

MOTHERS WORK INC
Form 10-Q
August 09, 2006

**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 June 30, 2006

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

MOTHERS WORK, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

13-3045573

(IRS Employer Identification No.)

456 North 5th Street, Philadelphia, Pennsylvania

(Address of principal executive offices)

19123

(Zip code)

Registrant's telephone number, including area code **(215) 873-2200**

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 is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

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 5,453,731 shares outstanding as of August 3, 2006

MOTHERS WORK, INC. AND SUBSIDIARIES
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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****MOTHERS WORK, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts)

(unaudited)

| | June 30, 2006 | September 30, 2005 |
|--|---------------|--------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 15,641 | \$ 3,037 |
| Short-term investments | 25,650 | |
| Trade receivables, net | 10,200 | 7,681 |
| Inventories | 97,076 | 105,911 |
| Deferred income taxes | 6,015 | 6,015 |
| Prepaid expenses and other current assets | 3,354 | 4,816 |
| Total current assets | 157,936 | 127,460 |
| Property, plant and equipment, net | 72,673 | 76,173 |
| Assets held for sale | 700 | 925 |
| Other assets: | | |
| Goodwill | 50,389 | 50,389 |
| Deferred financing costs, net of accumulated amortization of \$2,331 and \$1,855 | 3,224 | 3,697 |
| Other intangible assets, net of accumulated amortization of \$2,377 and \$2,481 | 694 | 878 |
| Deferred income taxes | 13,897 | 13,261 |
| Other non-current assets | 529 | 534 |
| Total other assets | 68,733 | 68,759 |
| Total assets | \$ 300,042 | \$ 273,317 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Line of credit borrowings | \$ | \$ |
| Current portion of long-term debt | 793 | 769 |
| Accounts payable | 22,278 | 19,900 |
| Accrued expenses and other current liabilities | 48,474 | 35,563 |
| Total current liabilities | 71,545 | 56,232 |
| Long-term debt | 127,729 | 128,087 |
| Deferred rent and other non-current liabilities | 24,613 | 25,670 |
| Total liabilities | 223,887 | 209,989 |
| Commitments and contingencies (Note 9) | | |
| Stockholders' equity: | | |
| Preferred stock, 2,000,000 shares authorized | | |
| Series A cumulative convertible preferred stock, \$.01 par value; 41,000 shares authorized, none outstanding | | |
| 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, 5,385,921 and 5,268,535 shares issued and outstanding, respectively | 54 | 53 |

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| | | |
|--|------------|------------|
| Additional paid-in capital | 66,286 | 63,164 |
| Retained earnings | 9,815 | 111 |
| Total stockholders' equity | 76,155 | 63,328 |
| Total liabilities and stockholders' equity | \$ 300,042 | \$ 273,317 |

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

MOTHERS WORK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|-------------|--------------------------|-------------|
| | June 30, | | June 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Net sales | \$ 163,883 | \$ 152,740 | \$ 459,919 | \$ 426,390 |
| Cost of goods sold | 74,023 | 71,373 | 217,853 | 206,055 |
| Gross profit | 89,860 | 81,367 | 242,066 | 220,335 |
| Selling, general and administrative expenses | 71,933 | 68,547 | 215,035 | 200,476 |
| Operating income | 17,927 | 12,820 | 27,031 | 19,859 |
| Interest expense, net | 3,541 | 3,779 | 11,120 | 11,391 |
| Income before income taxes | 14,386 | 9,041 | 15,911 | 8,468 |
| Income tax provision | 5,612 | 3,532 | 6,207 | 3,303 |
| Net income | \$ 8,774 | \$ 5,509 | \$ 9,704 | \$ 5,165 |
| Income per share Basic | \$ 1.64 | \$ 1.05 | \$ 1.83 | \$ 0.99 |
| Average shares outstanding Basic | 5,334 | 5,253 | 5,298 | 5,235 |
| Income per share Diluted | \$ 1.54 | \$ 1.03 | \$ 1.77 | \$ 0.96 |
| Average shares outstanding Diluted | 5,684 | 5,372 | 5,496 | 5,373 |

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

MOTHERS WORK, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

| | Nine Months Ended June 30, | |
|---|-------------------------------|-----------------|
| | 2006 | 2005 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 9,704 | \$ 5,165 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 11,879 | 11,543 |
| Stock-based compensation expense | 1,706 | |
| Loss on impairment of long-lived assets | 2,345 | 1,773 |
| (Gain) loss on disposal of assets | (45) | 673 |
| Accretion of discount on senior notes | 139 | 123 |
| Deferred income tax benefit | (636) | (332) |
| Tax benefit of stock option exercises | | 100 |
| Amortization of deferred financing costs | 476 | 427 |
| Changes in assets and liabilities: | | |
| Decrease (increase) in | | |
| Trade receivables | (2,519) | (2,089) |
| Inventories | 8,835 | (19,015) |
| Prepaid expenses and other assets | 1,467 | 2,665 |
| Increase (decrease) in | | |
| Accounts payable, accrued expenses and other current liabilities | 13,912 | 8,224 |
| Deferred rent and other non-current liabilities | (1,311) | (372) |
| Net cash provided by operating activities | 45,952 | 8,885 |
| Cash Flows from Investing Activities | | |
| Purchase of short-term investments | (69,655) | (7,000) |
| Proceeds from sale of short-term investments | 44,005 | 13,400 |
| Capital expenditures | (10,811) | (15,281) |
| Proceeds from sale of assets held for sale | 225 | |
| Purchase of intangible assets | (11) | (162) |
| Net cash used in investing activities | (36,247) | (9,043) |
| Cash Flows from Financing Activities | | |
| Increase in cash overdraft | 1,167 | 1,364 |
| Repayment of long-term debt | (473) | (383) |
| Payout of redeemed Series A Preferred Stock | | (373) |
| Deferred financing costs | (3) | (621) |
| Proceeds from exercise of stock options | 1,598 | 412 |
| Excess tax benefit from exercise of stock options | 610 | |
| Net cash provided by financing activities | 2,899 | 399 |
| Net Increase in Cash and Cash Equivalents | 12,604 | 241 |
| Cash and Cash Equivalents, Beginning of Period | 3,037 | 8,467 |
| Cash and Cash Equivalents, End of Period | \$ 15,641 | \$ 8,708 |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash paid for interest | \$ 7,435 | \$ 7,345 |
| Cash paid for income taxes | \$ 1,110 | \$ 1,785 |
| Supplemental Disclosures of Non-Cash Investing and Financing Activities: | | |
| Purchase of equipment under capital lease obligations | \$ | \$ 1,438 |

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

MOTHERS WORK, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2006

(unaudited)

1. BASIS OF FINANCIAL STATEMENT PRESENTATION

The accompanying unaudited consolidated financial statements 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. Reference is made to the Annual Report on Form 10-K as of and for the year ended September 30, 2005 for Mothers Work, Inc. and subsidiaries (the Company or Mothers Work) as filed with the Securities and Exchange Commission, for additional disclosures including a summary of the Company's accounting policies.

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

The Company operates on a fiscal year ending September 30 of each year. All references to fiscal years of the Company refer to fiscal years ended on September 30 in those years. For example, the Company's fiscal 2006 will end on September 30, 2006. Certain reclassifications have been made to the prior year consolidated financial statements to conform to the current year presentation.

2. EARNINGS PER SHARE (EPS)

Basic earnings per share (Basic EPS) is computed by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share (Diluted EPS) is computed by dividing net income by the weighted average number of common shares outstanding, after giving effect to the potential dilution, if applicable, from the exercise of securities, such as stock options and warrants, into shares of common stock as if those securities were exercised.

