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Destination Maternity Corp
Form 10-Q
December 03, 2015

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 31, 2015

or

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

For the transition period from _____ to _____

Commission file number 0-21196

Destination Maternity Corporation

(Exact name of registrant as specified in its charter)

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

(856) 291-9700

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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 or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

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

Common Stock, \$.01 par value — 13,858,438 shares outstanding as of November 27, 2015

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 31, 2015	January 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$2,066	\$ 1,349
Trade receivables, net	11,087	9,203
Inventories	80,047	75,759
Deferred income taxes	13,830	14,281
Prepaid expenses and other current assets	10,492	12,986
Total current assets	117,522	113,578
Property, plant and equipment, net of accumulated depreciation and amortization of \$82,202 and \$80,735	94,028	90,135
Other assets:		
Deferred financing costs, net of accumulated amortization of \$581 and \$445	558	543
Other intangible assets, net of accumulated amortization of \$633 and \$588	1,178	1,128
Deferred income taxes	15,907	13,704
Other non-current assets	1,189	972
Total other assets	18,832	16,347
Total assets	\$230,382	\$ 220,060
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit borrowings	\$31,600	\$ —
Current portion of long-term debt	2,873	2,801
Accounts payable	23,915	26,482
Accrued expenses and other current liabilities	38,079	46,862
Total current liabilities	96,467	76,145
Long-term debt	10,035	12,199
Deferred rent and other non-current liabilities	25,497	25,714
Total liabilities	131,999	114,058
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, 13,864,601 and 13,807,124 shares issued and outstanding	139	138
Additional paid-in capital	104,477	102,370
Retained earnings (accumulated deficit)	(6,164)	3,558
Accumulated other comprehensive loss	(69)	(64)
Total stockholders' equity	98,383	106,002
Total liabilities and stockholders' equity	\$230,382	\$ 220,060

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

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Nine Months Ended	
	October	November	October	November
	31, 2015	1, 2014	31, 2015	1, 2014
Net sales	\$ 119,548	\$ 125,105	\$ 380,466	\$ 389,417
Cost of goods sold	59,147	62,402	193,354	188,475
Gross profit	60,401	62,703	187,112	200,942
Selling, general and administrative expenses	60,445	63,110	186,121	187,839
Store closing, asset impairment and asset disposal expenses (income)	601	548	(2,342)	1,299
Other charges	1,052	809	4,497	2,999
Operating income (loss)	(1,697)	(1,764)	(1,164)	8,805
Interest expense, net	374	110	1,147	309
Income (loss) before income taxes	(2,071)	(1,874)	(2,311)	8,496
Income tax (benefit) provision	(797)	(722)	(890)	1,617
Net income (loss)	\$(1,274)	\$(1,152)	\$(1,421)	\$ 6,879
Net income (loss) per share— Basic	\$(0.09)	\$(0.09)	\$(0.10)	\$ 0.51
Average shares outstanding— Basic	13,591	13,504	13,585	13,486
Net income (loss) per share— Diluted	\$(0.09)	\$(0.09)	\$(0.10)	\$ 0.51
Average shares outstanding— Diluted	13,591	13,504	13,585	13,577

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		Nine Months Ended	
	Ended		October	
	October	November	October	November
	31,	1, 2014	31,	1, 2014
	2015		2015	2014
Net income (loss)	\$(1,274)	\$ (1,152)	\$(1,421)	\$ 6,879
Foreign currency translation adjustments	(1)	(3)	(5)	3
Comprehensive income (loss)	\$(1,275)	\$ (1,155)	\$(1,426)	\$ 6,882

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			Retained Earnings (Accumulated Deficit)	Accumulated	
	Number of Shares	Amount	Additional Paid-in Capital		Other Comprehensive Loss	Total
Balance as of January 31, 2015	13,807	\$ 138	\$ 102,370	\$ 3,558	\$ (64)	\$ 106,002
Net loss	—	—	—	(1,421)	—	(1,421)
Foreign currency translation adjustments	—	—	—	—	(5)	(5)
Cash dividends	—	—	—	(8,301)	—	(8,301)
Stock-based compensation	51	1	2,138	—	—	2,139
Exercise of stock options, net	11	—	69	—	—	69
Tax benefit shortfall from stock option exercises and restricted stock vesting	—	—	(38)	—	—	(38)
Repurchase and retirement of common stock	(4)	—	(62)	—	—	(62)
Balance as of October 31, 2015	13,865	\$ 139	\$ 104,477	\$ (6,164)	\$ (69)	\$ 98,383
Balance as of February 1, 2014	13,712	\$ 137	\$ 99,527	\$ 24,574	\$ (66)	\$ 124,172
Net income	—	—	—	6,879	—	6,879
Foreign currency translation adjustments	—	—	—	—	3	3
Cash dividends	—	—	—	(8,204)	—	(8,204)
Stock-based compensation	—	—	2,882	—	—	2,882
Exercise of stock options, net	15	—	65	—	—	65
Excess tax benefit from stock option exercises and restricted stock vesting	—	—	95	—	—	95
Repurchase and retirement of common stock	(24)	—	(500)	—	—	(500)
Balance as of November 1, 2014	13,703	\$ 137	\$ 102,069	\$ 23,249	\$ (63)	\$ 125,392

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 31, 2015	November 1, 2014
Operating Activities		
Net income (loss)	\$(1,421)	\$ 6,879
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	12,721	11,525
Stock-based compensation expense	2,139	2,882
Loss on impairment of long-lived assets	1,598	1,096
Loss (gain) on disposal of assets	47	(4,086)
Deferred income tax benefit	(1,908)	(2,247)
Amortization of deferred financing costs	136	149
Changes in assets and liabilities:		
Decrease (increase) in:		
Trade receivables	(1,884)	(6,486)
Inventories	(4,288)	(4,214)
Prepaid expenses and other current assets	2,494	(4,605)
Other non-current assets	(217)	(61)
Increase (decrease) in:		
Accounts payable, accrued expenses and other current liabilities	(6,598)	12,476
Deferred rent and other non-current liabilities	(422)	4,354
Net cash provided by operating activities	2,397	17,662
Investing Activities		
Capital expenditures	(23,947)	(42,555)
Proceeds from sale of property, plant and equipment	35	12,545
Additions to intangible assets	(144)	(1,179)
Net cash used in investing activities	(24,056)	(31,189)
Financing Activities		
Increase in cash overdraft	1,318	2,386
Increase in line of credit borrowings	31,600	—
Proceeds from long-term debt	—	13,478
Repayment of long-term debt	(2,092)	—
Deferred financing costs paid	(151)	—
Withholding taxes on stock-based compensation paid in connection with repurchase of common stock	(62)	(500)
Cash dividends paid	(8,301)	(8,204)
Proceeds from exercise of stock options	69	65
Excess tax benefit from exercise of stock options and restricted stock vesting	—	95

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Net cash provided by financing activities	22,381	7,320
Effect of exchange rate changes on cash and cash equivalents	(5)	2
Net Increase (Decrease) in Cash and Cash Equivalents	717	(6,205)
Cash and Cash Equivalents, Beginning of Period	1,349	17,574
Cash and Cash Equivalents, End of Period	\$2,066	\$ 11,369
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$1,068	\$ 159
Cash paid for income taxes, net of refunds	\$(1,566)	\$ 5,780

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

Destination Maternity Corporation and its subsidiaries (the “Company” or “Destination Maternity”) have historically operated on a fiscal year ending September 30 of each year. On December 4, 2014 the Company announced that its Board of Directors approved a change in its fiscal year end from September 30 to the Saturday nearest January 31 of each year. The fiscal year end change aligns the Company’s reporting cycle with the National Retail Federation (“NRF”) fiscal calendar. The change is effective with the Company’s fiscal year 2015, which began February 1, 2015 and will end January 30, 2016, and resulted in a four month transition period from October 1, 2014 to January 31, 2015. The accompanying unaudited consolidated financial statements for the three and nine months ended October 31, 2015 and November 1, 2014 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 September 30, 2014 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.

