses	$ 5,461.7

In connection with the purchase price allocation, we made estimates of the fair values of our long-lived and intangible assets based upon assumptions related to future cash flows, discount rates and asset lives utilizing currently available information. As of October 29, 2005, we recorded preliminary purchase accounting adjustments to increase the carrying value of our property and equipment and inventory, to establish intangible assets for our tradenames, customer lists and favorable lease commitments and to revalue our long-term benefit plan obligations, among other things. We revised these preliminary purchase accounting adjustments during the second, third and fourth quarters of fiscal year 2006 as additional information became available. The final purchase accounting adjustments, as reflected in our July 29, 2006 consolidated balance sheet, were as follows (in millions):

Cash consideration:		
Paid to shareholders		$ 5,092.9
Transaction costs		63.5
		5,156.4
Non-cash consideration		36.7
Total consideration		5,193.1
Net assets acquired at historical cost		1,638.2
Adjustments to state acquired assets at fair value:		
1) Increase carrying value of property and equipment	$ 137.8	
2) Increase carrying value of inventory	38.1	
3) Write-off historical goodwill and tradenames	(71.5)	
4) Record intangible assets acquired		
Customer lists	576.5	
Favorable lease commitments	480.0	
Tradenames	1,621.8	
5) Write-off other assets, primarily debt issue costs	(3.7)	
6) Adjustment to state 2008 Notes at redemption value	(6.2)	
7) Adjustment to state 2028 Debentures at fair value	4.5	
8) Write-off deferred real estate credits	90.2	
9) Increase in long-term benefit obligations, primarily pension obligations	(57.6)	
10) Tax impact of purchase accounting adjustments	(1,049.3)	
11) Increase carrying values of assets of Gurwitch Products, L.L.C and Kate Spade LLC.	120.0	
Deemed dividend to management shareholders	69.2	1,949.8
Net assets acquired at fair value		3,588.0
Goodwill at Acquisition date		$ 1,605.1

Goodwill and indefinite-lived intangible assets, such as tradenames, are not subject to amortization. Rather, recoverability of goodwill and indefinite-lived intangible assets is assessed annually and upon the occurrence of certain events. The recoverability assessment requires us to make judgments and estimates regarding fair values. Fair values are determined using estimated future cash flows, including growth assumptions for future revenues, gross margin rates and other estimates. To the extent that our estimates are not realized, future assessments could result in impairment charges.

Customer lists are amortized using the straight-line method over their estimated useful lives, ranging from 5 to 26 years (weighted average life of 13 years). Favorable lease commitments are amortized straight-line over the remaining lives of the leases, ranging from 6 to 49 years (weighted average life of 33 years). Total estimated amortization of all acquisition-related intangible assets for the next five fiscal years is currently estimated as follows (in thousands):

2007	$ 72,254
2008	72,254
2009	72,254
2010	72,254
2011	61,543
2012	48,898

4. Transactions with Sponsors

In connection with the Transactions, we entered into a management services agreement with affiliates of the Sponsors pursuant to which affiliates of one of the Sponsors received on the closing date a transaction fee of $25 million in cash. Affiliates of the other Sponsor waived any cash transaction fee in connection with the Transactions.

In addition, pursuant to such agreement, and in exchange for on-going consulting and management advisory services that will be provided to us by the Sponsors and their affiliates, affiliates of the Sponsors will receive an aggregate annual management fee equal to the lesser of (i) 0.25% of our consolidated annual revenues or (ii) $10 million. Affiliates of the Sponsors will also receive reimbursement for out-of-pocket expenses incurred by them or their affiliates in connection with services provided pursuant to the agreement. These management fees are payable quarterly in arrears. We recorded management fees of $2.6 million during the thirteen weeks ended October 28, 2006 and $0.7 million during the four weeks ended October 29, 2005, which are included in selling, general and administrative expenses in the condensed consolidated statements of earnings.

The management services agreement also provides that affiliates of the Sponsors may receive future fees in connection with certain subsequent financing and acquisition or disposition transactions. The management services agreement includes customary exculpation and indemnification provisions in favor of the Sponsors and their affiliates.

5. Stock-Based Compensation

The Predecessor accounted for stock-based compensation awards to employees in accordance with Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (APB No. 25) and its related interpretations. Accordingly, we recognized compensation expense on our restricted stock awards but did not recognize compensation expense for stock options since all options granted had an exercise price equal to the market value of our common stock on the grant date. We did not adopt the previous voluntary expense recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123), whereby the fair value of stock-based compensation awards would have been expensed over the terms of awards. However, consistent with the disclosure requirements of SFAS No. 123, we made pro forma disclosures of the effect that application of the fair value expense recognition provisions of SFAS No. 123 would have had on our net earnings.

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment (SFAS No. 123(R)). This standard is a revision of SFAS No. 123 and supersedes APB No. 25 and its related implementation guidance. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. We adopted SFAS No. 123(R) as of the beginning of our first quarter of fiscal year 2006 using the modified prospective method, which required us to record stock compensation for all unvested and new awards as of the adoption date. Accordingly, we have not restated prior period amounts presented herein.

Predecessor Stock-Based Compensation Accounting. In connection with the adoption of the provisions of SFAS No. 123(R), we recorded non-cash charges for stock compensation of approximately $20.0 million in the period from July 31, 2005 to October 1, 2005 primarily as a result of the accelerated vesting of all Predecessor options and restricted stock in connection with the Transactions.

Successor Stock-Based Compensation Accounting. In connection with the Transactions, the Company authorized new equity-based management arrangements which authorize equity awards to be granted for up to 87,992.0 shares of the common stock of the Company, of which options for 81,716.3 shares were issued to certain management employees. All options are outstanding at October 28, 2006. Substantially all options had an initial exercise price of $1,445 per share, with the exercise price with respect to approximately 50% of such options escalating at a 10% compound rate per year until the earlier to occur of (i) exercise, (ii) the fifth anniversary of the date of grant or (iii) the occurrence of a change in control; provided that in the event the Sponsors cause the sale of shares of the Company to an unaffiliated entity, the exercise price will cease to accrete at the time of the sale with respect to a pro rata portion of the accreting options.

Using the Black-Scholes option-pricing model, the per share fair value was approximately $494 for the fixed price options and $247 for the options with escalating exercise prices. In estimating the fair value of our options, we made the following assumptions: expected term to exercise of five years; expected volatility of 30%; risk-free interest rate of 4.23%; and no dividend yield. Expected volatility is based on a combination of the Predecessor s historical volatility adjusted for our new leverage and estimates of implied volatility of our peer group. In October 2006, the exercise price with respect to the 38,121.7 escalating options accreted from $1,445 to $1,590 per share. Options generally vest over four to five years and expire 10 years from the date of grant. At October 28, 2006, options for 21,618.8 shares were vested.