The following table summarizes the Basic EPS and Diluted EPS calculation (in thousands, except per share amounts):

| | Three Months Ended June 30, 2006 | | | Three Months Ended June 30, 2005 | | |
|--|-------------------------------------|--------|---------|-------------------------------------|--------|---------|
| | Net Income | Shares | EPS | Net Income | Shares | EPS |
| Basic EPS | \$ 8,774 | 5,334 | \$ 1.64 | \$ 5,509 | 5,253 | \$ 1.05 |
| Incremental shares from the assumed exercise of outstanding stock options and warrants | | 350 | (0.10) | | 119 | (0.02) |
| Diluted EPS | \$ 8,774 | 5,684 | \$ 1.54 | \$ 5,509 | 5,372 | \$ 1.03 |

| | Nine Months Ended June 30, 2006 | | | Nine Months Ended June 30, 2005 | | |
|--|------------------------------------|--------|---------|------------------------------------|--------|---------|
| | Net Income | Shares | EPS | Net Income | Shares | EPS |
| Basic EPS | \$ 9,704 | 5,298 | \$ 1.83 | \$ 5,165 | 5,235 | \$ 0.99 |
| Incremental shares from the assumed exercise of outstanding stock options and warrants | | 198 | (0.06) | | 138 | (0.03) |
| Diluted EPS | \$ 9,704 | 5,496 | \$ 1.77 | \$ 5,165 | 5,373 | \$ 0.96 |

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For the three months ended June 30, 2006 and 2005, options and warrants to purchase 149,900 and 545,250 shares, respectively, were excluded from the calculation of Diluted EPS as their effect would have been antidilutive. For the nine months ended June 30, 2006 and 2005, options and warrants to purchase 555,710 and 580,933 shares, respectively, were

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excluded from the calculation of Diluted EPS as their effect would have been antidilutive. These options and warrants could potentially dilute EPS in the future.

3. STOCK-BASED COMPENSATION

Effective October 1, 2005, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, using the modified prospective application method. Prior to adopting SFAS No. 123(R), the Company followed the intrinsic value method of accounting for stock-based employee compensation in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. On September 27, 2005, the Compensation Committee of the Company's Board of Directors approved, and the Board ratified, the acceleration of the vesting of all outstanding stock options having exercise prices of \$23.50 or more. Options to purchase 133,500 shares, having exercise prices ranging from \$23.62 to \$37.05 per share, were affected by the vesting acceleration. The closing price of the Company's common stock on September 26, 2005 (the trading day prior to the vesting acceleration) was \$11.31 per share. The primary purpose of this accelerated vesting program was to eliminate the compensation expense associated with these stock options that the Company would otherwise have been required to recognize in future financial statements pursuant to SFAS No. 123(R). The amount of future compensation expense that was avoided in connection with this acceleration was approximately \$1.3 million, net of tax.

The Company has three stock option plans: the Director Stock Option Plan (the Director Plan), the Amended and Restated 1987 Stock Option Plan (the 1987 Plan) and the 2005 Equity Incentive Plan (the 2005 Plan). The Director Plan expired on December 31, 2004 and no further options may be granted under that plan. Options issued under the Director Plan will remain outstanding until they have expired, been exercised or have otherwise terminated. Under the 1987 Plan, as amended and restated, officers and certain employees, including outside directors, may be granted options to purchase the Company's common stock with exercise prices as determined by the Compensation Committee of the Board of Directors that are no lower than the fair market value of the stock at the date of grant. In February 2003, the stockholders of the Company approved an amendment to increase the number of shares of common stock available for issuance upon the exercise of options granted under the 1987 Plan and the Director Plan by 500,000, up to a total of 2,175,000 options which may be issued under the two plans (including up to a total of 200,000 options which were issuable under the Director Plan). In January 2006, the stockholders of the Company approved the adoption of the 2005 Plan. Under the 2005 Plan, employees, directors, consultants and other individuals who provide services to the Company, may be granted awards in the form of options, stock appreciation rights, restricted stock or restricted stock units. Up to 500,000 shares of the Company's common stock may be issued in respect of awards under the 2005 Plan, and awards of options to purchase the Company's common stock will have exercise prices as determined by the Compensation Committee of the Board of Directors that are no lower than the fair market value of the stock at the date of grant.

Effective October 1, 2004, each outside director is granted 5,000 fully vested options on an annual basis, with an exercise price equal to the fair market value of the stock on the grant date. No options have been granted by the Company with an exercise price less than the fair market value of the Company's common stock on the date of grant for any of the periods presented. The majority of the options issued under the plans vest ratably over a five-year period, although some options vest immediately, and options issued under the plans generally expire ten years from the date of grant. The Company issues new shares upon exercise of vested options. As of June 30, 2006, there were 562,967 options available for grant under the plans.

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For the three months and nine months ended June 30, 2006, the Company recognized stock-based employee compensation expense of \$895,000 and \$1,706,000, less related income tax benefits of \$349,000 and \$665,000, under the provisions of SFAS No. 123(R). For the three months and nine months ended June 30, 2005, no compensation expense was recognized for stock option awards granted at fair market value under the provisions of APB Opinion No. 25. The following table illustrates the pro forma effect on net income and earnings per share if the Company had accounted for its stock option plans prior to October 1, 2005, using the fair value method of accounting under SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure :

| (in thousands, except per share amounts): | Three Months Ended June 30, 2005 | Nine Months Ended June 30, 2005 |
|---|--|---------------------------------------|
| Net income, as reported | \$ 5,509 | \$ 5,165 |
| Deduct: Total stock-based employee compensation expense determined under the fair value based method for all grants, net of tax | (270) | (1,436) |
| Pro forma net income | \$ 5,239 | \$ 3,729 |
| Basic EPS: | | |
| As reported | \$ 1.05 | \$ 0.99 |
| Pro forma net income | \$ 1.00 | \$ 0.71 |
| Diluted EPS: | | |
| As reported | \$ 1.03 | \$ 0.96 |
| Pro forma net income | \$ 0.98 | \$ 0.69 |

Stock option activity for all plans was as follows:

| | Outstanding Options (in thousands) | Weighted Average Exercise Price | Weighted Average Remaining Life (years) | Aggregate Intrinsic Value (in thousands) |
|----------------------------|--|---------------------------------------|--|--|
| Balance September 30, 2005 | 1,230 | \$ 14.50 | | |
| Granted | 273 | 13.71 | | |
| Exercised | (117) | 13.72 | | |
| Forfeited | (32) | 11.11 | | |
| Expired | (80) | 15.37 | | |
| Balance June 30, 2006 | 1,274 | 14.45 | 6.9 | \$ 26,323 |
| Exercisable June 30, 2006 | 809 | \$ 15.06 | 5.8 | \$ 16,262 |

As of June 30, 2006, \$4,654,000 of total unrecognized compensation cost related to non-vested awards is expected to be recognized over a weighted-average period of 1.8 years. During the three months ended June 30, 2006 and 2005, the total intrinsic value of options exercised was \$943,000 and \$61,000, respectively. The total cash received from these option exercises was \$1,168,000 and \$151,000, respectively, and the actual tax benefit realized for the tax deductions from these option exercises was \$368,000 and \$20,000, respectively. During the nine months ended June 30, 2006 and 2005, the total intrinsic value of options exercised was \$1,564,000 and \$322,000, respectively. The total cash received from these option exercises was \$1,598,000 and \$412,000, respectively, and the actual tax benefit realized for the tax deductions from these option exercises was \$610,000 and \$100,000, respectively. During the nine months ended June 30, 2005, options to purchase 27,270 shares of common stock with an aggregate exercise price of \$307,000 were exercised by the option holders tendering 20,286 shares of the Company's common stock, which were held by the option holders.