References to fiscal years of the Company prior to fiscal 2015 refer to the fiscal years ended on September 30 in those years, unless otherwise indicated. For example, the Company’s “fiscal 2014” ended on September 30, 2014. The Company now operates on a fiscal year ending on the Saturday nearest January 31 of each year. References to the Company’s fiscal 2015 refer to the fiscal year, or periods within such fiscal year, which began February 1, 2015 and will end January 30, 2016.

2. EARNINGS PER SHARE (“EPS”) AND CASH DIVIDENDS

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

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

Three Months Ended

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	October 31, 2015			November 1, 2014		
	Net Loss	Shares	EPS	Net Loss	Shares	EPS
Basic EPS	\$(1,274)	13,591	\$(0.09)	\$(1,152)	13,504	\$(0.09)
Incremental shares from the assumed exercise of outstanding stock options	—	—		—	—	
Incremental shares from the assumed lapse of restrictions on restricted stock awards	—	—		—	—	
Diluted EPS	\$(1,274)	13,591	\$(0.09)	\$(1,152)	13,504	\$(0.09)

	Nine Months Ended October 31, 2015			November 1, 2014		
	Net Loss	Shares	EPS	Net Income	Shares	EPS
Basic EPS	\$(1,421)	13,585	\$(0.10)	\$6,879	13,486	\$0.51
Incremental shares from the assumed exercise of outstanding stock options	—	—		—	50	
Incremental shares from the assumed lapse of restrictions on restricted stock awards	—	—		—	41	
Diluted EPS	\$(1,421)	13,585	\$(0.10)	\$6,879	13,577	\$0.51

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DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

In addition to performance-based RSUs, for the nine months ended November 1, 2014 stock options and unvested restricted stock totaling 268,233 shares were excluded from the calculation of Diluted EPS as their effect would have been antidilutive. Options and unvested restricted stock totaling 1,114,428 and 649,092 shares of the Company's common stock were outstanding as of October 31, 2015 and November 1, 2014, respectively, but were not included in the computation of Diluted EPS for the three and nine months ended October 31, 2015 and the three months ended November 1, 2014 due to the Company's net loss. Had the Company reported a profit for the three and nine months ended October 31, 2015 and the three months ended November 1, 2014 the weighted average number of dilutive shares outstanding for computation of Diluted EPS would have been approximately 13,636,000, 13,622,000 and 13,578,000 shares, respectively.

During the nine months ended October 31, 2015 and November 1, 2014 the Company paid cash dividends totaling \$8,301,000 (or \$0.60 per share) and \$8,204,000 (or \$0.60 per share), respectively. On December 1, 2015 the Company declared a quarterly cash dividend of \$0.20 per share payable on January 21, 2016, which is projected to total approximately \$2,770,000.

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 31, 2015 and January 31, 2015 the Company's trade receivables were net of allowance for doubtful accounts of \$136,000 and \$132,000, respectively.

4. INVENTORIES

Inventories were comprised of the following (in thousands):

	October 31, 2015	January 31, 2015
Finished goods	\$77,647	\$69,455

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Work-in-progress	1,081	2,414
Raw materials	1,319	3,890
	\$80,047	\$75,759

5. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

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

	October 31, 2015	January 31, 2015
Employee compensation and benefits	\$10,390	\$10,593
Insurance, primarily self-insurance reserves	6,543	5,888
Gift certificates and store credits	3,727	4,704
Deferred rent	3,346	3,824
Sales and use taxes	2,241	3,112
Accrued property, plant and equipment additions	2,001	3,619
Accounting and legal	1,850	1,998
Product return reserve	1,757	2,084
Income taxes payable	—	129
Other	6,224	10,911
	\$38,079	\$46,862

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

6. LINE OF CREDIT AND LONG-TERM DEBT

On November 1, 2012 the Company entered into a five-year \$61,000,000 senior secured revolving credit facility (the "Credit Facility"), which replaced the Company's former \$55,000,000 credit facility (the "Prior Credit Facility"). The Credit Facility consists of two tranches: (1) a senior secured revolving credit and letter of credit facility of up to \$55,000,000 ("Tranche A") and (2) a senior secured first-in, last-out revolving credit facility of up to \$6,000,000 ("Tranche A-1"). Upon the Company's request and with the consent of the lender, permitted borrowings under Tranche A could be increased up to an additional \$15,000,000, in increments of \$2,500,000, up to a Tranche A maximum limit of \$70,000,000. In accordance with the terms of the Credit Facility, effective June 3, 2015 the Company's permitted borrowings under Tranche A of the Credit Facility were increased by \$15,000,000 at the Company's request. Effective August 25, 2015 the Credit Facility was amended to reflect the increase to Tranche A permitted borrowings and to extend the maturity date to August 25, 2020 from November 1, 2017. Proceeds from advances under the Credit Facility, with certain restrictions, were permitted to be used to repay then existing term loan or other debt, and may be used to provide financing for working capital, letters of credit, capital expenditures, dividends, share repurchases and other general corporate purposes. The Credit Facility contains various affirmative and negative covenants and representations and warranties. Under the Credit Facility, the Company is required to maintain minimum Excess Availability (as defined in the related Credit Facility agreement) equal to 10% of the Borrowing Base (as defined in the related Credit Facility agreement). 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 2.00% for Tranche A-1 borrowings. The applicable margin for LIBOR rate borrowings is 1.50% for Tranche A borrowings and 3.00% for Tranche A-1 borrowings. Tranche A-1 borrowings are 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 amendment of the Credit Facility, the Company incurred deferred financing costs of \$1,139,000.

As of October 31, 2015 the Company had \$31,600,000 in outstanding borrowings under the Credit Facility of which \$25,600,000 were Tranche A borrowings and \$6,000,000 were Tranche A-1 borrowings, and \$6,348,000 in letters of credit, with \$21,968,000 of availability under the Credit Facility based on the Company's Borrowing Base formula and minimum Excess Availability requirement. As of November 1, 2014 the Company had no outstanding borrowings under the Credit Facility and \$6,423,000 in letters of credit, with \$49,076,000 of availability under the Credit Facility based on the Company's Borrowing Base formula and minimum Excess Availability requirement. For the three and nine months ended October 31, 2015 Tranche A borrowings had a weighted interest rate of 1.86% and 2.46%, respectively, per annum, and Tranche A-1 borrowings had a weighted interest rate of 3.20% and 3.79%, respectively, per annum. During the nine months ended October 31, 2015 the Company's average level of direct borrowings was \$24,470,000 and the Company's maximum borrowings at any time were \$39,900,000. During the nine months ended November 1, 2014 the Company did not have any direct borrowings under the Credit Facility.

During the four month transition period ended January 31, 2015 the Company received \$15,000,000 proceeds from a five-year equipment financing arrangement with its 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 (see Note 9). As of October 31, 2015 there was \$12,908,000 outstanding under the equipment note.