For the thirteen weeks ended October 28, 2006, we recognized non-cash stock compensation expense of $1.4 million, which is included in selling, general and administrative expenses. At October 28, 2006, unearned non-cash stock-based compensation that we expect to recognize as expense over the next 4 years aggregates approximately $22.0 million.

6. Discontinued Operations

Gurwitch Products, L.L.C. On July 27, 2006, we sold our former majority interest in Gurwitch Products, L.L.C. to Alticor Inc., for pretax net cash proceeds of approximately $40.8 million (Gurwitch Disposition). Gurwitch Products, L.L.C. designs and markets the Laura Mercier cosmetics line and had revenues of approximately $71.6 million in fiscal year 2006. At July 27, 2006, Gurwitch Products, L.L.C. had 1) net tangible assets, primarily accounts receivable, inventory and property and equipment, of $31.6 million, 2) net intangible assets and goodwill of $40.7 million and 3) total liabilities of $31.5 million.

Kate Spade LLC. In April 2005, the minority investor in Kate Spade LLC exercised the put option with respect to the sale of the full amount of its 44% stake in such company to NMG. We subsequently entered into a standstill agreement to postpone the put process while we engaged in discussions with the minority investor in Kate Spade LLC regarding certain strategic alternatives, including the possible sale of such company. In October 2006, we entered into an agreement to settle the put option whereby we will purchase the interest held by the minority investor for approximately $59 million. In November 2006, we entered into a definitive agreement to sell 100% of the ownership interests in Kate Spade LLC to Liz Claiborne, Inc. (consisting of both our current 56% interest and the 44% minority interest to be purchased by NMG) for estimated pretax net proceeds of approximately $117 million. Both the purchase of the minority interest in Kate Spade LLC and the sale of Kate Spade LLC to Liz Claiborne, Inc. are anticipated to close no later than January 2007.

Kate Spade LLC designs and markets high-end accessories and had revenues of approximately $84.7 million in fiscal year 2006. In the first quarter of fiscal year 2007, Kate Spade LLC generated operating income of approximately $0.5 million and we wrote the net assets of Kate Spade LLC down by $24.7 million (including impairment of intangible assets of $12.5 million) in order to state the net assets of Kate Spade LLC at their estimated net realizable value to NMG. At October 28, 2006, after the writedown of the intangible assets, Kate Spade LLC had 1) net tangible assets, primarily accounts receivable, inventory and property and equipment, of $29.9 million, 2) net intangible assets and goodwill of $65.8 million and 3) total liabilities of $41.3 million.

The Company s unaudited condensed consolidated financial statements, accompanying notes and other information provided in this Quarterly Report on Form 10-Q reflect Gurwitch Products, L.L.C. and Kate Spade LLC as discontinued operations for all periods presented.

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7. Income from Credit Card Operations

Pursuant to a long-term marketing and servicing alliance with HSBC, HSBC offers credit card and non-card payment plans bearing our brands and we receive ongoing payments from HSBC based on credit card sales and compensation for marketing and servicing activities (HSBC Program Income). We recognize HSBC Program Income when earned.

8. Long-term Debt

The significant components of our long-term debt are as follows:

(in thousands)	**Interest Rate**	**October 28, 2006 (Successor)**	**July 29, 2006 (Successor)**	**October 29, 2005 (Successor)**
Asset-Based Revolving Credit Facility	variable	$	$	$ 150,000
Senior Secured Term Loan Facility	variable	1,875,000	1,875,000	1,975,000
2028 Debentures	7.125%	120,760	120,711	120,565
Senior Notes	9.0%/9.75%	700,000	700,000	700,000
Senior Subordinated Notes	10.375%	500,000	500,000	500,000
2008 Notes	6.65%			134,734
		3,195,760	3,195,711	3,580,299
Less: current portion of 2008 Notes				134,734
Long-term debt		$ 3,195,760	$ 3,195,711	$ 3,445,565

Senior Secured Asset-Based Revolving Credit Facility. On October 6, 2005, in connection with the Transactions, NMG entered into a credit agreement and related security and other agreements for a senior secured Asset-Based Revolving Credit Facility with Deutsche Bank Trust Company Americas as administrative agent and collateral agent. The Asset-Based Revolving Credit Facility provides financing of up to $600.0 million, subject to a borrowing base equal to at any time the lesser of 80% of eligible inventory (valued at the lower of cost or market value) and 85% of net orderly liquidation value of the eligible inventory, less certain reserves. The Asset-Based Revolving Credit Facility includes borrowing capacity available for letters of credit and for borrowings on same-day notice. At the closing of the Transactions, NMG utilized $150.0 million of the Asset-Based Revolving Credit Facility for loans and approximately $16.5 million for letters of credit. In the second quarter of fiscal year 2006, NMG repaid all loans under the Asset-Based Revolving Credit Facility. As of October 28, 2006, NMG had $574.3 million of unused borrowing availability under the Asset-Based Revolving Credit Facility based on a borrowing base of over $600.0 million and after giving effect to $25.7 million used for letters of credit.

The Asset-Based Revolving Credit Facility provides that NMG has the right at any time to request up to $200.0 million of additional commitments, but the lenders are under no obligation to provide any such additional commitments, and any increase in commitments will be subject to customary conditions precedent. If NMG were to request any such additional commitments and the existing lenders or new lenders were to agree to provide such commitments, the Asset-Based Revolving Credit Facility size could be increased to up to $800.0 million, but NMG s ability to borrow would still be limited by the amount of the borrowing base.

Borrowings under the Asset-Based Revolving Credit Facility bear interest at a rate per annum equal to, at NMG s option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Deutsche Bank Trust Company Americas and (2) the federal funds effective rate plus ½ of 1% or (b) a LIBOR rate, subject to certain adjustments, in each case plus an applicable margin. The initial applicable margin is 0% with respect to base rate borrowings and 1.75% with respect to LIBOR borrowings. The applicable margin is subject to adjustment based on the historical availability under the Asset-Based Revolving Credit Facility. In addition, NMG is required to pay a commitment fee of 0.375% per annum in respect of the unutilized commitments. If the average revolving loan utilization is 50% or more for any applicable period, the commitment fee will be reduced to 0.250% for such period. NMG must also pay customary letter of credit fees and agency fees.