The weighted average fair value of the options granted during the three months ended June 30, 2006 and 2005 was estimated at \$15.19 and \$8.41 per share, respectively. The weighted average fair value of the options granted during the nine months ended June 30, 2006 and 2005 was estimated at \$8.21 and \$8.78 per share, respectively. The weighted average fair value was calculated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

| | Three Months Ended | | Nine Months Ended | | | | | |
|---------------------------|--------------------|-------|-------------------|-------|---------------|-------|------|-------|
| | June 30, 2006 | | 2005 | | June 30, 2006 | | 2005 | |
| Dividend yield | None | | None | | None | | None | |
| Expected price volatility | 55.7 | % | 60.9 | % | 57.7 | % | 60.9 | % |
| Risk-free interest rates | 5.0 | % | 3.9 | % | 4.5 | % | 4.0 | % |
| Expected lives | 6.5 | years | 8.0 | years | 6.4 | years | 8.0 | years |

Expected volatility was determined using a weighted average of the historic volatility of the Company's common stock as of the option grant date measured over a period equal to the expected life of the grant. Risk free interest rates were based on the U. S. Treasury yield curve in effect at the date of the grant. Expected lives were determined using the simplified method, which measures the average of the option vesting term and the option contractual term.

4. INVENTORIES

Inventories were comprised of the following (in thousands):

| | June 30, 2006 | | September 30, 2005 | |
|------------------|---------------|--------|--------------------|---------|
| Finished goods | \$ | 89,099 | \$ | 97,056 |
| Work-in-progress | | 3,191 | | 3,283 |
| Raw materials | | 4,786 | | 5,572 |
| | \$ | 97,076 | \$ | 105,911 |

5. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

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

| | June 30, 2006 | | September 30, 2005 | |
|---|---------------|--------|--------------------|--------|
| Salaries, wages and employee benefits | \$ | 12,073 | \$ | 8,846 |
| Income taxes payable | | 5,357 | | 1,161 |
| Interest | | 5,977 | | 2,483 |
| Deferred rent | | 4,084 | | 3,790 |
| Sales taxes | | 2,142 | | 2,456 |
| Insurance | | 2,350 | | 2,671 |
| Rent | | 285 | | 328 |
| Audit and legal | | 3,270 | | 3,400 |
| Reserves recorded in the iMaternity acquisition (Note 6) | | 50 | | 232 |
| Remaining payout for redemption of Series A Preferred Stock | | 677 | | 677 |
| Accrued store construction costs | | 509 | | 152 |
| Gift certificates and store credits | | 3,861 | | 3,233 |
| Other | | 7,839 | | 6,134 |
| | \$ | 48,474 | \$ | 35,563 |

Interest payments on the Company's \$125,000,000, 11¼% senior notes (the Senior Notes) are made semiannually on February 1st and August 1st.

6. iMATERNITY ACQUISITION EXIT/RESTRUCTURING ACTIVITY

The Company acquired eSpecialty Brands, LLC (iMaternity) on October 17, 2001. The iMaternity manufacturing and warehousing operations in Costa Rica have been shut down, are being marketed for sale, are not being depreciated and are separately reflected in the accompanying Consolidated Balance Sheets as Assets held for sale. The carrying values of the Costa Rica facilities are recorded at their estimated realizable values, which were determined based on purchase offers from interested parties, less estimated selling costs. In January 2006, the Company sold a portion of the Costa Rica facilities for approximately \$225,000, which approximated its estimated realizable value.

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During the nine months ended June 30, 2006 and 2005, the Company made payments of \$182,000 and \$518,000, respectively, for lease termination fees, severance and other exit costs in connection with the iMaternity acquisition exit/restructuring activities. A summary of the remaining iMaternity acquisition exit/restructuring reserves is as follows (in thousands):

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| | June 30, 2006 | September 30, 2005 |
|----------------------|---------------|--------------------|
| Severance | \$ 50 | \$ 200 |
| Exit and other costs | | 32 |
| | \$ 50 | \$ 232 |

The balance of the severance reserve reflects a non-compete and severance arrangement that is payable ratably on a monthly basis through September 30, 2006.

7. NEW ACCOUNTING PRONOUNCEMENTS

SFAS No. 154

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154, Accounting Changes and Error Corrections. SFAS No.154 provides guidance on the accounting for and reporting of accounting changes and error corrections. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted. The Company expects to adopt SFAS No. 154 effective as of October 1, 2006.

FASB Interpretation No. 48

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes. FASB Interpretation No. 48 provides guidance for the recognition and measurement of uncertain tax positions in an enterprise's financial statements. Recognition involves a determination of whether it is more likely than not that a tax position will be sustained upon examination with the presumption that the tax position will be examined by the appropriate taxing authority that would have full knowledge of all relevant information. This interpretation is effective for fiscal years beginning after December 15, 2006. Early adoption is permitted if the enterprise has not issued financial statements, including interim financial statements, in the period of adoption. The impact from adoption of FASB Interpretation No. 48, if any, on the Company's consolidated financial position or results of operations has not yet been determined.

EITF Issue 06-3

In June 2006, the Emerging Issues Task Force (EITF) issued EITF Issue 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation). EITF Issue 06-3 provides guidance related to the presentation in financial statements of any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer, including, but not limited to, sales, use, value added, and some excise taxes. The EITF concluded that the presentation of taxes within the scope of EITF Issue 06-3 on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed. In addition, the aggregate amount of any such taxes that are reported on a gross basis should be disclosed in interim and annual financial statements. The guidance in EITF Issue 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. The Company presently reports taxes within the scope of EITF Issue 06-3 on a net basis and adoption is not expected to have an impact on the consolidated financial statements.

8. GUARANTOR SUBSIDIARIES

Pursuant to the terms of the indenture relating to the Senior Notes, each of the domestic subsidiaries of Mothers Work, Inc. (the Guarantor Subsidiaries) has jointly and severally provided an unconditional guarantee of the obligations of Mothers Work with respect to the Senior Notes. There are no restrictions on any of the assets of the Guarantor Subsidiaries which would limit their ability to transfer funds to Mothers Work in the form of loans, advances or cash dividends, except as provided by applicable law. None of the Company's foreign subsidiaries (the Non-Guarantor Subsidiaries) have guaranteed the Senior Notes. The condensed consolidating financial information for the parent company, the Guarantor Subsidiaries, and the Non-Guarantor Subsidiaries as of and for the nine months ended June 30, 2006 as presented below has been prepared from the books and records maintained by the Guarantor Subsidiaries and the Company. The condensed financial information may not necessarily be indicative of the results of operations or financial position had the Guarantor Subsidiaries operated as independent entities. Certain intercompany revenues and expenses included in the subsidiary records are eliminated in consolidation. As a result of this activity, an amount due to/due from the parent company will exist at any time.

Mothers Work, Inc.
Condensed Consolidating Balance Sheet
June 30, 2006
(in thousands)
(unaudited)

| | Mothers Work (Parent Company) | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (Foreign Operations) | Consolidating Eliminations | Mothers Work Consolidated |
|--|-------------------------------------|---------------------------|--|-------------------------------|------------------------------|
| ASSETS | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | \$ 14,012 | \$ 53 | \$ 1,576 | \$ | \$ 15,641 |
| Short-term investments | 25,650 | | | | 25,650 |
| Trade receivables, net | 10,200 | | | | 10,200 |
| Inventories | 94,425 | | 2,651 | | 97,076 |
| Deferred income taxes | 6,015 | | | | 6,015 |
| Prepaid expenses and other current assets | 3,246 | 1 | 107 | | 3,354 |
| Total current assets | 153,548 | 54 | 4,334 | | 157,936 |
| Property, plant and equipment, net | 70,319 | | 2,354 | | 72,673 |
| Assets held for sale | | | 700 | | 700 |
| Other assets | 68,601 | | 132 | | 68,733 |
| Investments in and advances to (from) affiliates | (7,801 |) 275,443 | (4,057 |) (263,585 |) |
| Total assets | \$ 284,667 | \$ 275,497 | \$ 3,463 | \$ (263,585 |) \$ 300,042 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | | | | |
| Current liabilities: | | | | | |
| Line of credit borrowings | \$ | \$ | \$ | \$ | \$ |
| Current portion of long-term debt | 793 | | | | 793 |
| Accounts payable | 22,278 | | | | 22,278 |
| Accrued expenses and other current liabilities | 34,158 | 13,922 | 394 | | 48,474 |
| Total current liabilities | 57,229 | 13,922 | 394 | | 71,545 |
| Long-term debt | 127,729 | | | | 127,729 |
| Deferred rent and other non-current liabilities | 23,554 | | 1,059 | | 24,613 |
| Total liabilities | 208,512 | 13,922 | 1,453 | | 223,887 |
| Total stockholders equity | 76,155 | 261,575 | 2,010 | (263,585 |) 76,155 |
| Total liabilities and stockholders equity | \$ 284,667 | \$ 275,497 | \$ 3,463 | \$ (263,585 |) \$ 300,042 |