7. 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 31, 2015 and January 31, 2015 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.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

The Company's Credit Facility has variable interest rates that are tied to market indices. As of October 31, 2015 the Company had \$31,600,000 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 long-term debt bears interest at a fixed rate. The fair value of the Company's debt 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.

8. STORE CLOSING, ASSET IMPAIRMENT AND ASSET DISPOSAL EXPENSES (INCOME)

For the three and nine months ended October 31, 2015 store closing, asset impairment and asset disposal expenses (income) were comprised of \$57,000 and \$(3,940,000), respectively, for store closings and other asset disposals, and \$544,000 and \$1,598,000, respectively, for impairment of store assets. For the three and nine months ended November 1, 2014 store closing, asset impairment and asset disposal expenses were comprised of \$71,000 and \$203,000, respectively, for store closings and other asset disposals, and \$477,000 and \$1,096,000, respectively, for impairment of store assets.

For the nine months ended October 31, 2015 store closings and other asset disposals includes income of \$4,100,000 representing an incentive from the landlord for early termination of a Company superstore lease.

9. OTHER CHARGES, NET

In September 2013 the Company announced plans to relocate its corporate headquarters and distribution operations from Philadelphia, Pennsylvania to southern New Jersey. In September 2014 the Company recorded pretax income of \$4,110,000 from the gain realized on the sale and leaseback of its then principal headquarters and distribution center building. The Company completed the relocation of its corporate headquarters to Moorestown, New Jersey in January 2015 and completed the relocation of its distribution operations to Florence, New Jersey in August 2015. In December 2014 the Company received notice of substantial completion and lease commencement from the landlord for the Florence distribution center building. Accordingly, the Florence lease, which has a 15-year term, commenced effective January 1, 2015, with the first rent payment paid as of March 1, 2015. During the nine months ended October 31, 2015 and November 1, 2014 the Company recorded \$2,641,000 and \$(2,302,000), respectively, of charges (income) related to the sale and closure of its prior facilities, and the preparation for occupancy of and relocation to its new facilities.

In August 2014 the Company announced the appointment of Anthony M. Romano as the Company's new Chief Executive Officer ("CEO"). Subsequent to the CEO change, the Company commenced a program to evaluate its business processes, key management personnel and planning resources. In connection with this evaluation, the Company changed its fiscal year (see below) and continues to implement changes to certain business processes that have resulted in replacement of certain key management personnel and some reductions in headcount. The Company also implemented an improved product life cycle calendar and terminated an e-commerce development contract as it continues to improve its planning and allocation methodologies and e-commerce platform. During the nine months

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ended October 31, 2015 and November 1, 2014 the Company incurred \$1,829,000 and \$4,256,000, respectively, of charges related to these management and organizational changes.

In December 2014 the Company announced that its Board of Directors approved a change in its fiscal year end from September 30 to the Saturday nearest January 31 of each year. The fiscal year end change aligns the Company's reporting cycle with the traditional 4-5-4 NRF calendar ending with January. The fiscal year change is expected to benefit the Company by providing a framework for more consistent product decisions, improved planning of marketing and promotional activities, and faster assimilation of new experienced retail hires. During the nine months ended October 31, 2015 the Company incurred \$27,000 of charges related to the fiscal year change.

During the nine months ended November 1, 2014 the Company incurred \$1,045,000 of charges related to its proposal for a possible business combination with Mothercare plc, which was announced and subsequently withdrawn in July 2014.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

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

	Three Months Ended October 31, 2015		Nine Months Ended October 31, 2015	
	November 1, 2014		November 1, 2014	
Facilities Relocations				
Pre-opening rent expense on new corporate headquarters and distribution facility	\$—	\$ 342	\$1,615	\$ 912
Accelerated depreciation and amortization expense	—	319	233	884
Gain on sale of building	—	(4,110)	—	(4,110)
Moving and other costs	547	2	793	12
Total facilities relocations	547	(3,447)	2,641	(2,302)
Management and Organizational Changes				
Consulting fees	198	—	1,280	—
Severance and related benefits	307	—	549	—
CEO separation benefits	—	4,107	—	4,107
Other	—	149	—	149
Total management and organizational changes	505	4,256	1,829	4,256
Fiscal Year Change				
Systems modifications	—	—	27	—
Proposed Business Combination				
Legal and other professional fees	—	—	—	1,045
Total other charges, net	\$1,052	\$ 809	\$4,497	\$ 2,999

10. GOVERNMENT INCENTIVES

In September 2013 the Company announced its plans to relocate its corporate headquarters and distribution operations from Philadelphia, Pennsylvania to southern New Jersey (the “Project”). The Company completed the relocation of its corporate headquarters in January 2015 and completed the relocation of its distribution operations in August 2015. To partially offset the costs of these relocations, the Board of the New Jersey Economic Development Authority (“NJEDA”) approved the Company for an incentive package of up to \$40,000,000 in benefits under the Grow New

Jersey Assistance Program (“Grow NJ”) in the form of transferrable income tax credits over a ten-year period from the State of New Jersey. The Company’s Grow NJ award required a minimum capital investment of \$20,000,000 with the total potential award being equal to the total eligible capital investment in the Project and subject to an overall award limit of \$40,000,000. The award provides annually over a ten-year period up to \$7,000 per eligible new full-time job, as defined under Grow NJ, with a requirement that at least 100 eligible jobs were created and subject to an annual award limit of \$4,000,000.

In September 2015 the Company confirmed to NJEDA that it had submitted all documentation required to qualify for the full amount of the Grow NJ award, including certification of over 600 eligible jobs and over \$50,000,000 in capital investment, including building construction costs of the landlord for the Company’s newly constructed distribution center in Florence, New Jersey. The Grow NJ award will be earned on an annual basis over the ten-year period, subject to the \$4,000,000 annual award limit, with a full annual award in fiscal 2015, 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

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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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. For fiscal 2015 the full annual Grow NJ award is being recognized during the third and fourth quarters of fiscal 2015, which represents the measurement period for the Company's fiscal 2015 required average employment certification. 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. During the third quarter of fiscal 2015 the Company recognized \$1,755,000 of cost reduction related to the Grow NJ award, of which \$1,332,000 is included in the Consolidated Statement of Operations as a reduction of cost of goods sold (\$845,000) and selling, general and administrative expenses (\$487,000), and \$423,000 is included in the Consolidated Balance Sheet as a reduction to overhead in inventory. A deferred tax asset of \$1,800,000, net of valuation allowance, is included in the Consolidated Balance Sheet in short-term deferred income taxes, and is expected to be converted to a receivable and collected in fiscal 2016 upon sale of the income tax credits.

11. INCOME TAXES

As of October 31, 2015 the Company had \$1,458,000 of unrecognized tax benefits related to uncertain income tax positions, including accrued interest and penalties of \$530,000. 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 \$1,024,000, net of federal benefit.

During the 12 months subsequent to October 31, 2015 it is reasonably possible that the gross unrecognized tax benefits could potentially decrease by \$347,000 (of which \$248,000 would affect the effective tax rate, net of federal benefit) for uncertain tax positions, including the continued effect of interest on unrecognized tax benefits and limitations on certain potential tax credits, offset by the effect of expiring statutes of limitations and settlements.