If at any time the aggregate amount of outstanding loans, unreimbursed letter of credit drawings and undrawn letters of credit under the Asset-Based Revolving Credit Facility exceeds the lesser of (i) the commitment amount and (ii) the borrowing base, NMG will be required to repay outstanding loans or cash collateralize letters of credit in an aggregate amount equal to such excess, with no reduction of the commitment amount. If the amount available under the Asset-Based Revolving Credit Facility is less than $60 million or an event of default has occurred, NMG will be required to repay outstanding loans and cash collateralize

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letters of credit with the cash NMG would then be required to deposit daily in a collection account maintained with the agent under the Asset-Based Revolving Credit Facility. NMG may voluntarily reduce the unutilized portion of the commitment amount and repay outstanding loans at any time without premium or penalty other than customary breakage costs with respect to LIBOR loans. There is no scheduled amortization under the Asset-Based Revolving Credit Facility; the principal amount of the loans outstanding is due and payable in full on October 6, 2010.

All obligations under the Asset-Based Revolving Credit Facility are guaranteed by the Company and certain of NMG s existing and future domestic subsidiaries (excluding, among others, Kate Spade LLC). As of October 28, 2006, the liabilities of NMG s non-guarantor subsidiaries totaled approximately $46.1 million, or 0.9% of consolidated liabilities, and the assets of NMG s non-guarantor subsidiaries aggregated approximately $102.6 million, or 1.5% of consolidated total assets. All obligations under NMG s Asset-Based Revolving Credit Facility, and the guarantees of those obligations, are secured, subject to certain significant exceptions, by substantially all of the assets of the Company, NMG and the subsidiaries that have guaranteed the Asset-Based Revolving Credit Facility (subsidiary guarantors), including:

- a first-priority security interest in personal property consisting of inventory and related accounts, cash, deposit accounts, all payments received by NMG or the subsidiary guarantors from credit card clearinghouses and processors or otherwise in respect of all credit card charges for sales of inventory by NMG and the subsidiary guarantors, certain related assets and proceeds of the foregoing; and

- a second-priority pledge of 100% of NMG s capital stock and certain of the capital stock held by NMG, the Company or any subsidiary guarantor (which pledge, in the case of any foreign subsidiary is limited to 100% of the non-voting stock (if any) and 65% of the voting stock of such foreign subsidiary); and

- a second-priority security interest in, and mortgages on, substantially all other tangible and intangible assets of NMG, the Company and each subsidiary guarantor, including a significant portion of NMG s material owned and leased real property (which currently consists of approximately half of NMG s full-line retail stores) and equipment.

Capital stock and other securities of a subsidiary of NMG that are owned by NMG or any subsidiary guarantor will not constitute collateral under NMG s Asset-Based Revolving Credit Facility to the extent that such securities cannot secure NMG s 2028 Debentures or other secured public debt obligations without requiring the preparation and filing of separate financial statements of such subsidiary in accordance with applicable Securities and Exchange Commission s rules. As a result, the collateral under NMG s Asset-Based Revolving Credit Facility will include shares of capital stock or other securities of subsidiaries of NMG or any subsidiary guarantor only to the extent that the applicable value of such securities (on a subsidiary-by-subsidiary basis) is less than 20% of the aggregate principal amount of the 2028 Debentures or other secured public debt obligations of NMG. Stock of Kate Spade LLC and its assets does not constitute collateral under NMG s Asset-Based Revolving Credit Facility.

The Asset-Based Revolving Credit Facility contains a number of covenants that, among other things and subject to certain significant exceptions, restrict its ability and the ability of its subsidiaries to:

- incur additional indebtedness;

- pay dividends on NMG s capital stock or redeem, repurchase or retire NMG s capital stock or indebtedness;

- make investments, loans, advances and acquisitions;

- create restrictions on the payment of dividends or other amounts to NMG from its subsidiaries that are not guarantors;

- engage in transactions with NMG s affiliates;

- sell assets, including capital stock of NMG s subsidiaries;

- consolidate or merge;

- create liens; and
- enter into sale and lease back transactions.

The covenants limiting dividends and other restricted payments; investments, loans, advances and acquisitions; and prepayments or redemptions of other indebtedness, each permit the restricted actions in an unlimited amount, subject to the satisfaction of certain payment conditions, principally that NMG must have at least $75.0 million of pro forma excess availability under the Asset-Based Revolving Credit Facility and that NMG must be in pro forma compliance with the fixed charge coverage ratio described below.

Although the credit agreement governing the Asset-Based Revolving Credit Facility does not require NMG to comply with any financial ratio maintenance covenants, if less than $60.0 million were available to be borrowed under the Asset-Based Revolving Credit Facility at any time, NMG would not be permitted to borrow any additional amounts unless its pro forma ratio of consolidated EBITDA to consolidated Fixed Charges (as such terms are defined in the credit agreement) were at least 1.1 to 1.0. The credit agreement also contains customary affirmative covenants and events of default.

Senior Secured Term Loan Facility. On October 6, 2005, in connection with the Transactions, NMG entered into a credit agreement and related security and other agreements for a $1,975.0 million Senior Secured Term Loan Facility with Credit Suisse as administrative agent and collateral agent. The full amount of the Senior Secured Term Loan Facility was borrowed on October 6, 2005. In the second quarter of fiscal year 2006, NMG repaid $100.0 million principal amount of the loans under the Senior Secured Term Loan Facility. On October 12, 2006, NMG entered into an amendment to the credit agreement for the Senior Secured Term Loan Facility decreasing the interest rates applicable to borrowings under that facility.

Borrowings under the Senior Secured Term Loan Facility bear interest at a rate per annum equal to, at NMG s option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Credit Suisse and (2) the federal funds effective rate plus 1⁄2 of 1% or (b) a LIBOR rate, subject to certain adjustments, in each case plus an applicable margin. Since October 12, 2006, (a) the applicable margin with respect to base rate borrowings (which was previously 1.50%) on a given date is 1.00% or 1.25%, depending upon NMG s Consolidated Leverage Ratio (as defined in the amended credit agreement) on such date and (b) the applicable margin with respect to LIBOR borrowings (which was previously 2.50%) on a given date is 2.00% or 2.25%, also depending upon NMG s Consolidated Leverage Ratio on such date. At October 28, 2006, the applicable margin with respect to base rate borrowings was 1.25% and the applicable margin with respect to LIBOR borrowings was 2.25%. The interest rate on the outstanding borrowings pursuant to the Senior Secured Term Loan Facility was 7.89% at October 28, 2006.