Mothers Work, Inc.
Consolidating Statement of Operations
For the Nine Months Ended June 30, 2006
(in thousands)
(unaudited)

| | Mothers Work (Parent Company) | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (Foreign Companies) | Consolidating Eliminations | Mothers Work Consolidated |
|---|--|-----------------------------------|---|---------------------------------------|--------------------------------------|
| Net sales | \$ 446,771 | \$ 23,675 | \$ 13,148 | \$ (23,675) | \$ 459,919 |
| Cost of goods sold | 212,245 | | 5,608 | | 217,853 |
| Gross profit | 234,526 | 23,675 | 7,540 | (23,675) | 242,066 |
| Selling, general and administrative expenses | 232,273 | 288 | 6,149 | (23,675) | 215,035 |
| Operating income | 2,253 | 23,387 | 1,391 | | 27,031 |
| Interest income (expense), net | (26,107) |) 14,987 | | | (11,120) |
| Equity in earnings of subsidiaries | 39,765 | | | (39,765) |) |
| Income before income taxes | 15,911 | 38,374 | 1,391 | (39,765) |) 15,911 |
| Income tax provision | 6,207 | 13,431 | 542 | (13,973) |) 6,207 |
| Net income | \$ 9,704 | \$ 24,943 | \$ 849 | \$ (25,792) |) \$ 9,704 |

Mothers Work, Inc.
Consolidating Cash Flow Statement
For the Nine Months Ended June 30, 2006
(in thousands)
(unaudited)

| | Mothers Work (Parent Company) | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (Foreign Companies) | Consolidating Eliminations | Mothers Work Consolidated |
|---|-------------------------------------|---------------------------|---|-------------------------------|------------------------------|
| Cash Flows from Operating Activities: | | | | | |
| Net income | \$ 9,704 | \$ 24,943 | \$ 849 | \$ (25,792) | \$ 9,704 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | | |
| Depreciation and amortization | 11,531 | | 348 | | 11,879 |
| Stock-based compensation expense | 1,706 | | | | 1,706 |
| Loss on impairment of long-lived assets | 2,271 | | 74 | | 2,345 |
| Gain on disposal of assets | (50) | | 5 | | (45) |
| Accretion of discount on senior notes | 139 | | | | 139 |
| Deferred income tax benefit | (636) | | | | (636) |
| Amortization of deferred financing costs | 476 | | | | 476 |
| Changes in assets and liabilities: | | | | | |
| Decrease (increase) in | | | | | |
| Trade receivables | (2,596) | | 77 | | (2,519) |
| Inventories | 8,811 | | 24 | | 8,835 |
| Prepaid expenses and other assets | 1,571 | 3 | (107) | | 1,467 |
| Investments in and advances to (from) affiliates | 1,487 | (27,368) | 89 | 25,792 | |
| Increase (decrease) in | | | | | |
| Accounts payable, accrued expenses and other current liabilities | 11,378 | 2,438 | 96 | | 13,912 |
| Deferred rent and other non-current liabilities | (1,369) | | 58 | | (1,311) |
| Net cash provided by operating activities | 44,423 | 16 | 1,513 | | 45,952 |
| Cash Flows from Investing Activities: | | | | | |
| Purchase of short-term investments | (69,655) | | | | (69,655) |
| Proceeds from sale of short-term investments | 44,005 | | | | 44,005 |
| Capital expenditures | (10,559) | | (252) | | (10,811) |
| Proceeds from sale of assets held for sale | | | 225 | | 225 |
| Purchase of intangible assets | (2) | | (9) | | (11) |
| Net cash used in investing activities | (36,211) | | (36) | | (36,247) |
| Cash Flows from Financing Activities: | | | | | |
| Increase in cash overdraft | 1,167 | | | | 1,167 |
| Repayment of long-term debt | (473) | | | | (473) |
| Deferred financing costs | (3) | | | | (3) |
| Proceeds from exercise of stock options | 1,598 | | | | 1,598 |
| Excess tax benefit of stock option exercises | 610 | | | | 610 |

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| | | | | | |
|---|-----------|-------|----------|----|-----------|
| Net cash provided by financing activities | 2,899 | | | | 2,899 |
| Net Increase in Cash and Cash Equivalents | 11,111 | 16 | 1,477 | | 12,604 |
| Cash and Cash Equivalents, Beginning of Period | 2,901 | 37 | 99 | | 3,037 |
| Cash and Cash Equivalents, End of Period | \$ 14,012 | \$ 53 | \$ 1,576 | \$ | \$ 15,641 |

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9. COMMITMENTS AND CONTINGENCIES

From time to time, the Company is named as a defendant in legal actions arising from its normal business activities. 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.

10. SEGMENT AND ENTERPRISE WIDE DISCLOSURES

Operating Segment. Under SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, a company may be required to report segmented information about separately identifiable parts of its business, which both (i) meet the definition of an operating segment under SFAS No. 131, and (ii) exceed certain quantitative thresholds established in SFAS No. 131. The Company has determined that its business is comprised of one operating segment: the design, manufacture and sale of maternity apparel and related accessories. While the Company offers a wide range of products for sale, the substantial portion of its products are initially distributed through the same distribution facilities, many of the Company's products are manufactured at common contract manufacturer production facilities, the Company's products are marketed through a common marketing department, and these products are sold to a similar customer base, consisting of expectant mothers.

Geographic Information. Information concerning the Company's operations by geographic area is as follows (in thousands):

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| | Three Months Ended, June 30, | | Nine Months Ended June 30, | |
|---|---------------------------------|------------|-------------------------------|------------|
| | 2006 | 2005 | 2006 | 2005 |
| <u>Net Sales to Unaffiliated Customers</u> | | | | |
| United States | \$ 158,293 | \$ 148,341 | \$ 446,771 | \$ 416,183 |
| Canada | \$ 5,590 | \$ 4,399 | \$ 13,148 | \$ 10,207 |

| | June 30, 2006 | September 30, 2005 |
|---------------------------------|------------------|-----------------------|
| <u>Long-Lived Assets</u> | | |
| United States | \$ 70,881 | \$ 74,393 |
| Canada | \$ 2,486 | \$ 2,658 |
| Costa Rica | \$ 700 | \$ 925 |

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

11. INTEREST EXPENSE, NET

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

| | Three Months Ended, June 30, | | Nine Months Ended June 30, | |
|-----------------------|---|-------------|---------------------------------------|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| Interest expense | \$ 3,841 | \$ 3,792 | \$ 11,580 | \$ 11,445 |
| Interest income | (300) | (13) | (460) | (54) |
| Interest expense, net | \$ 3,541 | \$ 3,779 | \$ 11,120 | \$ 11,391 |