The Company's United States Federal income tax returns for years ended September 30, 2012 and thereafter remain subject to examination by the United States Internal Revenue Service ("IRS"). The Company also files tax returns in Canada, India, Kuwait and numerous United States state jurisdictions, which have varying statutes of limitations. Generally, Canadian tax returns for tax years ended September 30, 2008 and thereafter, Indian tax returns for tax years ended March 31, 2010 and thereafter, Kuwaiti tax returns for tax years ended September 30, 2013 and thereafter, and United States state tax returns for tax years ended September 30, 2011 and thereafter, depending upon the jurisdiction, remain subject to examination. However, the statutes of limitations on certain of the Company's United States state tax returns remain open for years prior to fiscal 2011.

12. EQUITY AWARD PLANS

The Compensation Committee of the Company's Board of Directors established performance goals for the award of performance-based RSUs for four executive officers, under the Amended and Restated Destination Maternity Corporation 2005 Equity Incentive Plan, in each of April 2015 (the "Fiscal 2015 Awards"), December 2013 (the "Fiscal 2014 Awards") and November 2012 (the "Fiscal 2013 Awards"). The RSUs earned, if any, under the awards will be based on the Company's cumulative operating income, as defined in the applicable award agreement ("RSU Operating Income") for a specified three-year period ("Performance Period"). The grant of any RSUs under these awards will generally be further contingent on the continued employment of the executive officers with the Company through the dates on which the shares in respect of these RSUs, if any, are issued following the end of the applicable Performance Periods, as well as the achievement of certain minimum levels of RSU Operating Income in the final fiscal year of each applicable Performance Period. Any dividends declared on the shares of the Company's common stock underlying the RSUs will be credited as additional RSUs based on the fair market value of the Company's common stock on the dividend record date. The additional RSUs, if any, will be earned on the same terms as the original RSUs.

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Awards	Performance Period	Minimum RSUs	Target RSUs	Maximum RSUs
Fiscal 2015 Awards	February 2, 2015 to January 28, 2017	23,253	46,504	69,757
Fiscal 2014 Awards	October 1, 2013 to September 30, 2016	15,113	30,224	45,337
Fiscal 2013 Awards	October 1, 2012 to September 30, 2015	18,541	37,080	55,621

During fiscal 2014, the Company determined that the Fiscal 2014 Awards and the Fiscal 2013 Awards were unlikely to be earned, even at the minimum level.

During the nine months ended November 1, 2014 options to purchase 24,000 shares of common stock with an aggregate exercise price of \$285,000 were exercised by the option holder and net-share settled by the Company, such that the Company withheld 15,019 shares of the Company's common stock, which had a fair market value equal to the aggregate exercise price of the stock options.

During the nine months ended October 31, 2015 and November 1, 2014 certain stock option exercises and vesting restricted stock awards were net-share settled by the Company such that the Company withheld shares of the Company's common stock, which had a fair market value equivalent to the minimum statutory obligation for the applicable income and employment taxes for the awards, and the Company remitted the cash value to the appropriate taxing authorities. The total shares withheld, which were 4,183 and 23,573 shares, respectively, during the nine months ended October 31, 2015 and November 1, 2014, are reflected as repurchase of common stock in the accompanying financial statements, and were based on the value of the Company's common stock on the exercise or vesting date. The remaining shares, net of those withheld, were delivered to the award holders. Total payments for tax obligations to the tax authorities were \$62,000 and \$500,000 for the nine months ended October 31, 2015 and November 1, 2014, respectively.

13. RECENT ACCOUNTING PRONOUNCEMENTS

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

In April 2015 the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. ASU No. 2015-03 requires that debt issuance costs related to a recognized debt

liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The existing recognition and measurement guidance for debt issuance costs is not affected by ASU 2015-03. ASU No. 2015-03 is effective for financial statements issued for annual reporting periods beginning after December 15, 2015 and interim periods within those years. Earlier application is permitted for financial statements that have not been previously issued. The new guidance must be applied on a retrospective basis to all periods presented. Because this guidance impacts presentation only, the adoption of the new requirements of ASU 2015-03 will not have any impact on the Company's consolidated financial position or results of operations.

In May 2014 the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2014-09 requires an entity to recognize revenue for the amount of consideration to which it expects to be entitled for the transfer of promised goods or services to customers. Additionally, ASU No. 2014-09 requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. The standard will replace most existing revenue recognition guidance in generally accepted accounting principles in the United States ("GAAP") when it becomes effective. ASU No. 2014-09 is effective for financial statements issued for annual reporting periods beginning after December 15, 2016 and

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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interim periods within those years. In August 2015 the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date which deferred the effective date of ASU No. 2014-09 by one year, making the guidance effective for fiscal years beginning after December 15, 2017. Early adoption will be permitted, but not earlier than the original effective date for annual and interim periods. The impact from adoption of the new requirements of ASU No. 2014-09 on the Company's consolidated financial position or results of operations has not yet been determined.

In April 2014 the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. ASU No. 2014-08 changes the requirements for reporting discontinued operations and improves the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results. ASU No. 2014-08 also requires expanded disclosures for discontinued operations to provide users of financial statements with more information about the assets, liabilities, revenues, and expenses of discontinued operations. ASU No. 2014-08 is effective for all disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within annual periods beginning on or after December 15, 2015. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. Adoption of the new requirements of ASU No. 2014-08 is not expected to have a material impact on the Company's consolidated financial position or results of operations.

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.

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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	November	October	November
	31, 2015	1, 2014	31, 2015	1, 2014
Net Sales to Unaffiliated Customers				
United States	\$ 111,955	\$ 116,923	\$ 356,921	\$ 367,008
Foreign	7,593	8,182	23,545	22,409

	October	January
	31,	31,
	2015	2015
Long-Lived Assets		
United States	\$ 91,846	\$ 88,120
Foreign	3,360	3,143

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

DESTINATION MATERNITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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16. INTEREST EXPENSE, NET

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

	Three Months Ended October 31, 2015		Nine Months Ended October 31, 2015	
	November 1, 2014		November 1, 2014	
Interest expense	\$ 375	\$ 113	\$ 1,155	\$ 318
Interest income	(1)	(3)	(8)	(9)
Interest expense, net	\$ 374	\$ 110	\$ 1,147	\$ 309

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

We have historically operated on a fiscal year ending September 30 of each year. On December 4, 2014 we announced that our Board of Directors approved a change in our fiscal year end from September 30 to the Saturday nearest January 31 of each year. The fiscal year end change aligns our reporting cycle with the NRF fiscal calendar. The change is effective with our fiscal year 2015, which began February 1, 2015 and will end January 30, 2016, and resulted in a four month transition period from October 1, 2014 to January 31, 2015. References in this discussion to our fiscal years prior to fiscal 2015 refer to the fiscal years ended on September 30 in those years, unless otherwise indicated. For example, our "fiscal 2014" ended on September 30, 2014. References to our fiscal 2015 refer to the fiscal year, or periods within such fiscal year, which began February 1, 2015 and will end January 30, 2016. References to the transition period refer to the four month period from October 1, 2014 to January 31, 2015.

Overview

We are the leading designer and retailer of maternity apparel in the United States with 1,864 retail locations, including 554 stores in the United States, Canada and Puerto Rico, and 1,310 leased departments located within department stores and baby specialty stores throughout the United States, in Puerto Rico and, most recently, in England. In July 2015 we opened an A Pea in the Pod branded leased department in Harrods department store in London, England (our first brick and mortar leased department outside of North America). We also sell merchandise on the Internet, primarily through our motherhood.com, apeainthepod.com and destinationmaternity.com websites. We have store franchise and product supply relationships in the Middle East, South Korea, Mexico and Israel. As of October 31, 2015 we have 184 international franchised locations, including 25 stand-alone stores operated under one of our retail nameplates and 159 shop-in-shop locations. We are also the exclusive provider of maternity apparel to Kohl's®, which operates approximately 1,166 stores throughout the United States and offers maternity apparel in a significant number of its stores.