The credit agreement governing the Senior Secured Term Loan Facility requires NMG to prepay outstanding term loans with 50% (which percentage will be reduced to 25% if NMG s total leverage ratio is less than a specified ratio and will be reduced to 0% if NMG s total leverage ratio is less than a specified ratio) of its annual excess cash flow (as defined in the credit agreement). For fiscal year 2006, NMG was not required to prepay any outstanding term loans pursuant to the annual excess cash flow requirements. If a change of control (as defined in the credit agreement) occurs, NMG will be required to offer to prepay all outstanding term loans, at a prepayment price equal to 101% of the principal amount to be prepaid, plus accrued and unpaid interest to the date of prepayment. NMG also must offer to prepay outstanding term loans at 100% of the principal amount to be prepaid, plus accrued and unpaid interest, with the proceeds of certain asset sales under certain circumstances.

NMG may voluntarily prepay outstanding loans under the Senior Secured Term Loan Facility at any time without premium or penalty other than customary breakage costs with respect to LIBOR loans. If NMG repays all or any portion of the Senior Secured Term Loan Facility prior to October 6, 2006 (other than a prepayment that is made with certain designated asset sale proceeds), NMG must pay 101% of the principal amount to be repaid. There is no scheduled amortization under the Senior Secured Term Loan Facility. The principal amount of the loans outstanding is due and payable in full on April 6, 2013.

All obligations under the Senior Secured Term Loan Facility are unconditionally guaranteed by the Company and each direct and indirect domestic subsidiary of NMG that guarantees the obligations of NMG under its Asset-Based Revolving Credit Facility. All obligations under the Senior Secured Term Loan Facility, and the guarantees of those obligations, are secured, subject to certain significant exceptions, by substantially all of the assets of the Company, NMG and the subsidiary guarantors, including:

- a first-priority pledge of 100% of NMG s capital stock and certain of the capital stock held by NMG, the Company or any subsidiary guarantor (which pledge, in the case of any foreign subsidiary is limited to 100% of the non-voting stock (if any) and 65% of the voting stock of such foreign subsidiary); and

- a first-priority security interest in, and mortgages on, substantially all other tangible and intangible assets of NMG, the Company and each subsidiary guarantor, including a significant portion of NMG s material owned and leased real property (which currently consists of approximately half of NMG s full-line retail stores) and equipment, but excluding, among other things, the collateral described in the following bullet point; and

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- a second-priority security interest in personal property consisting of inventory and related accounts, cash, deposit accounts, all payments received by NMG or the subsidiary guarantors from credit card clearinghouses and processors or otherwise in respect of all credit card charges for sales of inventory by NMG and the subsidiary guarantors, certain related assets and proceeds of the foregoing.

Capital stock and other securities of a subsidiary of NMG that are owned by NMG or any subsidiary guarantor will not constitute collateral under NMG s Senior Secured Term Loan Facility to the extent that such securities cannot secure the 2028 Debentures or other secured public debt obligations without requiring the preparation and filing of separate financial statements of such subsidiary in accordance with applicable SEC rules. As a result, the collateral under NMG s Senior Secured Term Loan Facility will include shares of capital stock or other securities of subsidiaries of NMG or any subsidiary guarantor only to the extent that the applicable value of such securities (on a subsidiary-by-subsidiary basis) is less than 20% of the aggregate principal amount of the 2028 Debentures or other secured public debt obligations of NMG. Stock of Kate Spade LLC and its assets does not constitute collateral under NMG s Senior Secured Term Loan Facility.

The credit agreement governing the Senior Secured Term Loan Facility contains a number of negative covenants that are substantially similar to those governing the Senior Notes and additional covenants related to the security arrangements for the Senior Secured Term Loan Facility. The credit agreement also contains customary affirmative covenants and events of default.

2028 Debentures. In May 1998, NMG issued $125.0 million aggregate principal amount of its 7.125% 2028 Debentures. In connection with the Transactions, NMG equally and ratably secured the 2028 Debentures by a first lien security interest on certain collateral subject to liens granted under NMG s Senior Secured Credit Facilities constituting (a) (i) 100% of the capital stock of certain of NMG s existing and future domestic subsidiaries, and (ii) 100% of the non-voting stock and 65% of the voting stock of certain of NMG s existing and future foreign subsidiaries and (b) certain of NMG s principal properties that include approximately half of NMG s full-line stores, in each case, to the extent required by the terms of the indenture governing the 2028 Debentures. The 2028 Debentures contain covenants that restrict NMG s ability to create liens and enter into sale and lease back transactions. The collateral securing the 2028 Debentures will be released upon the release of liens on such collateral under NMG s Senior Secured Credit Facilities and any other debt (other than the 2028 Debentures) secured by such collateral. Capital stock and other securities of a subsidiary of NMG that are owned by NMG or any subsidiary will not constitute collateral under the 2028 Debentures to the extent such property does not constitute collateral under NMG s Senior Secured Credit Facilities as described above. The 2028 Debentures are guaranteed on an unsecured, senior basis by the Company.

The fair value of 2028 Debentures at October 28, 2006 was approximately $125.0 million.

Senior Notes. On October 6, 2005, Newton Acquisition Merger Sub, Inc. issued $700.0 million aggregate original principal amount of 9.0% / 9.75% Senior Notes under a senior indenture (Senior Indenture) with Wells Fargo Bank, National Association, as trustee. At the closing of the Transactions, as the surviving corporation in the Acquisition, NMG assumed all the obligations of Newton Acquisition Merger Sub, Inc. under the Senior Indenture. The Senior Notes mature on October 15, 2015.

For any interest payment period through October 15, 2010, NMG may, at its option, elect to pay interest on the Senior Notes entirely in cash (Cash Interest) or entirely by increasing the principal amount of the outstanding Senior Notes or by issuing additional Senior Notes (PIK Interest). Cash Interest on the Senior Notes accrues at the rate of 9% per annum. PIK Interest on the Senior Notes accrues at the rate of 9.75% per annum. After October 15, 2010, NMG will make all interest payments on the Senior Notes entirely in cash. All Senior Notes mature on October 15, 2015 and have the same rights and benefits as the senior notes issued on October 6, 2005. Interest on the Senior Notes is payable quarterly in arrears on each January 15, April 15, July 15 and October 15, commencing on January 15, 2006.