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

The following tables set forth certain operating data as a percentage of net sales and as a percentage change for the three and nine months ended June 30:

| | % of Net Sales (1) | | | | % Period to Period Increase (Decrease) | | | |
|--|-----------------------------|---------|----------------------------|---------|---|--|--|--|
| | Three Months Ended June 30, | | Nine Months Ended June 30, | | Three Months Ended June 30, 2006 vs. 2005 | | Nine Months Ended June 30, 2006 vs. 2005 | |
| | 2006 | 2005 | 2006 | 2005 | | | | |
| Net sales | 100.0 % | 100.0 % | 100.0 % | 100.0 % | 7.3 % | | 7.9 % | |
| Cost of goods sold (2) | 45.2 | 46.7 | 47.4 | 48.3 | 3.7 | | 5.7 | |
| Gross profit | 54.8 | 53.3 | 52.6 | 51.7 | 10.4 | | 9.9 | |
| Selling, general and administrative expenses (3) | 43.9 | 44.9 | 46.8 | 47.0 | 4.9 | | 7.3 | |
| Operating income | 10.9 | 8.4 | 5.9 | 4.7 | 39.8 | | 36.1 | |
| Interest expense, net | 2.2 | 2.5 | 2.4 | 2.7 | (6.3) | | (2.4) | |
| Income before income taxes | 8.8 | 5.9 | 3.5 | 2.0 | 59.1 | | 87.9 | |
| Income tax provision | 3.4 | 2.3 | 1.3 | 0.8 | 58.9 | | 87.9 | |
| Net income | 5.4 % | 3.6 % | 2.1 % | 1.2 % | 59.3 | | 87.9 | |

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

(2) The Cost of goods sold line item 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, warehousing costs, internal transfer costs, and the other costs of our distribution network.

(3) The Selling, general and administrative expenses line item includes: advertising and marketing expenses, corporate administrative expenses, store expenses (including store payroll and store occupancy expenses), store opening and store closing expenses, and store asset impairment charges.

The following table sets forth certain information concerning the number of our stores and leased departments for the periods indicated:

| Retail Locations | Three Months Ended June 30, 2006 | | | June 30, 2005 | | |
|---------------------|----------------------------------|--------------------|------------------------|---------------|--------------------|------------------------|
| | Stores | Leased Departments | Total Retail Locations | Stores | Leased Departments | Total Retail Locations |
| Beginning of period | 831 | 728 | 1,559 | 869 | 728 | 1,597 |
| Opened | 1 | 3 | 4 | 5 | 10 | 15 |
| Closed | (17) | (6) | (23) | (17) | (2) | (19) |
| End of period | 815 | 725 | 1,540 | 857 | 736 | 1,593 |

| Retail Locations | Nine Months Ended June 30, 2006 | | | June 30, 2005 | | |
|---------------------|---------------------------------|--------------------|------------------------|---------------|--------------------|------------------------|
| | Stores | Leased Departments | Total Retail Locations | Stores | Leased Departments | Total Retail Locations |
| Beginning of period | 852 | 739 | 1,591 | 883 | 232 | 1,115 |
| Opened | 12 | 15 | 27 | 25 | 508 | 533 |
| Closed | (49) | (29) | (78) | (51) | (4) | (55) |
| End of period | 815 | 725 | 1,540 | 857 | 736 | 1,593 |

Our fiscal year ends on September 30. All references in this discussion to our fiscal years refer to the fiscal year ended on September 30 in the year mentioned. For example, our fiscal 2006 will end on September 30, 2006.

Three Months Ended June 30, 2006 and 2005

Net Sales. Our net sales for the third quarter of fiscal 2006 increased by 7.3%, or approximately \$11.2 million, to \$163.9 million from \$152.7 million for the third quarter of fiscal 2005. Net sales increased primarily due to our comparable store sales increase and, to a lesser extent, due to sales increases realized from our internet sales, our licensed arrangement with Kohl's®, and our marketing partnerships. Comparable store sales increased by 6.4% during the third quarter of fiscal 2006, based on 1,472 retail locations, versus a comparable store sales decrease of 1.9% during the third quarter of fiscal 2005, based on 978 retail locations.

As of June 30, 2006, we operated a total of 815 stores and 1,540 total retail locations, compared to 857 stores and 1,593 total retail locations as of June 30, 2005. In addition, our Oh Baby! by Motherhood collection is available at Kohl's stores throughout the United States. As of June 30, 2006, our store total included 49 multi-brand stores, including 11 Destination Maternity superstores, with the remaining multi-brand stores under the Mimi Maternity® brand. In comparison, as of June 30, 2005, we operated 46 multi-brand stores, including eight Destination Maternity superstores. These multi-brand store figures exclude our A Pea in the Pod® stores, which have traditionally carried a full line of both A Pea in the Pod and Mimi Maternity branded merchandise. During the third quarter of fiscal 2006, we opened one store and closed 17 stores, with one of these store closings related to a prior period multi-brand store opening.

Gross Profit. Our gross profit for the third quarter of fiscal 2006 increased by 10.4%, or \$8.5 million, to \$89.9 million from \$81.4 million for the third quarter of fiscal 2005, reflecting the increase in net sales and an increase in gross margin. Gross profit as a percentage of net sales (gross margin) for the third quarter of fiscal 2006 was 54.8% compared to 53.3% for the third quarter of fiscal 2005. The increase in gross margin of approximately 1.5 percentage points compared to the prior year resulted primarily from a higher maintained gross margin in our own stores, largely due to lower overall markdowns compared to last year.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses for the third quarter of fiscal 2006 increased by 4.9%, or \$3.4 million, to \$71.9 million from \$68.5 million for the third quarter of fiscal 2005. This increase in expense for the quarter resulted primarily from increases in accrued incentive compensation expense related to improvements in our operating performance compared to fiscal 2005, and stock-based compensation expense. As a percentage of net sales, selling, general and administrative expenses decreased to 43.9% for fiscal 2006 compared to 44.9% for fiscal 2005. This decrease in the expense percentage for the quarter resulted primarily from the favorable expense leverage created by our comparable store sales increase, partially offset by higher variable incentive compensation expense and stock option expense. We incurred charges relating to store closings of \$0.2 million for fiscal 2006 as compared to \$0.7 million for fiscal 2005 (primarily lease termination fees). We incurred \$0.9 million of non-cash expenses related to stock-based compensation expense, including \$0.8 million in selling, general and administrative expense, in the third quarter of fiscal 2006 versus none in the third quarter of fiscal 2005, since we adopted the provisions of SFAS No. 123(R) as of the beginning of fiscal 2006. We also incurred impairment charges for write-downs of store long-lived assets of \$0.5 million for fiscal 2006, as compared to \$0.4 million for fiscal 2005.

Operating Income. Our operating income for the third quarter of fiscal 2006 increased by 39.8%, or \$5.1 million, to \$17.9 million from \$12.8 million for the third quarter of fiscal 2005, due to increased sales volume and gross profit, which more than offset the impact of higher selling, general and administrative expenses. Operating income as a percentage of net sales (operating income margin) for the third quarter of fiscal 2006 increased to 10.9% from 8.4% for the third quarter of fiscal 2005. Excluding non-cash stock-based compensation expense, our operating income for the third quarter of fiscal 2006 was \$18.8 million, which represents an 11.5% adjusted operating income margin. We were not required to recognize and, therefore, did not recognize any non-cash stock-based compensation expense in fiscal 2005. The increase in operating income margin was due to our increased gross margin and our lower operating expense ratio.

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Interest Expense, Net. Our net interest expense for the third quarter of fiscal 2006 decreased by 6.3%, or approximately \$0.3 million, to \$3.5 million from \$3.8 million for the third quarter of fiscal 2005, primarily due to our increased balance of cash and short-term investments and the resulting increased interest income. During the third quarter of fiscal 2006, we had no direct borrowings under our credit facility. During the third quarter of fiscal 2005, our average level of direct borrowings under our credit facility was \$1.2 million.

Income Tax Provision. Our effective tax rate was a provision of 39.0% for the third quarter of fiscal 2006 and 39.1% for the third quarter of fiscal 2005. We expect our effective tax rate for the full year fiscal 2006 to be approximately

39%.

