

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

/X/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 30, 1998  
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

133045573

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

456 North Fifth Street, Philadelphia, PA

19123

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code

(215) 873-2200

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

NONE

N/A

Securities registered pursuant to Section 12(g) of the Act:  
Common Stock, par value \$.01 per share

(Title of class)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No\_\_.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. |\_ |

On December 11, 1998, the aggregate market value of the Registrant's Common Stock, \$.01 par value, held by nonaffiliates of the Registrant was approximately \$23,958,115.

On December 11, 1998, 3,608,747 shares of the Registrant's Common

Stock, \$.01 par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement to be filed with the Commission in connection with the Annual Meeting of Stockholders scheduled to be held on January 22, 1999 are incorporated by reference into Part III of this Form 10-K

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PART I

ITEM 1. Business1

General

Mothers Work, Inc., a Delaware corporation ("Mothers Work" or the "Company"), which began operations in 1982, is the largest specialty retailer of maternity clothing in the United States. Until September 1998, the Company also operated in the non-maternity women's apparel market through its Episode(R) division ("Episode"), which was acquired in June 1996, and marketed women's bridge fashion apparel. As of September 30, 1998, the Company operated 460 stores under the Mimi Maternity(R), A Pea in the Pod(R) ("Pea"), Motherhood Maternity(R) ("Motherhood") and Maternity Works(R) concepts offering a full range of career, casual and special occasion maternity wear. In addition, the Company operated 123 leased maternity departments in stores such as Lazarus, Rich's, and Macy's.

The Company locates its stores primarily in regional shopping malls, factory-direct outlet centers and to a lesser extent, in central business districts within major metropolitan areas. The Company is vertically-integrated, performing design, manufacturing, distribution and retail sales functions primarily in-house. The Company takes sales orders over the phone, by mail and over the internet for a selected assortment of its maternity apparel, gifts and other materials. In-store merchandise is further supplemented by various mail order catalogs and brochures.

The Company's maternity wear retail stores, although having different merchandising and marketing strategies, are all targeted to those women seeking to purchase moderate to upscale maternity fashions. All of the Company's maternity store concepts sell clothing that is designed to meet an expectant mother's entire lifestyle fashion needs including her career requirements, as well as her casual and special occasion needs. In April 1997 the Company restructured its core maternity business by combining the Mimi Maternity and Maternite lines and consolidating store operations in selected markets.<sup>2</sup> Mimi Maternity is designed to meet the needs of fashion forward women who are willing to spend more to make a fashion statement. Pea markets the most upscale of the Company's maternity fashions and offers a premium merchandise selection manufactured by the Company, including the Company's Mimi Maternity line of clothing, and certain designer labels. Mimi Maternity and Pea collectively constitute the Company's "high end" product line. Motherhood is the oldest chain specialty retailer of maternity clothing in the United States and markets moderately priced maternity clothing. Maternity Works, a chain of factory-direct outlet stores, serves the woman who seeks apparel during her pregnancy but cannot or will not purchase at full retail prices, and primarily serves the moderate market with the introduction of Motherhood products during fiscal 1998.

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1 The terms "Mothers Work" and the "Company" as used in this Report include Mothers Work, Inc. and Cave Springs, Inc., its wholly-owned subsidiary. All references in this Report to stores or Company-owned stores include leased

departments.

2 The Company continues to operate stores under the names Maternite and Mothers Work where bound by lease arrangements or where it would otherwise not be economical to change the name of the store to Mimi Maternity at this time.

The Company's strategy is to:

- o Respond quickly to customer fashion demand utilizing its Real Time Retailing(R) business model.
- o Secure and maintain desirable retail locations within regional shopping malls and factory-direct outlet centers.
- o Use a combination of domestic and international production to ensure both responsiveness to market demands and cost efficiencies.
- o Expand presence in the moderate price market by identifying key items and offering them at everyday low prices.

In May 1998, the Company announced that its Board of Directors had instructed management to restructure the Episode non-maternity bridge women's apparel business to eliminate the losses from that business. The Company operated 50 stores under its Episode concept at that time the restructuring and closure commenced. The first step of this restructuring involved closing or converting to maternity stores 21 of the Episode stores. In September, a decision was made to close the remainder of the Episode stores. At this time, the Company entered into a contract with a liquidator under which the liquidator agreed to operate the Episode stores to sell off the remaining Episode inventory. At September 30, 1998, 30 Episode stores were being operated by the liquidator. The Company expects the closures to be completed during the second quarter of the 1999 fiscal year. In connection with the restructuring, the Company also entered into an asset transfer agreement with The Wet Seal, Inc., a Delaware corporation, by which the Company agreed to sell its leasehold rights and interests in up to 24 of the remaining Episode stores to The Wet Seal, Inc. The initial closing of the asset transfer occurred in early December, 1998, and will continue through the month. In early December, the Company also assigned its interest in its Madison Avenue store to Toppo International Limited ("Toppo"), and concurrently terminated its distribution agreements and Trademark License Agreement related to Episode. Those stores not closed or assigned to The Wet Seal, Inc. will cease operations by the end of the second quarter of fiscal 1999.