The Senior Notes are fully and unconditionally guaranteed, on a joint and several unsecured, senior basis, by each of NMG s wholly-owned domestic subsidiaries that guarantee NMG s obligations under its Senior Secured Credit Facilities and by the Company. The Senior Notes and the guarantees thereof are NMG s and the guarantors unsecured, senior obligations and rank (i) equal in the right of payment with all of NMG s and the guarantors existing and future senior indebtedness, including any borrowings under NMG s Senior Secured Credit Facilities and the guarantees thereof and NMG s 2028 Debentures; and (ii) senior to all of NMG s and its guarantors existing and future subordinated indebtedness, including the Senior Subordinated Notes due 2015 and the guarantees thereof. The Senior Notes also are effectively junior in priority to NMG s and its guarantors obligations under all secured indebtedness, including NMG s Senior Secured Credit Facilities, the 2028 Debentures, and any other secured obligations of NMG, in each case, to the extent of the value of the assets securing such obligations. In addition, the Senior Notes are structurally subordinated to all existing and future liabilities, including trade payables, of NMG s subsidiaries that are not providing guarantees.

NMG is not required to make any mandatory redemption or sinking fund payments with respect to the Senior Notes, but under certain circumstances, NMG may be required to offer to purchase Senior Notes as described below. NMG may from time to time acquire Senior Notes by means other than a redemption, whether by tender offer, in open market purchases, through negotiated transactions or otherwise, in accordance with applicable securities laws.

Except as described below, the Senior Notes are not redeemable at NMG s option prior to October 15, 2010. From and after October 15, 2010, NMG may redeem the Senior Notes, in whole or in part, at a redemption price equal to 104.5% of principal amount, declining annually to 100% of the principal amount on October 15, 2013, plus accrued and unpaid interest, and Additional Interest (as defined in the Senior Indenture), if any, thereon to the applicable redemption date.

Prior to October 15, 2008, NMG may, at its option, subject to certain conditions, redeem up to 35% of the original aggregate principal amount of Senior Notes at a redemption price equal to 109% of the aggregate principal amount thereof, plus accrued and unpaid interest, and Additional Interest, if any, thereon to the redemption date, with the net cash proceeds of one or more equity offerings of NMG or any direct or indirect parent of NMG to the extent such net proceeds are contributed to NMG. At any time prior to October 15, 2010, NMG also may redeem all or a part of the Senior Notes at a redemption price equal to 100% of the principal amount of Senior Notes redeemed plus an applicable premium, as provided in the Senior Indenture, and accrued and unpaid interest and Additional Interest, if any, to the redemption date.

Upon the occurrence of a change of control (as defined in the Senior Indenture), each holder of the Senior Notes has the right to require NMG to repurchase some or all of such holder s Senior Notes at a price in cash equal to 101% of the aggregate principal amount thereof plus accrued and unpaid interest, and Additional Interest, if any, to the date of purchase.

The indenture governing the Senior Notes contains covenants that limit NMG s ability and certain of its subsidiaries ability to:

- incur additional indebtedness;
- pay dividends on NMG s capital stock or redeem, repurchase or retire NMG s capital stock or subordinated indebtedness;
- make investments;
- create restrictions on the payment of dividends or other amounts to NMG from its restricted subsidiaries that are not guarantors of the notes;
- engage in transactions with NMG s affiliates;
- sell assets, including capital stock of NMG s subsidiaries;
- consolidate or merge;
- create liens; and
- enter into sale and lease back transactions.

NMG s interest in Kate Spade LLC is not subject to the covenants contained in the Senior Indenture. The Senior Indenture also provides for events of default, which, if any of them occurs, would permit or require the principal, premium, if any, interest and any other monetary obligations on all outstanding Senior Notes to be due and payable immediately.

The fair value of NMG s Senior Notes at October 28, 2006 was approximately $750.8 million.

Senior Subordinated Notes. On October 6, 2005, Newton Acquisition Merger Sub, Inc. issued $500.0 million aggregate principal amount of 10.375% Senior Subordinated Notes under a senior subordinated indenture (Senior Subordinated Indenture) with Wells Fargo Bank, National Association, as trustee. At the closing of the Transactions, as the surviving corporation in the Acquisition, NMG assumed all the obligations of Newton Acquisition Merger Sub, Inc.

under the Senior Subordinated Indenture. The Senior Subordinated Notes mature on October 15, 2015. Interest on the Senior Subordinated Notes is payable in cash semi-annually in arrears on each April 15 and October 15, commencing April 15, 2006.

The Senior Subordinated Notes are fully and unconditionally guaranteed, on a joint and several unsecured, senior subordinated basis, by each of NMG s wholly-owned domestic subsidiaries that guarantee NMG s obligations under its Senior Secured Credit Facilities and by the Company. The Senior Subordinated Notes and the guarantees thereof are NMG s and the guarantors unsecured, senior subordinated obligations and rank (i) junior to all of NMG s and the guarantors existing and future senior indebtedness, including the Senior Notes and any borrowings under NMG s Senior Secured Credit Facilities, and the guarantees thereof and NMG s 2028 Debentures; (ii) equally with any of NMG s and the guarantors future senior subordinated indebtedness; and (iii) senior to any of NMG s and the guarantors future subordinated indebtedness. In addition, the Senior Subordinated Notes are structurally subordinated to all existing and future liabilities, including trade payables, of NMG s subsidiaries that are not providing guarantees.

NMG is not required to make any mandatory redemption or sinking fund payments with respect to the Senior Subordinated Notes, but, under certain circumstances, NMG may be required to offer to purchase Senior Subordinated Notes as described below. The Company may from time to time acquire Senior Subordinated Notes by means other than a redemption, whether by tender offer, in open market purchases, through negotiated transactions or otherwise, in accordance with applicable securities laws.

Except as described below, the Senior Subordinated Notes are not redeemable at NMG s option prior to October 15, 2010. From and after October 15, 2010, NMG may redeem the Senior Subordinated Notes, in whole or in part, at a redemption price equal to 105.188% of principal amount, declining annually to 100% of principal amount on October 15, 2013, plus accrued and unpaid interest, and Additional Interest (as defined in the Senior Subordinated Indenture), if any, thereon to the applicable redemption date.

Prior to October 15, 2008, NMG may, at its option, subject to certain conditions, redeem up to 35% of the original aggregate principal amount of Senior Subordinated Notes at a redemption price equal to 110.375% of the aggregate principal amount thereof, plus accrued and unpaid interest, and Additional Interest, if any, thereon to the redemption date, with the net cash proceeds of one or more equity offerings of NMG or any direct or indirect parent of NMG to the extent such net proceeds are contributed to NMG.