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

Comparable sales figures represent sales at retail locations (which does not include licensed brand or international franchise relationships) that have been in operation by us for at least twelve full months at the beginning of the period for which such data is presented, as well as Internet sales. Comparable sales figures do not include retail locations opened during a period even if such location was opened in connection with the closure of other retail locations in the same geographic area (including, for example, the opening of a new Destination Maternity combo store or superstore). Also, our comparable sales figures generally do not include: 1) retail locations which change store nameplate, 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, or 4) retail locations which, in the judgment of management, have undergone other significant changes which materially alter the comparability of the retail location (either with respect to the manner of its operation or otherwise) (such as, for example only, in the case of closure of retail locations in connection with the cessation of a leased department

relationship where the manner of operation of such retail location has been materially altered prior to closure, or in the case of construction in, on or near a retail location, which significantly interferes with the customer traffic, visibility or operation of a retail location). There may be variations in the way in which other retailers calculate comparable sales. As a result, data in this quarterly report regarding our comparable sales may not be comparable to similar data made available by other retailers.

Following is a summary of our results for the third quarter and first nine months of fiscal 2015 with regard to each of the key measures noted above:

Third Quarter Fiscal 2015 Financial Results

Net loss for the third quarter of fiscal 2015 was \$1.3 million, or \$0.09 per share (diluted), compared to net loss of \$1.2 million, or \$0.09 per share (diluted), for the comparable three month period ended November 1, 2014.

Net loss for the third quarter of fiscal 2015 includes other charges of 1) approximately \$0.4 million, net of tax, or \$0.02 per share (diluted), related to the relocations of our headquarters and distribution facilities and 2) \$0.3 million, net of tax, or \$0.02 per share (diluted), related to management and organizational changes. Net loss for the three months ended November 1, 2014

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includes other charges of 1) \$0.4 million, net of tax, or \$0.03 per share (diluted), related to the relocations of our headquarters and distribution facilities, 2) \$2.7 million, net of tax, or \$0.20 per share (diluted), related to management and organizational changes, and 3) a gain of \$2.5 million, net of tax, or \$0.19 per share (diluted), from the sale of our prior headquarters/distribution facility.

Adjusted net loss for the third quarter of fiscal 2015 was \$0.6 million, or \$0.05 per share (diluted), compared to the comparably adjusted net loss for the three months ended November 1, 2014 of \$0.6 million, or \$0.05 per share (diluted).

Adjusted EBITDA was \$4.0 million for the third quarter of fiscal 2015, an increase compared to \$(0.5) million of Adjusted EBITDA for the three months ended November 1, 2014.

Adjusted EBITDA before other charges was \$5.1 million for the third quarter of fiscal 2015, an increase compared to \$4.1 million of Adjusted EBITDA before other charges for the three months ended November 1, 2014.

Net sales for the third quarter of fiscal 2015 decreased 4.4% to \$119.5 million from \$125.1 million for the three months ended November 1, 2014.

Comparable sales for the third quarter of fiscal 2015 decreased 3.6% compared to a comparable sales decrease of 6.9% for the three months ended November 1, 2014.

Third quarter of fiscal 2015 results compared to the comparable three month period ended November 1, 2014 include higher occupancy and depreciation expenses from our facilities relocations, and lower sales and gross profit as a result of temporary disruption from our distribution center move, largely offset by lower distribution center employment costs and our Grow NJ award benefit, which we began to recognize during the quarter.

First Nine Months of Fiscal 2015 Financial Results

Net loss for the first nine months of fiscal 2015 was \$1.4 million, or \$0.10 per share (diluted), compared to net income of \$6.9 million, or \$0.51 per share (diluted), for the comparable nine month period ended November 1, 2014.

Net loss for the first nine months of fiscal 2015 includes other charges of 1) \$1.6 million, net of tax, or \$0.12 per share (diluted), related to the relocations of our headquarters and distribution facilities and 2) approximately \$1.2 million, net of tax, or \$0.08 per share (diluted), related to management and organizational changes, and the fiscal year change.

Net income for the nine months ended November 1, 2014 includes other charges of 1) \$1.1 million, net of tax, or \$0.08 per share (diluted), related to the relocations of our headquarters and distribution facilities, 2) \$2.7 million, net of tax, or \$0.20 per share (diluted), related to management and organizational changes, 3) \$0.6 million, net of tax, or \$0.05 per share (diluted), related to a proposed business combination that was withdrawn, and 4) a gain of \$2.5 million, net of tax, or \$0.19 per share (diluted), from the sale of our prior headquarters/distribution facility. Net income for the nine months ended November 1, 2014 also includes \$1.7 million, net of tax, or \$0.12 per share (diluted), for reductions of state income tax expense related to settlements of uncertain income tax positions.

Adjusted net income for the first nine months of fiscal 2015 was \$1.4 million, or \$0.10 per share (diluted), compared to the comparably adjusted net income for the nine months ended November 1, 2014 of \$7.1 million, or \$0.52 per share (diluted).

Adjusted EBITDA was \$15.3 million for the first nine months of fiscal 2015, a decrease compared to \$20.2 million of Adjusted EBITDA for the nine months ended November 1, 2014.

Adjusted EBITDA before other charges was \$19.6 million for the first nine months of fiscal 2015, a decrease compared to \$26.4 million of Adjusted EBITDA before other charges for the nine months ended November 1, 2014.

Net sales for the first nine months of fiscal 2015 decreased 2.3% to \$380.5 million from \$389.4 million for the nine months ended November 1, 2014.

Comparable sales for the first nine months of fiscal 2015 decreased 1.0% compared to a comparable sales decrease of 5.5% for the nine months ended November 1, 2014.

Results of Operations

The following table sets forth certain operating data as a percentage of net sales and as a percentage change for the three and nine months ended October 31, 2015 and November 1, 2014:

	% of Net Sales (1)				% Change Period to Period Favorable (Unfavorable)		
	Three Months Ended		Nine Months Ended		Three Months Ended October 31, 2015 vs. November 1, 2014	Nine Months Ended October 31, 2015 vs. November 1, 2014	
	October 31, 2015	November 1, 2014	October 31, 2015	November 1, 2014			
Net sales	100.0	% 100.0	% 100.0	% 100.0	% (4.4	) % (2.3) %
Cost of goods sold (2)	49.5	49.9	50.8	48.4	5.2	(2.6)
Gross profit	50.5	50.1	49.2	51.6	(3.7	) (6.9)
Selling, general and administrative expenses (3)	50.6	50.4	48.9	48.2	4.2	0.9	
Store closing, asset impairment and asset disposal expenses (income)	0.5	0.4	(0.6	) 0.3	(9.7	) 280.3	
Other charges	0.9	0.6	1.2	0.8	(30.0	) (49.9)
Operating income (loss)	(1.4	) (1.4	) (0.3	) 2.3	3.8	(113.2)
Interest expense, net	0.3	0.1	0.3	0.1	(240.0	) (271.2)
Income (loss) before income taxes	(1.7	) (1.5	) (0.6	) 2.2	(10.5	) (127.2)
Income tax (benefit) provision	(0.7	) (0.6	) (0.2	) 0.4	10.4	155.0	
Net income (loss)	(1.1	) % (0.9	) % (0.4	) % 1.8	% (10.6	) % (120.7) %