The Company is incorporated under the laws of the State of Delaware and entered into the maternity apparel business in 1982. Its principal executive offices and production facility are located at 456 North Fifth Street, Philadelphia, Pennsylvania 19123 and its telephone number is (215) 873-2200.

#### The Maternity Apparel Market

The Company is unaware of any reliable data on the revenue size of the maternity apparel market. The Company believes that the number of maternity clothing wholesale vendors has decreased during the past. The Company's vertical integration reduces the need for the Company to rely on the availability of merchandise from outside vendors, providing a competitive advantage for the

Company. Management believes that the market is elastic due in part to customers who shop the regular market and choose loose-fitting or larger-sized clothing as a substitute for maternity wear.

## Strategy

The key components of the Company's strategic objectives are described below.

**Real Time Retailing** - Real Time Retailing is the Company's proprietary and comprehensive capability to monitor better and respond more quickly to consumer fashion demand, thereby reducing the fashion risk inherent in the apparel business. Through the use of computerized point of sale and merchandising systems, daily replenishment of inventory to the stores, "quick-response" design, "quick-turn" domestic manufacturing and cost efficient international production, the Company is able to provide its customers with the merchandise that they want when they want it. The objective is to maximize the sales potential of each store by matching the profile of the store's customers with the proper merchandise. Real Time Retailing also assists the Company in maximizing its in-store inventory turns and sales per square foot, reducing its cost of goods sold and leading to higher gross profit margins.

**Prime Locations and Broad Distribution** - The Company's historical ability to generate high sales per square foot, the fact that the Company's stores project an image and design consistent with other quality retailers and its multiple concept approach have enabled the Company to secure and maintain desirable retail locations within regional shopping malls and factory-direct outlet centers for its stores. These factors have enabled the Company not only to locate stores at many of the most desirable shopping malls and factory-direct outlet centers, but also to obtain desirable locations within such malls and centers.

By operating four different store concepts, the Company is positioned to satisfy demand for maternity clothing throughout the moderate and high end segments of the market. Mall operators require an appropriate mix of stores for the mall's consumer and market position. For regional malls that require one maternity store, the Company provides several different concepts within the moderate and high end segments of the market. In the case of multi-mall operators, the Company has the flexibility to supply packages of stores in multiple malls utilizing all of its concepts.

As of September 30, 1998, the Company's operations included 123 leased departments. Generally, start-up and operating costs for a leased department are substantially less than for a stand-alone store. The departments are leased from stores such as Lazarus, Rich's, and Macy's and are generally staffed with Company employees. The Company plans to terminate its lease departments in Famous Barr stores during fiscal year 1999. The inventory of the leased departments is merchandised and owned by the Company. Approximately 64% of the leased departments utilize

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EDI to capture sales information, and 100% of the leased departments use Company registers to communicate with its employees. The Company's leased department arrangements generally have an initial term of one year.

**Production** - The Company's strategy is to use a combination of domestic and international production. International sources are used for items such as those in the moderate business where lower costs are necessary for competitive reasons, and the fashion marketability of the item is not adversely affected by the longer lead times which are inherent when a product is acquired from an international vendor. The Company also uses domestic production which helps ensure (1) in-season manufacturing capability for fast selling moderate price product to reduce stock-outs; (2) pre-season production of time-sensitive fashion

apparel; and (3) in-season production of fashion items identified during the season. This domestic manufacturing capability allows the Company to react in real time to changing market trends providing the Company with a competitive advantage over other apparel retailers who source the majority of their product overseas.

Key Items - During 1998 the Company pushed heavily into the moderate key item market with the introduction of the \$16.99 maternity jean. The Company's strategy is to expand on the moderate item market by offering seasonal items at everyday low prices. Typical seasonal offerings are turtlenecks, t-shirts, leggings, and additional items identified in the market that fit the key-item profile. The Company sources this product using a combination of international and domestic production.

#### Expansion Strategy

Expansion of Apparel Business. Since the time of its initial public offering in March 1993, the Company has increased its maternity store base by approximately 770% (from 67 stores to 583 stores) as of September 30, 1998. These increases include stores acquired as a result of the Company's January 1994 acquisition of Page Boy (22 stores acquired) ("Page Boy Acquisition"), its April 1995 acquisition of A Pea in the Pod (66 stores acquired) ("Pea Acquisition"), and its August 1995 acquisition of Motherhood (217 stores acquired) ("Motherhood Acquisition").

Following the Pea Acquisition in 1995, the Company undertook an analysis of all of its stores and entered into a store rationalization and consolidation program to determine which acquired stores would be best operated under separate names and which stores should be closed as redundant. In addition, in April 1997 the Company announced a plan to restructure its core maternity business by combining the Mimi Maternity and Maternite over-lapping product styles, closing certain stores, and converting others. Upon completion of the restructuring, and other routine openings and closings, the Company operates 115 high end stores under the Mimi Maternity and Pea concepts. This restructuring indicates the Company's commitment to continually refine its upscale offerings to meet customer needs.