Net Income. Net income for the third quarter of fiscal 2006 was \$8.8 million, or \$1.54 per share (diluted), compared to net income of \$5.5 million, or \$1.03 per share (diluted), for the third quarter of fiscal 2005, representing increases versus last year of 59.3% in net income and 49.5% in diluted earnings per share. Excluding non-cash stock-based compensation expense, net income for the third quarter of fiscal 2006 was \$9.3 million, or \$1.64 per share (diluted). We were not required to recognize and, therefore, did not recognize any non-cash stock-based compensation expense in the third quarter of fiscal 2005.

Our average diluted shares outstanding of 5,684,000 for the third quarter of fiscal 2006 was 5.8% higher than the 5,372,000 average diluted shares outstanding for the third quarter of fiscal 2005. The increase in average diluted shares outstanding reflects the higher dilutive impact of outstanding stock options in fiscal 2006 compared to fiscal 2005, as well as higher shares outstanding in fiscal 2006 compared to fiscal 2005.

Nine Months Ended June 30, 2006 and 2005

Net Sales. Our net sales for the first nine months of fiscal 2006 increased by 7.9%, or \$33.5 million, to \$459.9 million from \$426.4 million for the first nine months of fiscal 2005. Net sales increased primarily due to our increased comparable store sales, sales from the expansion of our Two Hearts Maternity collection to additional Sears® locations during late March 2005 and, to a lesser extent, sales increases realized from our internet sales, our licensed arrangement with Kohls, and our marketing partnerships. Comparable store sales increased by 3.7% during fiscal 2006, based on 959 retail locations, versus a comparable store sales decrease of 3.1% during fiscal 2005, based on 846 retail locations.

Gross Profit. Our gross profit for the first nine months of fiscal 2006 increased by 9.9%, or approximately \$21.8 million, to \$242.1 million from \$220.3 million for the first nine months of fiscal 2005, reflecting the increase in net sales and an increase in gross margin. Gross margin for the first nine months of fiscal 2006 was 52.6% compared to 51.7% for the first nine months of fiscal 2005. The increase in gross margin of approximately 0.9 percentage points compared to the prior year resulted from a higher maintained gross margin in our own stores, largely due to lower overall markdowns compared to last year.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses for the first nine months of fiscal 2006 increased by 7.3%, or approximately \$14.5 million, to \$215.0 million from \$200.5 million for the first nine months of fiscal 2005. This increase in expense for the nine month period resulted primarily from increases in accrued incentive compensation expense related to improvements in our operating performance compared to fiscal 2005, rent and related expenses for our retail locations, employee wages and benefits for our retail locations, and stock-based compensation expense. As a percentage of net sales, selling, general and administrative expenses was slightly lower at 46.8% for fiscal 2006 compared to 47.0% for fiscal 2005. This slight decrease in the expense percentage for the nine-month period resulted primarily from the favorable expense leverage from our comparable store sales increase, the additional sales from our Sears and Kohls relationships for the nine-month period, and a continued sharp focus on expense control. This favorable expense leverage offset increases as a percentage of net sales in accrued incentive compensation expense and stock-based compensation expense. We incurred charges relating to store closings of \$1.8 million for fiscal 2006 (primarily lease termination fees) as compared to \$1.4 million for fiscal 2005. The majority of the store closing charges for the first nine months of fiscal 2006 and fiscal 2005 were for stores closed in connection with multi-brand store openings. We incurred impairment charges for write-downs of store long-lived assets of \$2.3 million for fiscal 2006, as compared to \$1.8 million for fiscal 2005. We also incurred \$1.7 million of non-cash expenses related to stock-based compensation expense, including \$1.5 million in selling, general and administrative expense, in the first nine months of fiscal 2006 versus none in the first nine months of fiscal 2005, since we adopted the provisions of SFAS No. 123(R) as of the beginning of fiscal 2006.

Operating Income. Our operating income for the first nine months of fiscal 2006 increased by 36.1%, or approximately \$7.1 million, to \$27.0 million from \$19.9 million for the first nine months of fiscal 2005, due to increased sales volume and gross profit, which more than offset the impact of higher selling, general and administrative expenses. Operating income as a percentage of net sales (operating income margin) for the first nine months of fiscal 2006 increased to 5.9% from 4.7% for the first nine months of fiscal 2005. Excluding non-cash stock-based compensation expense, our operating income for the first nine months of fiscal 2006 was \$28.7 million, which represents a 6.2% adjusted operating income margin. We were not required to recognize and, therefore, did not recognize any non-cash stock-based compensation expense in fiscal 2005. The increase in operating income margin was primarily due to our increased gross margin.

Interest Expense, Net. Our net interest expense for the first nine months of fiscal 2006 of \$11.1 million was slightly lower than the first nine months of fiscal 2005 figure of \$11.4 million, due to our increased balance of cash and short-term investments and

the resulting increased interest income. During the first nine months of fiscal 2006, our average level of direct borrowings under our credit facility was \$0.4 million, but we had no direct borrowings under our credit facility as of June 30, 2006. During the first nine months of fiscal 2005, our average level of direct borrowings under our credit facility was \$2.2 million.

Income Tax Provision. Our effective tax rate was a provision of 39.0% for the first nine months of fiscal 2006 and fiscal 2005. We expect our effective tax rate for the full year fiscal 2006 to be approximately 39%.

Net Income. Net income for the first nine months of fiscal 2006 was \$9.7 million, or \$1.77 per share (diluted), compared to net income of \$5.2 million, or \$0.96 per share (diluted), for the first nine months of fiscal 2005, representing increases versus last year of 87.9% in net income and 84.4% in diluted earnings per share. Excluding non-cash stock-based compensation expense, net income for the first nine months of fiscal 2006 was \$10.7 million, or \$1.95 per share (diluted). We were not required to recognize and, therefore, did not recognize any non-cash stock-based compensation expense in the first nine months of fiscal 2005.

Our average diluted shares outstanding of 5,496,000 for the first nine months of fiscal 2006 was 2.3% higher than the 5,373,000 average diluted shares outstanding for the first nine months of fiscal 2005. The increase in average diluted shares outstanding reflects the higher dilutive impact of outstanding stock options in fiscal 2006 compared to fiscal 2005, as well as higher shares outstanding in fiscal 2006 compared to fiscal 2005.

Seasonality

Our business, like that of many other retailers, is seasonal. Our quarterly net sales have historically been highest in our third fiscal quarter, corresponding to the Spring selling season, followed by the first fiscal quarter, corresponding to the Fall/holiday selling season. Given the typically higher gross margin we experience in the third fiscal quarter compared to other quarters, the relatively fixed nature of most of our operating expenses and interest expense, and the historically higher sales level in the third quarter, we have typically generated a very significant percentage of our full year operating income and net income during the third quarter. Results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year. Quarterly results may fluctuate materially depending upon, among other things, the timing of new store openings and new leased department openings, net sales and profitability contributed by new stores and leased departments, increases or decreases in comparable store sales, the timing of the fulfillment of purchase orders under our product and license arrangements, adverse weather conditions, shifts in the timing of certain holidays and promotions, changes in inventory and production levels and the timing of deliveries of inventory, and changes in our merchandise mix.

Liquidity and Capital Resources

Our cash needs have primarily been for: (i) debt service, (ii) capital expenditures, including leasehold improvements, fixtures and equipment for new stores, store relocations and expansions of our existing stores, as well as improvements and new equipment for our distribution and corporate facilities and information systems, and (iii) working capital, including inventory to support our new business initiatives and our new and existing stores. We have historically financed these capital requirements from cash flows from operations, borrowings under our credit facility or available cash balances.