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

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

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

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

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Retail Locations (1)	Three Months Ended October 31, 2015			November 1, 2014		
	Stores	Leased Departments	Total Retail Locations	Stores	Leased Departments	Total Retail Locations
Beginning of period	552	1,313	1,865	572	1,326	1,898
Opened	10	4	14	5	8	13
Closed	(8)	(7)	(15)	(5)	(7)	(12)
End of period	554	1,310	1,864	572	1,327	1,899

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Retail Locations (1)	Nine Months Ended October 31, 2015			November 1, 2014		
	Stores	Leased Departments	Total Retail Locations	Stores	Leased Departments	Total Retail Locations
Beginning of period	564	1,311	1,875	586	1,321	1,907
Opened	16	16	32	19	25	44
Closed	(26)	(17)	(43)	(33)	(19)	(52)
End of period	554	1,310	1,864	572	1,327	1,899

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

International Franchised Locations (1)	Three Months Ended October 31, 2015			November 1, 2014		
	Stores	Shop-in- Shop Locations	Total International Franchised Locations	Stores	Shop-in- Shop Locations	Total International Franchised Locations
Beginning of period	26	122	148	18	59	77
Opened	—	39	39	1	2	3
Closed	(1)	(2)	(3)	—	—	—
End of period	25	159	184	19	61	80

International Franchised Locations (1)	Nine Months Ended October 31, 2015			November 1, 2014		
	Stores	Shop-in- Shop Locations	Total International Franchised Locations	Stores	Shop-in- Shop Locations	Total International Franchised Locations
Beginning of period	23	62	85	20	127	147
Opened	4	101	105	2	51	53
Closed	(2)	(4)	(6)	(3)	(117)	(120)
End of period	25	159	184	19	61	80

(1) During April 2014 we commenced our expansion in Mexico. As of October 31, 2015 our merchandise is offered in 100 shop-in-shops and four franchise stores in Mexico. During June 2015 we commenced our expansion into Israel. As of October 31, 2015 our merchandise is offered in 31 shop-in-shops and two franchise stores in Israel. During March 2014 one franchise store and 116 shop-in-shop locations operated by our former India franchisee were closed.

Three Months Ended October 31, 2015 and November 1, 2014

Net Sales. Our net sales for the third quarter of fiscal 2015 decreased by 4.4%, or \$5.6 million, to \$119.5 million from \$125.1 million for the three months ended November 1, 2014. Comparable sales for the third quarter of fiscal 2015 decreased 3.6% compared to a comparable sales decrease of 6.9% for the three months ended November 1, 2014. The decrease in total reported sales for the third quarter of fiscal 2015 compared to the three months ended November 1, 2014 resulted primarily from the decrease in comparable sales and decreased sales related to the Company's continued efforts to close underperforming stores (see our discussion in Item 1. Business Overview of our Annual Report on Form 10-K for the year ended September 30, 2014 regarding closing underperforming stores), partially offset by increased sales from our licensed relationship. We believe the primary drivers of the comparable sales decrease were lower transactions and lower unit sales that were negatively impacted by both internal and external factors. Externally, the difficult retail environment resulted in decreased traffic and unseasonably warm weather adversely impacted sales of Fall merchandise. Internally, the now completed move to our new distribution center presented some transitional challenges in August and September that adversely impacted both web fulfillment and store deliveries. We estimate the disruption from our distribution center move negatively impacted our reported comparable sales by approximately 2.0% for the third quarter of fiscal 2015.

Gross Profit. Our gross profit for the third quarter of fiscal 2015 decreased by 3.7%, or \$2.3 million, to \$60.4 million from \$62.7 million for the three months ended November 1, 2014, and our gross profit as a percentage of net sales (gross margin) for the third quarter of fiscal 2015 was 50.5% compared to 50.1% for the three months ended November 1, 2014. The decrease in gross profit for the third quarter of fiscal 2015 compared to the three months ended November 1, 2014 was primarily due to our lower sales

volume as a result of the factors discussed above. The year-over-year increase in gross margin reflects less price promotion and markdown activity as a result of better managed inventory, lower levels of excess current season and aged merchandise, and benefit from our Grow NJ award. During the third quarter of fiscal 2015 higher occupancy and depreciation expenses from our relocations were substantially offset by lower employment costs and \$0.8 million of benefit from our Grow NJ award, which we began to recognize during the quarter. In fiscal 2016 and beyond the Grow NJ benefit is expected to partially offset our relocation related costs on an annual basis. Due to the timing of the initial benefit recognition in the third quarter of fiscal 2015, we estimate our third quarter fiscal 2015 gross margin was approximately 0.4% higher than the annualized benefit expected in the future.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses for the third quarter of fiscal 2015 decreased by 4.2%, or \$2.7 million, to \$60.4 million from \$63.1 million for the three months ended November 1, 2014. As a percentage of net sales, selling, general and administrative expenses increased to 50.6% for the third quarter of fiscal 2015 from 50.4% for the three months ended November 1, 2014. This decrease in expense for the quarter reflects lower marketing and advertising expense and cost reductions resulting from our continued closure of underperforming stores. We recognized \$0.5 million from our Grow NJ benefit in the third quarter of fiscal 2015, which substantially offset higher occupancy and depreciation expenses for our corporate headquarters. The increase in expense percentage for the three month period reflects the unfavorable leverage from our decreased sales due to the relatively fixed nature of much of our expenses.

Store Closing, Asset Impairment and Asset Disposal (Income) Expenses. Our store closing, asset impairment and asset disposal expenses for the third quarter of fiscal 2015 increased by \$0.1 million, to \$0.6 million from \$0.5 million for the three months ended November 1, 2014, reflecting slightly higher impairment charges for write-downs of long-lived assets.

Other Charges. In the third quarter of fiscal 2015 we incurred other charges of \$1.1 million related to the relocations of our headquarters and distribution facilities, and management and organizational changes. Other charges related to our relocations of our corporate headquarters and distribution operations from Philadelphia, Pennsylvania to southern New Jersey were approximately \$0.6 million, primarily for moving costs for the new distribution center and shut down costs of the prior facility. Other charges related to management and organizational changes were \$0.5 million, primarily for consulting fees, and to a lesser extent, severance and other benefits. In the three months ended November 1, 2014 we incurred other charges of \$0.8 million related to the relocations of our headquarters and distribution operations, and management and organizational changes. Other charges related to our relocations were approximately \$0.6 million, for pre-opening rent expense for the new distribution center and accelerated depreciation, offset by a gain of \$4.1 million on the sale our prior headquarters/distribution facility. Other charges related to management and organizational changes were \$4.3 million, primarily for severance and other benefits in connection with the resignation of our former CEO.

Operating Income (Loss). We had an operating loss of \$1.7 million for the third quarter of fiscal 2015 compared to an operating loss of \$1.8 million for the three months ended November 1, 2014. The \$0.1 million reduction in operating loss was primarily due to our lower selling, general and administrative expenses (\$3.2 million), substantially offset by our lower gross profit (\$2.8 million).

Interest Expense, Net. Our net interest expense for the third quarter of fiscal 2015 increased to \$0.4 million from \$0.1 million for the three months ended November 1, 2014. This increase was due to borrowings under our Credit Facility during the first nine months of fiscal 2015 and the \$15.0 million of equipment financing received during the four month transition period ended January 31, 2015.