At any time prior to October 15, 2010, NMG also may redeem all or a part of the Senior Subordinated Notes at a redemption price equal to 100% of the principal amount of Senior Subordinated Notes redeemed plus an applicable premium, as provided in the Senior Subordinated Indenture, and accrued and unpaid interest and Additional Interest, if any, to the redemption date.

Upon the occurrence of a change of control (as defined in the Senior Subordinated Indenture), NMG will make an offer to purchase all of the Senior Subordinated Notes at a price in cash equal to 101% of the aggregate principal amount thereof plus accrued and unpaid interest, and Additional Interest, if any, to the date of purchase.

The indenture governing the Senior Subordinated Notes contains covenants substantially similar to those applicable to NMG s Senior Notes described above. The Senior Subordinated Indenture also provides for events of default, which, if any of them occurs, would permit or require the principal, premium, if any, interest and any other monetary obligations on all outstanding Senior Notes to be due and payable immediately, subject to certain exceptions.

The fair value of NMG s Senior Subordinated Notes at October 28, 2006 was approximately $546.3 million.

Redemption of 2008 Notes. In May 1998, NMG issued $125.0 million aggregate principal amount of its 2008 Notes. Upon closing of the Transactions, NMG called its 2008 Notes for redemption pursuant to their terms. On November 7, 2005, NMG used $134.7 million of reserved cash to redeem its 2008 Notes, which included a call premium of $6.2 million plus accrued interest of $3.5 million through the redemption date.

Maturities of Long-Term Debt. At October 28, 2006, annual maturities of long-term debt during the next five fiscal years and thereafter are as follows (in millions):

2007	$
2008	
2009	
2010	
2011	
2012	
Thereafter	3,195.8

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The above table does not reflect future excess cash flow prepayments, if any, that may be required under the term loan facility.

Interest Rate Swaps. The Company uses derivative financial instruments to help manage its interest rate risk. Effective December 6, 2005, NMG entered into floating to fixed interest rate swap agreements for an aggregate notional amount of $1,000.0 million to limit its exposure to interest rate increases related to a portion of its floating rate indebtedness. The interest rate swap agreements terminate after five years. As of the effective date, NMG designated the interest rate swaps as cash flow hedges. As a result, changes in the fair value of NMG s swaps are recorded as a component of other comprehensive income. For the thirteen weeks ended October 28, 2006, we recorded $7.7 million of unrecognized losses, net of tax, in other comprehensive income.

At October 28, 2006, the fair value of NMG s interest rate swap agreements was a gain of approximately $7.4 million, which amount is included in other assets. As a result of the swap agreements, NMG s effective fixed interest rates as to the $1,000.0 million in floating rate indebtedness will range from 6.931% to 7.499% per quarter and result in an average fixed rate of 7.285%.

Interest expense. The significant components of interest expense are as follows:

(in thousands)	**Thirteen weeks ended October 28, 2006 (Successor)**	**Four weeks ended October 29, 2005 (Successor)**	**Nine weeks ended October 1, 2005 (Predecessor)**
Asset-Based Revolving Credit Facility	$	$ 581	$
Senior Secured Term Loan Facility	35,703	8,214	
2028 Debentures	2,226	685	1,542
Senior Notes	15,750	4,025	
Senior Subordinated Notes	12,968	3,314	
2008 Notes		639	1,439
Amortization of debt issue costs and other	4,538	1,162	301
Total interest expense	71,185	18,620	3,282
Less:			
Interest income	1,642	962	3,046
Capitalized interest	725	404	1,146
Interest expense (income), net	$ 68,818	$ 17,254	$ (910)

9. <u>Other Income</u>

In the first quarter of fiscal year 2007, we received consideration aggregating $4.2 million in connection with the merger of Wedding Channel.com and The Knot. We held a minority operating interest in Wedding Channel.com and accounted for our investment under the cost method. In prior years, we had previously reduced our carrying value of this investment to zero.

10. <u>Accumulated Other Comprehensive Income (Loss)</u>

The following table shows the components of accumulated other comprehensive income (loss):

(in thousands)	**October 28, 2006 (Successor)**	**July 29, 2006 (Successor)**	**October 29, 2005 (Successor)**
Unrealized gain (loss) on financial instruments	$ 2,894	$ 9,990	$ (754)
Other	(122)	(161)	156
Total accumulated other comprehensive income (loss)	$ 2,772	$ 9,829	$ (598)

11. Employee Benefit Plans

Description of Benefit Plans. We sponsor a defined benefit pension plan (Pension Plan) covering substantially all full-time employees. We also sponsor an unfunded supplemental executive retirement plan (SERP Plan) that provides additional pension benefits to certain employees. Benefits under both plans are based on the employees years of service and compensation over defined periods of employment. Pension Plan assets consist primarily of equity and fixed income securities.

Retirees and active employees hired prior to March 1, 1989 are eligible to participate in a plan providing certain limited postretirement health care benefits (Postretirement Plan) if they have met certain service and minimum age requirements.

Costs of Benefits. The components of the expenses incurred under our Pension Plan, SERP Plan and Postretirement Plan are as follows:

(in thousands)	Thirteen weeks ended October 28, 2006 (Successor)	Four weeks ended October 29, 2005 (Successor)	Nine weeks ended October 1, 2005 (Predecessor)
Pension Plan:			
Service cost	$ 3,922	$ 1,239	$ 2,823
Interest cost	5,863	1,615	3,468
Expected return on plan assets	(5,876)	(1,749)	(3,636)
Net amortization of losses and prior service costs			1,205
Pension Plan expense	$ 3,909	$ 1,105	$ 3,860
SERP Plan:			
Service cost	$ 469	$ 146	$ 330
Interest cost	1,232	343	730
Net amortization of losses and prior service costs			394
SERP Plan expense	$ 1,701	$ 489	$ 1,454
Postretirement Plan:			
Service cost	$ 14	$ 4	$ 8
Interest cost	227	65	139
Net amortization of losses (gains)			(5)
Postretirement expense	$ 241	$ 69	$ 142

Purchase Accounting Adjustments. The obligations and assets related to our benefit plans were valued at fair value as of the date of the Acquisition as follows:

(in thousands)	Pension Plan	SERP Plan	Postretirement Plan
Benefit obligations at fair value (5.75% discount rate)	$ 354,807	$ 76,806	$ 15,281
Assets held by defined benefit pension plan, at fair value	287,871		
Excess of benefit obligations over plan assets	66,936	76,806	15,281
Less: previously recorded benefit plan obligations recorded by Predecessor	(19,655)	(63,540)	(18,205)
Adjustment to increase benefit plan obligations	$ 47,281	$ 13,266	$ (2,924)

Funding Policy and Plan Assets. Our policy is to fund the Pension Plan at or above the minimum required by law. Based upon currently available information, we will not be required to make contributions to the Pension Plan for the 2007 plan year; however, we could decide to make a voluntary contribution based on our evaluation of the Pension Plan.