Cash and cash equivalents increased by \$12.6 million during the first nine months of fiscal 2006 compared to an increase of \$0.2 million for the first nine months of fiscal 2005. Cash provided by operations of \$46.0 million for the first nine months of fiscal 2006 increased by \$37.1 million from \$8.9 million provided for the first nine months of fiscal 2005. This increase in cash provided by operations was primarily the result of cash generated by reducing inventories in the first nine months of fiscal 2006 compared to an increase in inventories during the first nine months of fiscal 2005. Total inventories as of June 30, 2006 were \$97.1 million, a decrease of \$8.8 million or 8.3% below the \$105.9 million inventories balance as of September 30, 2005, and a decrease of \$14.7 million or 13.1% below the \$111.8 million inventories balance at June 30, 2005. During the first nine months of fiscal 2006, we used our cash provided by operations primarily to increase our short-term investments, increase our cash and cash equivalents, and pay for capital expenditures. During the first nine months of fiscal 2005, we paid for our capital expenditures through cash provided from operations and the utilization of proceeds from sales of short-term investments.

On August 3, 2006, we announced that our Board of Directors has authorized the repurchase at this time of up to \$10 million principal amount of our 11¼% Senior Notes. The timing and extent to which we repurchase our Senior Notes will depend upon market conditions and other corporate considerations, and will be at our sole discretion.

For the first nine months of fiscal 2006, we spent \$10.8 million on capital expenditures, including \$9.0 million for leasehold improvements, fixtures and equipment principally for new store facilities, as well as improvements to existing stores, and \$1.8 million for our distribution and

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corporate facilities and information systems. This compares to \$15.3 million in capital expenditures for the first nine months of fiscal 2005, of which \$11.7 million was spent for new store facilities and improvements to existing stores and retail locations, and \$3.5 million for our distribution and corporate facilities and information systems. The decrease in capital expenditures was primarily due to decreased expenditures for new stores and

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decreased expenditures for distribution facilities and information systems compared to last year.

On October 15, 2004, we entered into a new five-year \$60.0 million senior secured revolving credit facility (the Credit Facility). The Credit Facility will mature on October 15, 2009. There are no financial covenant requirements under the Credit Facility unless either (i) Excess Availability (as defined in the agreement) falls below \$10 million, or (ii) average Financial Covenant Adjusted Availability (as defined in the agreement) for any calendar month is less than \$15 million. If either of the events in items (i) or (ii) above occurs, we would be required to meet a certain minimum fixed charge coverage ratio (which increases from 1.00x during the first two years of the Credit Facility to 1.10x during the fifth year of the Credit Facility). During the first nine months of fiscal 2006 and the first nine months of fiscal 2005, we exceeded the requirements for Excess Availability and average Financial Covenant Adjusted Availability.

As of June 30, 2006, outstanding borrowings under the Credit Facility consisted of no direct borrowings and \$9.0 million in letters of credit, with \$51.0 million of availability under our credit line. Our average level of direct borrowings under our credit facility was \$0.4 million for the first nine months of fiscal 2006, compared to average direct borrowings of \$2.2 million during the first nine months of fiscal 2005.

Our management believes that our current cash and working capital positions, expected operating cash flows and available borrowing capacity under our Credit Facility, will be sufficient to fund our working capital, capital expenditures and debt repayment requirements and to fund stock and/or debt repurchases, if any, for at least the next twelve months.

Critical Accounting Policies and Estimates

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. These generally accepted accounting principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our consolidated financial statements and the reported amounts of net sales and expenses during the reporting period.

Our significant accounting policies are described in Note 2 of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended September 30, 2005. We believe that the following discussion addresses our critical accounting policies, which are those that are most important to the portrayal of our financial condition and results of operations and require management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. If actual results were to differ significantly from estimates made, future reported results could be materially affected. However, we are not currently aware of any reasonably likely events or circumstances that would result in materially different results.

Our senior management has reviewed these critical accounting policies and estimates and the related Management's Discussion and Analysis of Financial Condition and Results of Operations with the Audit Committee of our Board of Directors.

Inventories. We value our inventories, which consist primarily of maternity apparel, at the lower of cost or market. Cost is determined on the first-in, first-out method (FIFO) and includes the cost of merchandise, freight, duty and broker fees. A periodic review of inventory quantities on hand is performed in order to determine if inventory is properly valued at the lower of cost or market. Factors related to current inventories such as future consumer demand and fashion trends, current aging, current analysis of merchandise based on receipt date, current and anticipated retail markdowns or wholesale discounts, and class or type of inventory are analyzed to determine estimated net realizable values. Criteria utilized by us to quantify aging trends include factors such as the amount of merchandise received within the past twelve months, merchandise received more than one year before with quantities on-hand in excess of 12 months of sales, and merchandise currently selling below cost. A provision is recorded to reduce the cost of inventories to its estimated net realizable value, if required. Inventories as of June 30, 2006 and September 30, 2005 totaled \$97.1 million and \$105.9 million, respectively, representing approximately 32.4% and 38.7% of total assets, respectively. Given the significance of inventories to our consolidated financial statements, the determination of net realizable values is considered to be a critical accounting estimate. Any significant unanticipated changes in the factors noted above could have a significant impact on the value of our inventories and our reported operating results.

Long-Lived Assets. Our long-lived assets consist principally of store leasehold improvements (included in the Property, plant and equipment, net line item in our consolidated balance sheets) and, to a much lesser extent, lease

acquisition costs (included in the Other intangible assets, net line item in our consolidated balance sheets). These long-lived assets are recorded at cost and are amortized using the straight-line method over the shorter of the lease term or their useful life. Net long-lived assets as of June 30, 2006 and September 30, 2005 totaled \$73.4 million and \$77.1 million, respectively, representing approximately 24.5% and 28.2% of total assets, respectively.

In assessing potential impairment of these assets, we periodically evaluate the historical and forecasted operating results and cash flows on a store-by-store basis. Newly opened stores may take time to generate positive operating and cash flow results. Factors such as (i) store type, that is, company store or leased department, (ii) store concept, that is, Motherhood Maternity®, Mimi Maternity, A Pea in the Pod or Destination Maternity, (iii) store location, for example, urban area versus suburb, (iv) current marketplace awareness of our brands, (v) local customer demographic data, (vi) anchor stores within the mall in which our store is located and (vii) current fashion trends are all considered in determining the time frame required for a store to achieve positive financial results, which is assumed to be within two years from the date a store location is opened. If economic conditions are substantially different from our expectations, the carrying value of certain of our long-lived assets may become impaired. As a result of our impairment assessment, we recorded write-downs of long-lived assets of \$2.3 million for the first nine months of fiscal 2006, and \$1.8 million for the first nine months of fiscal 2005.

Goodwill. The purchase method of accounting for business combinations requires the use of estimates and judgments to allocate the purchase price paid for acquisitions to the net tangible and identifiable intangible assets. Goodwill represents the excess of the aggregate purchase price over the fair value of net assets acquired in business combinations and is separately disclosed in our consolidated balance sheets. As of both June 30, 2006 and September 30, 2005, goodwill totaled \$50.4 million, representing 16.8% and 18.4% of total assets, respectively. In June 2001, the FASB issued SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 142 requires that goodwill be tested for impairment at least annually or as impairment indicators arise.

The impairment test requires us to compare the fair value of business reporting units to their carrying value, including assigned goodwill. In assessing potential impairment of goodwill, we have determined that we have one reporting unit for purposes of applying SFAS No. 142 based on our reporting structure. The fair value of our single reporting unit is determined based on the fair market value of our outstanding common stock on a control basis and, if necessary, an outside independent valuation is obtained to determine the fair value. The carrying value of our single reporting unit, expressed on a per share basis, is represented by our book value per share of outstanding common stock. The results of the annual impairment test performed as of September 30, 2005 indicated the fair value of the reporting unit exceeded its carrying value. As of September 30, 2005, our book value was \$12.02 per share of outstanding common stock and the closing trading price of our common stock was \$10.00 per share. As part of the Company's impairment analysis as of September 30, 2005, an outside independent valuation was obtained that indicated that the fair value of the Company's single reporting unit exceeded the carrying value. If the per share fair value of our single reporting unit had been less than the book value per share on September 30, 2005, our goodwill would likely have become impaired. As of June 30, 2006, our book value was \$14.14 per share of outstanding common stock and the closing trading price of our common stock was \$35.05 per share.