Income Tax (Benefit) Provision. For the three months ended October 31, 2015 and November 1, 2014 our effective tax benefit rate was 38.5%. Our effective tax benefit rate was higher than the statutory federal tax rate of 35%

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

Net Income (Loss). Net loss for the third quarter of fiscal 2015 was \$1.3 million, or \$0.09 per share (diluted), compared to net loss of \$1.2 million, or \$0.09 per share (diluted), for the three months ended November 1, 2014. Net loss for the third quarter of fiscal 2015 includes other charges of approximately \$0.4 million, net of tax, related to the relocations of our headquarters and distribution facilities and \$0.3 million, net of tax, related to management and organizational changes. Net income for the three months ended November 1, 2014 includes other charges of \$0.4 million, net of tax, related to the relocations of our headquarters and distribution facilities, \$2.7 million, net of tax, related to management and organizational changes, and a gain of \$2.5 million, net of tax, from the sale of our prior headquarters/distribution facility. Before these charges and credits, our net loss for the third quarter of fiscal 2015 was \$0.6 million, or \$0.05 per share (diluted), compared to a net loss of \$0.6 million, or \$0.05 per share (diluted), for the three months ended November 1, 2014.

Our average diluted shares outstanding of 13,591,000 for the third quarter of fiscal 2015 were slightly higher than the 13,504,000 average diluted shares outstanding for the three months ended November 1, 2014. We had higher shares outstanding in the third quarter of fiscal 2015 compared to the three months ended November 1, 2014, as a result of stock option exercises and restricted stock awards.

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Following is a reconciliation of net loss and net loss per share (diluted) (“Diluted EPS”) to adjusted net loss and adjusted Diluted EPS for the three months ended October 31, 2015 and November 1, 2014 (in thousands, except per share amounts):

	Three Months Ended			November 1, 2014		
	October 31, 2015					
	Net Loss	Diluted Shares	Diluted EPS	Net Loss	Diluted Shares	Diluted EPS
As reported	\$(1,274)	13,591	\$(0.09)	\$(1,152)	13,504	\$(0.09)
Other charges for relocations, net of tax (1)	340	—		413	—	
Other charges for management and organizational changes, net of tax (2)	311	—		2,651	—	
Gain on sale of building, net of tax (3)	—	—		(2,540)	—	
As adjusted	\$(623)	13,591	\$(0.05)	\$(628)	13,504	\$(0.05)

(1) For the three months ended October 31, 2015 and November 1, 2014 other charges for relocations are net of income tax benefit of \$207 and \$250, which represents the difference in income tax (benefit) provision calculated with and without the specified pretax expense.

(2) For the three months ended October 31, 2015 and November 1, 2014 other charges for management and organizational changes are net of income tax benefit of \$194 and \$1,605, which represents the difference in income tax (benefit) provision calculated with and without the specified pretax expense.

(3) Gain on sale of building is net of income tax expense of \$1,570, which represents the difference in income tax (benefit) provision calculated with and without the specified pretax income.

Following is a reconciliation of net loss to Adjusted EBITDA and Adjusted EBITDA before other charges for the three months ended October 31, 2015 and November 1, 2014 (in thousands):

	Three Months Ended	
	October 31, 2015	November 1, 2014
Net loss	\$(1,274)	\$(1,152)
Add: income tax benefit	(797)	(722)
Add: interest expense, net	374	110
Operating loss	(1,697)	(1,764)
Add: depreciation and amortization expense	4,582	3,851
Add: loss on impairment of long-lived assets	544	477
Add: loss (gain) on disposal of assets	33	(4,055)
Add: stock-based compensation expense	587	1,035
Adjusted EBITDA	4,049	(456)
Add: other charges for relocations (1)	547	344
Add: other charges for management and organizational changes	505	4,256
Adjusted EBITDA before other charges	\$5,101	\$ 4,144

(1) For the three months ended November 1, 2014 other charges for relocations excludes accelerated depreciation expense of \$319 (included in depreciation and amortization expense above) and \$(4,110) representing gain on sale of our prior headquarters/distribution facility (included in gain on disposal of assets above).

Nine Months Ended October 31, 2015 and November 1, 2014

Net Sales. Our net sales for the first nine months of fiscal 2015 decreased by 2.3%, or approximately \$8.9 million, to \$380.5 million from \$389.4 million for the nine months ended November 1, 2014. Comparable sales for the first nine months of fiscal 2015 decreased 1.0% compared to a comparable sales decrease of 5.5% for the nine months ended November 1, 2014. The decrease in total reported sales for the first nine months of fiscal 2015 compared to the nine months ended November 1, 2014 resulted primarily from decreased sales related to the Company's continued efforts to close underperforming stores, and to a lesser extent, the comparable sales decrease. The comparable sales decrease primarily reflects higher year-over-year price promotional and markdown activity, as well as lower transactions and lower unit sales during the third quarter of fiscal 2015 from decreased traffic, the adverse impact of unseasonably warm weather on sales of Fall merchandise, and the adverse impact of the disruption from our distribution center move. We estimate the disruption from our distribution center move negatively impacted our reported comparable sales by approximately 0.7% for the first nine months of fiscal 2015.

Gross Profit. Our gross profit for the first nine months of fiscal 2015 decreased by 6.9%, or \$13.8 million, to \$187.1 million from \$200.9 million for the nine months ended November 1, 2014, and our gross margin for the first nine months of fiscal 2015 was 49.2% compared to 51.6% for the nine months ended November 1, 2014. The decrease in gross profit for the first nine months of fiscal 2015 compared to the nine months ended November 1, 2014 was primarily due to our lower gross margin, reflecting higher year-over-year price promotional and markdown activity to spur sales and more aggressively manage inventory, including our continued efforts to dispose of out-of-season and excess current season merchandise, as well as lower unit sales experienced during the third quarter of fiscal 2015 as a result of the factors discussed above. During the first nine months of fiscal 2015 higher occupancy and depreciation expenses from our relocations were substantially offset by lower employment costs and \$0.8 million of benefit from our Grow NJ award. Due to the timing of the initial benefit recognition in the third quarter of fiscal 2015, we estimate our first nine months of fiscal 2015 gross margin was approximately 0.1% higher than the annualized benefit expected in the future.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses for the first nine months of fiscal 2015 decreased by 0.9%, or \$1.7 million, to \$186.1 million from \$187.8 million for the nine months ended November 1, 2014. As a percentage of net sales, selling, general and administrative expenses increased to 48.9% for the first nine months of fiscal 2015 from 48.2% for the nine months ended November 1, 2014. This decrease in expense for the nine month period reflects lower marketing and advertising expense, cost reductions resulting from our continued closure of underperforming stores and a non-recurring reduction of \$1.2 million from settlement of certain unclaimed property matters during the first quarter of fiscal 2015, partially offset by higher expenses for self-insured employee healthcare benefits and variable incentive compensation (based on pro-rata financial projections). We recognized \$0.5 million from our Grow NJ benefit in the first nine months of fiscal 2015, which substantially offset higher occupancy and depreciation expenses for our corporate headquarters. The increase in expense percentage for the nine month period reflects the unfavorable leverage from our decreased sales due to the relatively fixed nature of much of our expenses.

Store Closing, Asset Impairment and Asset Disposal (Income) Expenses. For the first nine months of fiscal 2015 we had \$2.3 million of income from store closings, asset impairments and asset disposals compared to \$1.3 million of expense for the nine months ended November 1, 2014. During the nine months ended October 31, 2015 we received \$4.1 million as incentive for early termination of the lease for our superstore located on Madison Avenue in New York City. We also had higher impairment charges for write-downs of long-lived assets.