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12. Segments

We have identified two reportable segments: Specialty Retail stores and Direct Marketing. The Specialty Retail stores segment includes all Neiman Marcus and Bergdorf Goodman retail stores, including Neiman Marcus clearance stores. The Direct Marketing segment conducts both online and print catalog operations under the Neiman Marcus, Bergdorf Goodman and Horchow brand names.

Both the Specialty Retail stores and Direct Marketing segments derive their revenues from the sales of high-end fashion apparel, accessories, cosmetics and fragrances from leading designers, precious and fashion jewelry and decorative home accessories.

Operating earnings for the segments include 1) revenues, 2) cost of sales, 3) direct selling, general, and administrative expenses, 4) other direct operating expenses, 5) income from credit card operations and 6) depreciation expense for the respective segment. Items not allocated to our operating segments include those items not considered by management in measuring the assets and profitability of our segments. These amounts include 1) corporate expenses including, but not limited to, treasury, investor relations, legal and finance support services, and general corporate management, 2) charges related to the application of purchase accounting adjustments made in connection with the Acquisition including amortization of customer lists and favorable lease commitments and other non-cash valuation charges and 3) interest expense. These items, while often times related to the operations of a segment, are not considered by segment operating management, corporate operating management and the chief operating decision maker in assessing segment operating performance. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies (except with respect to purchase accounting adjustments not allocated to the operating segments). Our senior management evaluates the performance of our assets on a consolidated basis.

The following tables set forth the information for our reportable segments:

(in thousands)	**Thirteen weeks ended October 28, 2006 (Successor)**	**Four weeks ended October 29, 2005 (Successor)**	**Nine weeks ended October 1, 2005 (Predecessor)**
REVENUES:			
Specialty Retail stores	$ 879,932	$ 262,410	$ 544,857
Direct Marketing	159,279	51,402	87,515
Total	$ 1,039,211	$ 313,812	$ 632,372
OPERATING EARNINGS:			
Specialty Retail stores	$ 156,577	$ 44,065	$ 91,372
Direct Marketing	20,798	6,414	8,246
Subtotal	177,375	50,479	99,618
Corporate expenses	(9,276)	(3,984)	(5,811)
Amortization of customer lists and favorable lease commitments	(18,034)	(4,808)	
Non-cash charges related to other valuation adjustments made in connection with the Acquisition		(7,011)	
Other income (1)	4,210		
Transaction and other costs			(23,544)
Total	$ 154,275	$ 34,676	$ 70,263
CAPITAL EXPENDITURES:			
Specialty Retail stores	$ 38,217	$ 20,293	$ 22,784
Direct Marketing	3,202	1,703	2,791
Total	$ 41,419	$ 21,996	$ 25,575
DEPRECIATION EXPENSE:			
Specialty Retail stores	$ 28,941	$ 7,846	$ 16,970
Direct Marketing	3,070	765	1,836
Other		(110)	403
Subtotal	32,011	8,501	19,209
Depreciation expense on step-up of fixed assets made in connection with the Acquisition	1,164	821	
Total	$ 33,175	$ 9,322	$ 19,209

(1) Other income represents the proceeds we received in settlement of our cost method investment in an internet retailer. We had previously reduced our carrying value in this investment to zero.

13. Commitments and Contingencies

Long-term Incentive Plan. Following the consummation of the Transactions, the Company created a long-term incentive plan (Long-term Incentive Plan) that provides for a cash incentive payable upon a change of control, as defined, subject to the attainment of certain performance objectives to employees who have historically been eligible for stock-based compensation. Performance objectives and targets are based on cumulative EBITDA percentages for three year periods beginning in fiscal year 2006. Earned awards for each completed performance period will be credited to a book account and will earn interest at the rate of 5% annually until the award is paid. Awards will be paid within 30 days of a change of control or the first day there is a public market of at least 20% of total outstanding common stock.

Cash Incentive Plan. Following the consummation of the Transactions, the Company also adopted a cash incentive plan (Cash Incentive Plan) to aid in the retention of certain key executives. The Cash Incentive Plan provides for the creation of a $14 million cash bonus pool to be shared by all participants based on the number of vested and unvested stock options and underlying shares that were granted pursuant to the Management Equity Incentive Plan. Each participant in the Cash Incentive Plan will be entitled to a cash bonus upon the earlier to occur of a change of control or an initial public offering, as defined in the Cash Incentive Plan, provided that the internal rate of return to the Sponsors is positive.

Litigation. We are currently involved in various legal actions and proceedings that arose in the ordinary course of business. We believe that any liability arising as a result of these actions and proceedings will not have a material adverse effect on our financial position, results of operations or cash flows.

14. <u>Condensed Consolidating Financial Information</u> (with respect to NMG s obligations under the Senior Notes and the Senior Subordinated Notes)

All of NMG s obligations under the Senior Notes and the Senior Subordinated Notes, as well as its obligations under the Asset-Based Revolving Credit Facility and the Senior Secured Term Loan Facility, are guaranteed by the Company and certain of NMG s existing and future domestic subsidiaries (principally, Bergdorf Goodman, Inc. through which NMG conducts the operations of its Bergdorf Goodman stores and NM Nevada Trust which holds legal title to certain real property and intangible assets used by the Company in conducting its operations). Non-guarantor subsidiaries consist principally of Kate Spade LLC and the Neiman Marcus Funding Corporation through which the Company previously conducted its credit card operations prior to the Credit Card Sale. The guarantees by the Company and each subsidiary guarantor are full and unconditional and joint and several.

The following condensed consolidating financial information represents the financial information of Neiman Marcus, Inc. and its wholly-owned subsidiary guarantors, prepared on the equity basis of accounting. The information is presented in accordance with the requirements of Rule 3-10 under the Securities and Exchange Commission s Regulation S-X. The financial information may not necessarily be indicative of results of operations, cash flows or financial position had the subsidiary guarantors operated as independent entities.