Accounting for Income Taxes. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process requires us to estimate our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as depreciation of property and equipment and valuation of inventories, for tax and accounting purposes. We determine our provision for income taxes based on federal and state tax laws and regulations currently in effect, some of which have been recently revised. Legislation changes currently proposed by certain of the states in which we operate, if enacted, could increase our transactions or activities subject to tax. Any such legislation that becomes law could result in an increase in our state income tax expense and our state income taxes paid, which could have a material and adverse effect on our net income.

The temporary differences between the book and tax treatment of income and expenses result in deferred tax assets and liabilities, which are included within our consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income. As of September 30, 2005, we determined that the deferred tax assets should reflect the state tax benefits for several of the states in which we are operating. This determination was made in accordance with the provisions of SFAS No. 109, *Accounting for Income Taxes*. Actual results could differ from our assessments if adequate taxable income is not generated in future periods. Net deferred tax assets as of June 30, 2006 and September 30, 2005 totaled \$19.9 million and \$19.3 million, respectively, representing approximately 6.6% and 7.1% of total assets, respectively. To the extent we believe that recovery is not more likely than not, we must establish a valuation allowance. To the extent we establish a valuation allowance or change the allowance in a future period, income tax expense will be impacted.

Accounting for Contingencies. From time to time, we are named as a defendant in legal actions arising from our

normal business activities. We account for contingencies such as these in accordance with SFAS No. 5, Accounting for Contingencies. SFAS No. 5 requires us to record an estimated loss contingency when information available prior to the issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. An interpretation of SFAS No. 5 further states that when there is a range of loss and no amount within that range is a better estimate than any other, then the minimum amount of the range shall be accrued. Accounting for contingencies arising from contractual or legal proceedings requires management, after consultation with outside legal counsel, to use its best judgment when estimating an accrual related to such contingencies. As additional information becomes known, our accrual for a loss contingency could fluctuate, thereby creating variability in our results of operations from period to period. Likewise, an actual loss arising from a loss contingency which significantly exceeds the amount accrued for in our financial statements could have a material adverse impact on our operating results for the period in which such actual loss becomes known.

Recent Accounting Pronouncements

SFAS No. 154

In May 2005, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 154 (SFAS No. 154), Accounting Changes and Error Corrections. SFAS No.154 provides guidance on the accounting for and reporting of accounting changes and error corrections. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted. We expect to adopt SFAS No. 154 effective as of October 1, 2006.

FASB Interpretation No. 48

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes. FASB Interpretation No. 48 provides guidance for the recognition and measurement of uncertain tax positions in an enterprise's financial statements. Recognition involves a determination of whether it is more likely than not that a tax position will be sustained upon examination with the presumption that the tax position will be examined by the appropriate taxing authority that would have full knowledge of all relevant information. This interpretation is effective for fiscal years beginning after December 15, 2006. Early adoption is permitted if the enterprise has not issued financial statements, including interim financial statements, in the period of adoption. The impact from adoption of FASB Interpretation No. 48, if any, on our consolidated financial position or results of operations has not yet been determined.

EITF Issue 06-3

In June 2006, the Emerging Issues Task Force (EITF) issued EITF Issue 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation). EITF Issue 06-3 provides guidance related to the presentation in financial statements of any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer, including, but not limited to, sales, use, value added, and some excise taxes. The EITF concluded that the presentation of taxes within the scope of EITF Issue 06-3 on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed. In addition, the aggregate amount of any such taxes that are reported on a gross basis should be disclosed in interim and annual financial statements. The guidance in EITF Issue 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. We presently report taxes within the scope of EITF Issue 06-3 on a net basis and adoption is not expected to have an impact on our consolidated financial statements.

Forward-Looking Statements

Some of the information in this report, including information incorporated by reference, if applicable, (as well as information included in oral statements or other written statements made or to be made by us), contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). The forward-looking statements involve a number of risks and uncertainties. A number of factors could cause our actual results, performance, achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. These factors include, but are not limited to: the success of our new business initiatives, future sales trends in our existing store base, changes in consumer spending patterns, raw material price increases, consumer preferences and overall

economic conditions, the impact of competition and pricing, availability of suitable store locations, continued availability of capital and financing, ability to hire and develop senior management and sales associates, ability to develop and source merchandise, ability to receive production from foreign sources on a timely basis, potential stock repurchases, potential debt repurchases, war or acts of terrorism and other factors referenced in our Annual Report on Form 10-K, including those set forth under the caption Risk Factors.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

As of June 30, 2006, we had cash, cash equivalents and short-term investments of \$41.3 million, which include money market accounts and auction rate securities that bear interest at variable rates. A change in market interest rates earned on the cash, cash equivalents and short-term investments impacts the interest income and cash flows, but does not impact the fair market value of the financial instruments. Due to the average maturity and conservative nature of our investment portfolio, we believe a sudden change in interest rates would not have a material effect on the value of our investment portfolio.

As of June 30, 2006, the principal components of our debt portfolio were the \$125.0 million of Senior Notes and the \$60.0 million Credit Facility, both of which are denominated in U.S. dollars. The fair value of the debt portfolio is referred to as the debt value. The Senior Notes bear interest at a fixed rate of 11¼%. Although a change in market interest rates would not affect the interest incurred or cash flow related to this fixed rate portion of the debt portfolio, the debt value would be affected.

Our Credit Facility carries a variable interest rate that is tied to market indices. As of June 30, 2006, we had no direct borrowings and \$9.0 million of letters of credit outstanding under our Credit Facility. Borrowings under the Credit Facility would have borne interest at a rate between approximately 6.6% and 8.3% per annum as of June 30, 2006. Any future borrowings under the Credit Facility would, to the extent of outstanding borrowings, be affected by changes in market interest rates. A change in market interest rates on the variable portion of the debt portfolio impacts the interest incurred and cash flows, but does not impact the debt value of the financial instrument.

The sensitivity analysis as it relates to the fixed rate portion of our debt portfolio assumes an instantaneous 100 basis point move in interest rates from their levels as of June 30, 2006, with all other variables held constant. A 100 basis point increase in market interest rates would result in a decrease in the value of the debt by approximately \$4.0 million as of June 30, 2006. A 100 basis point decline in market interest rates would cause the debt value to increase by approximately \$4.1 million as of June 30, 2006.

Based on the variable rate debt included in our debt portfolio as of June 30, 2006, a 100 basis point increase in interest rates would result in additional interest incurred for the year of less than \$0.1 million. A 100 basis point decrease in interest rates would correspondingly lower our interest expense for the year by less than \$0.1 million.

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

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that are filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed under the Exchange Act is accumulated and communicated to our management on a timely basis to allow decisions regarding required disclosure. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2006. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that as of June 30, 2006, these controls and procedures were effective.

Internal Control over Financial Reporting

There have been no changes in internal control over financial reporting identified in connection with the foregoing evaluation that occurred during the fiscal quarter ended June 30, 2006, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is named as a defendant in legal actions arising from its normal business activities. 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.

Item 6. Exhibits

Exhibit

| No. | Description |
|------|---|
| 31.1 | Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Executive Vice President-Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of the Executive Vice President-Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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Signatures

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

MOTHERS WORK, INC.

Date: August 9, 2006

By: **/s/ DAN W. MATTHIAS**
Dan W. Matthias
*Chairman of the Board and
Chief Executive Officer*

Date: August 9, 2006

By: **/s/ EDWARD M. KRELL**
Edward M. Krell
*Executive Vice President
Chief Financial Officer*

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**INDEX OF EXHIBITS FILED WITH
FORM 10-Q OF MOTHERS WORK, INC.
FOR THE QUARTER ENDED JUNE 30, 2006**

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