Other Charges. In the first nine months of fiscal 2015 we incurred other charges of \$4.5 million primarily related to the relocations of our headquarters and distribution facilities, and management and organizational changes. Other charges related to our relocations of our corporate headquarters and distribution operations from Philadelphia, Pennsylvania to southern New Jersey were \$2.6 million, primarily for pre-opening rent expense for the new distribution center, moving costs for the new distribution center, shut down costs of the prior facility and accelerated depreciation. Other charges related to management and organizational changes were \$1.8 million, primarily for consulting fees, and to a lesser extent, severance and other benefits in connection with the replacement of certain key management personnel and some reductions in headcount. In the nine months ended November 1, 2014 we incurred other charges of \$3.0 million related to the relocations of our headquarters and distribution operations, management and organizational changes, and a proposed business combination that was withdrawn. Other charges related to our relocations were \$1.8 million, primarily for pre-opening rent expense for the new distribution center and accelerated depreciation, offset by a gain of \$4.1 million on the sale our prior headquarters/distribution facility. Other charges related to management and organizational changes were \$4.3 million, primarily for severance and other benefits in connection with the resignation of our former CEO. Other charges related to the proposed business combination were \$1.0 million, reflecting legal and other professional fees.

Operating Income (Loss). We had an operating loss of \$1.2 million for the first nine months of fiscal 2015 compared to operating income of \$8.8 million for the nine months ended November 1, 2014. The approximately \$10.0 million decrease in operating income was due to our lower gross margin and the resultant gross profit (\$14.3 million), and increased other charges (\$1.5 million), partially offset by the increased income from store closings, asset impairments and asset disposals (\$3.6 million) and decreased selling, general and administrative expenses (\$2.2 million).

Interest Expense, Net. Our net interest expense for the first nine months of fiscal 2015 increased to \$1.1 million from \$0.3 million for the nine months ended November 1, 2014. This increase was due to borrowings under our Credit Facility during the first nine months of fiscal 2015 and the \$15.0 million of equipment financing received during the four month transition period ended January 31, 2015.

Income Tax (Benefit) Provision. For the nine months ended October 31, 2015 our effective tax benefit rate was 38.5%. Our effective tax benefit rate for the nine months ended October 31, 2015 was higher than the statutory federal tax rate of 35% primarily due to state income tax benefits, net of federal expense. For the nine months ended November 1, 2014 our effective tax rate was 19.0%. Our effective tax rate for the nine months ended November 1, 2014 was lower than the statutory federal tax rate of 35% primarily due to reductions of state income tax expense, net of federal expense, of \$1.7 million, which were related to settlements of uncertain income tax positions.

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Net Income (Loss). Net loss for the first nine months of fiscal 2015 was \$1.4 million, or \$0.10 per share (diluted), compared to net income of \$6.9 million, or \$0.51 per share (diluted), for the nine months ended November 1, 2014. Net loss for the first nine months of fiscal 2015 includes other charges of \$1.6 million, net of tax, related to the relocations of our headquarters and distribution facilities and approximately \$1.2 million, net of tax, related to management and organizational changes, and the fiscal year change. Net income for the nine months ended November 1, 2014 includes other charges of \$1.1 million, net of tax, related to the relocations of our headquarters and distribution facilities, \$2.7 million, net of tax, related to management and organizational changes and \$0.6 million, net of tax, related to the proposed business combination, offset by a gain of \$2.5 million, net of tax, on the sale our prior headquarters/distribution facility. Net income for the nine months ended November 1, 2014 also includes \$1.7 million for reductions of state income tax expense, net of federal expense, related to settlements of uncertain income tax positions. Before these charges and credits, our net income for the first nine months of fiscal 2015 was \$1.4 million, or \$0.10 per share (diluted), compared to net income of \$7.1 million, or \$0.52 per share (diluted), for the nine months ended November 1, 2014.

Our average diluted shares outstanding of 13,585,000 for the first nine months of fiscal 2015 were slightly higher than the 13,577,000 average diluted shares outstanding for the nine months ended November 1, 2014. We had higher shares outstanding in the first nine months of fiscal 2015 compared to the nine months ended November 1, 2014 as a result of stock option exercises and restricted stock awards. Our higher outstanding shares were substantially offset by the elimination of the dilutive impact of outstanding stock options and restricted stock in the first nine months of fiscal 2015 due to the net loss, compared to the dilutive impact of outstanding stock options and restricted stock awards in the nine months ended November 1, 2014, when we generated net income.

Following is a reconciliation of net income (loss) and Diluted EPS to adjusted net income and adjusted Diluted EPS for the nine months ended October 31, 2015 and November 1, 2014 (in thousands, except per share amounts):

	Nine Months Ended			November 1, 2014		
	October 31, 2015			November 1, 2014		
	Net			Net		
	Income	Diluted	Diluted	Income	Diluted	Diluted
	(Loss)	Shares	EPS		Shares	EPS
As reported	\$(1,421)	13,585	\$(0.10)	\$6,879	13,577	\$ 0.51
Other charges for relocations, net of tax (1)	1,632	—		1,127	—	
Other charges for management and organizational changes, net of tax (2)	1,128	—		2,651	—	
Other charges for fiscal year change, net of tax (3)	17	—		—	—	
Other charges for proposed business combination, net of tax (4)	—	—		647	—	
Gain on sale of building, net of tax (5)	—	—		(2,540)	—	
Reductions of state income tax expense, net of federal expense, related to settlements of uncertain income tax positions	—	—		(1,654)	—	
Dilutive impact of outstanding stock options and restricted stock eliminated due to net loss	—	37		—	—	
As adjusted	\$1,356	13,622	\$0.10	\$7,110	13,577	\$ 0.52

(1)

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For the nine months ended October 31, 2015 and November 1, 2014 other charges for relocations are net of income tax benefit of \$1,009 and \$681, which represents the difference in income tax (benefit) provision calculated with and without the specified pretax expense.

- (2) For the nine months ended October 31, 2015 and November 1, 2014 other charges for management and organizational changes are net of income tax benefit of \$701 and \$1,605, which represents the difference in income tax (benefit) provision calculated with and without the specified pretax expense.
- (3) Other charges for fiscal year change are net of income tax benefit of \$10, which represents the difference in income tax (benefit) provision calculated with and without the specified pretax expense.
- (4) Other charges for proposed business combination are net of income tax benefit of \$398, which represents the difference in income tax (benefit) provision calculated with and without the specified pretax expense.
- (5) Gain on sale of building is net of income tax expense of \$1,570, which represents the difference in income tax (benefit) provision calculated with and without the specified pretax income.

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Following is a reconciliation of net income (loss) to Adjusted EBITDA and Adjusted EBITDA before other charges for the nine months ended October 31, 2015 and November 1, 2014 (in thousands):

	Nine Months Ended	
	October	November
	31,	1, 2014
	2015	
Net income (loss)	\$(1,421)	\$ 6,879
Add: income tax (benefit) provision	(890)	1,617
Add: interest expense, net	1,147	309
Operating income (loss)	(1,164)	8,805
Add: depreciation and amortization expense	12,721	11,525
Add: loss on impairment of long-lived assets	1,598	1,096
Add: loss (gain) on disposal of assets	47	(4,086)
Add: stock-based compensation expense	2,139	2,882
Adjusted EBITDA	15,341	20,222
Add: other charges for relocations (1)	2,408	