	October 28, 2006 (Successor)					
(in thousands)	**Company**	**NMG**	**Guarantor Subsidiaries**	**Non-Guarantor Subsidiaries**	**Eliminations**	**Consolidated**
ASSETS						
Current assets:						
Cash and cash equivalents	$	$ 157,589	$ 981	$ 860	$	$ 159,430
Accounts receivable, net of allowance		36,484	5,498	3,681	544	46,207
Merchandise inventories		870,900	100,892	7	(497)	971,302
Other current assets		68,506	7,422			75,928
Current assets of discontinued operations				16,354		16,354
Total current assets		1,133,479	114,793	20,902	47	1,269,221
Property and equipment, net		884,142	151,609	2,387		1,038,138
Goodwill and intangibles, net		1,990,447	2,215,276			4,205,723
Other assets		109,592	195	4		109,791
Investments in subsidiaries	1,449,207	2,421,126			(3,870,333)	
Non-current assets of discontinued operations				79,297		79,297
Total assets	$ 1,449,207	$ 6,538,786	$ 2,481,873	$ 102,590	$ (3,870,286)	$ 6,702,170
LIABILITIES AND SHAREHOLDERS EQUITY						
Current liabilities:						
Accounts payable	$	$ 283,593	$ 31,773	$ 4,302	$ 544	$ 320,212
Accrued liabilities		358,791	70,751	445	1,308	431,295
Notes payable and current maturities of long-term liabilities		4,179				4,179
Current liabilities of discontinued operations				28,565		28,565
Total current liabilities		646,563	102,524	33,312	1,852	784,251
Long-term liabilities:						
Long-term debt		3,195,760				3,195,760

Deferred income taxes		1,031,959				1,031,959
Other long-term liabilities		215,297	6,964	4		222,265
Non-current liabilities of discontinued operations				12,735		12,735
Total long-term liabilities		4,443,016	6,964	12,739		4,462,719
Minority interest					5,993	5,993
Total shareholders equity	1,449,207	1,449,207	2,372,385	56,539	(3,878,131)	1,449,207
Total liabilities and shareholders equity	$ 1,449,207	$ 6,538,786	$ 2,481,873	$ 102,590	$ (3,870,286)	$ 6,702,170

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	July 29, 2006 (Successor)					
(in thousands)	**Company**	**NMG**	**Guarantor Subsidiaries**	**Non-Guarantor Subsidiaries**	**Eliminations**	**Consolidated**
ASSETS						
Current assets:						
Cash and cash equivalents	$	$ 222,308	$ 986	$ 446	$	$ 223,740
Accounts receivable, net of allowance		22,189	3,750	3,681	544	30,164
Merchandise inventories		711,443	84,252	7	(2,081)	793,621
Other current assets		67,170	4,544			71,714
Current assets of discontinued operations				16,617		16,617
Total current assets		1,023,110	93,532	20,751	(1,537)	1,135,856
Property and equipment, net		875,725	152,109	2,445		1,030,279
Goodwill and intangibles, net		2,007,770	2,215,987			4,223,757
Other assets		124,929	389	5		125,323
Investments in subsidiaries	1,427,667	2,429,916			(3,857,583)	
Non-current assets of discontinued operations				92,746		92,746
Total assets	$ 1,427,667	$ 6,461,450	$ 2,462,017	$ 115,947	$ (3,859,120)	$ 6,607,961
LIABILITIES AND SHAREHOLDERS EQUITY						
Current liabilities:						
Accounts payable	$	$ 263,800	$ 31,835	$ 4,260	$ 544	$ 300,439
Accrued liabilities		310,551	67,340	77		377,968
Notes payable and current maturities of long-term liabilities		3,887				3,887
Current liabilities of discontinued operations				16,764		16,764
Total current liabilities		578,238	99,175	21,101	544	699,058
Long-term liabilities:						
Long-term debt		3,195,711				3,195,711
Deferred income taxes		1,048,925				1,048,925
Other long-term liabilities		210,909	6,597	5		217,511
Non-current liabilities of discontinued operations				12,775		12,775
Total long-term liabilities		4,455,545	6,597	12,780		4,474,922
Minority interest					6,314	6,314
Total shareholders equity	1,427,667	1,427,667	2,356,245	82,066	(3,865,978)	1,427,667
Total liabilities and shareholders equity	$ 1,427,667	$ 6,461,450	$ 2,462,017	$ 115,947	$ (3,859,120)	$ 6,607,961

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	October 29, 2005 (Successor)					
(in thousands)	**Company**	**NMG**	**Guarantor Subsidiaries**	**Non-Guarantor Subsidiaries**	**Eliminations**	**Consolidated**
ASSETS						
Current assets:						
Cash and cash equivalents	$	$ 189,699	$ 1,128	$ 705	$	$ 191,532
Reserved cash		134,734				134,734
Accounts receivable, net of allowance		14,222	4,988	3,357	548	23,115
Merchandise inventories		854,897	104,198	8		959,103
Other current assets		88,366	6,414			94,780
Current assets of discontinued operations				39,843		39,843
Total current assets		1,281,918	116,728	43,913	548	1,443,107
Property and equipment, net		934,015	158,750	2,638		1,095,403
Goodwill and intangibles, net		1,961,473	2,226,843			4,188,316
Other assets		118,643	526	4		119,173
Investments in subsidiaries	1,411,681	2,521,114			(3,932,795)	
Non-current assets of discontinued operations				140,416		140,416
Total assets	$ 1,411,681	$ 6,817,163	$ 2,502,847	$ 186,971	$ (3,932,247)	$ 6,986,415
LIABILITIES AND SHAREHOLDERS EQUITY						
Current liabilities:						
Accounts payable	$	$ 295,397	$ 34,969	$ 4,183	$ 548	$ 335,097
Accrued liabilities		258,516	64,048	(190)		322,374
Notes payable and current maturities of long-term liabilities		200				200
Senior notes due 2008		134,734				134,734
Current liabilities of discontinued operations				35,580		35,580
Total current liabilities		688,847	99,017	39,573	548	827,985
Long-term liabilities:						
Long-term debt		3,445,565				3,445,565
Deferred income taxes		1,106,419				1,106,419
Other long-term liabilities		164,651	5,171	4		169,826
Non-current liabilities of discontinued operations				13,188		13,188
Total long-term liabilities		4,716,635	5,171	13,192		4,734,998
Minority interest					11,751	11,751
Total shareholders equity	1,411,681	1,411,681	2,398,659	134,206	(3,944,546)	1,411,681
Total liabilities and shareholders equity	$ 1,411,681					