The Company opened 80 locations in fiscal 1998, consisting of 34 leased departments, 37 Motherhood and Maternity Works stores and 9 Episode and Episode outlet stores, compared with 152 locations in fiscal 1997, consisting of 45 Motherhood and Maternity Works stores, 91 leased

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departments and 16 Episode and Episode outlet stores. The Company plans to add approximately 50 maternity stores, principally Motherhood stores, in fiscal 1999.

The Company's growth has resulted from the addition of new stores, acquisition of existing maternity stores and the increased sales volume from such stores. The Company's ability to open new stores on a timely basis will depend upon the Company's success in identifying suitable store sites, obtaining leases for those sites on acceptable terms, constructing or refurbishing the sites where necessary, and hiring and training skilled store managers and personnel. There can be no assurance that suitable sites will be available for new stores or that new stores will generate sales volumes comparable to those of the Company's existing stores, and the costs associated with opening such stores may adversely affect the Company's profitability. Further, from time to time, the Company also evaluates store closing opportunities.

The Company continually identifies and evaluates real estate opportunities. In addition to its current stores, the Company has identified additional malls or other locations in the United States that would be well suited for maternity stores. The Company considers markets nationwide but favors

metropolitan areas with populations greater than 500,000. The Company has also identified additional malls and outlet centers which do not meet the Company's primary site selection criteria, but which may nevertheless be attractive locations for one of the Company's stores if lease terms are able to be negotiated to provide attractive store unit economics.

The Company is also undertaking several other maternity sales initiatives. In fiscal 1999, the Company will enter the realm of internet commerce. It plans to offer selected store merchandise and an expanded selection of nursing products through its internet store and has ensured convenient, safe shopping for its customers through a secure website. The Company also will expand its product offering during fiscal year 1999 to include Plus size maternity apparel and more clothing and accessories suitable for nursing mothers. Nursing products will be initially offered through a new mail brochure and some products will also be available in the Company's stores. The addition of several non-mall store locations can be expected during fiscal 1999.

Store Concepts

The Company operates its maternity stores under four concepts offering a full range of career, casual and special occasion maternity wear: Pea, Mimi Maternity, Motherhood and Maternity Works. The following table sets forth certain information regarding the Company's store composition as of September 30, 1998, including each store concept's target location, product description and selected price points:

Summary of Store Concepts

Store Concept	Description of Typical Location	Product Description	Price Range for Dresses/Blouses	Average Store Size (Sq. Ft.)	Typical Anchors and Comparable Retailers
A Pea in the Pod	High end regional malls & affluent residential districts	Bridge, high fashion	\$200-\$400 \$120-\$150	2,900	Bergdorf Goodman, Neiman Marcus, Saks Fifth Avenue, Gucci, Ralph Lauren
Mimi Maternity	High end regional malls	Fashion-forward, Contemporary	\$128-\$248 \$58-\$108	1,600	Neiman Marcus, Bloomingdales, Nordstrom's, Saks Fifth Avenue, Barney's, Joan & David, Bebe, Ann Taylor, Banana Republic
Motherhood	Moderate regional malls and department stores	Value-oriented, mostly casual basics; key items	\$29-\$98 \$22-\$38 jeans \$16.99 t-shirts \$11.90 leggings \$12.90	1,200	Macy's, Sears, J.C. Penney, Mervyn's, Casual Corner, Merry-Go-Round, Lerner's, Limited, Express, Eddie Bauer, Mothertime, Dan Howard, Target, K Mart, Kohl's and Wal-Mart
Maternity Works	Factory direct outlet malls and centers	Fashion at marked-down prices	\$78-\$158 \$48-\$78	1,700	Neiman Marcus' Last Call, Nordstrom Off the Rack, Saks Fifth Avenue Clearinghouse, and outlets for Ann Taylor, Polo, Donna Karan, Liz Claiborne, J. Crew and Brooks Brothers

Most malls require only one moderate to high end maternity store; however, major regional malls with several department stores may be able to accommodate two. With Mimi Maternity and Pea as the Company's prestige offerings, and Motherhood as the value oriented, mostly casual basics offering, the Company has the potential to fill both positions at a given mall. As of September 30, 1998, the Company had two or more maternity stores in 30 major

regional malls.

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#### Store Operations

The Company's centralized store operations allow store personnel to focus on selling as well as the physical maintenance of merchandise and store facilities. The Company employs skilled, motivated sales associates who are trained to provide the detailed assistance and the reassurance needed by the customer. A visual merchant coordinates with the merchandising department to develop a space allocation plan and design store display windows. The visual merchant travels among the Company's stores to enhance merchandise presentation.

#### Merchandising, Design and Store Inventory Planning

Merchandising. Guided by Real Time Retailing, the Company's merchandising department combines input from Company designers, current trends seen generally in women's clothing, outside vendor resources and store management input, with TrendTrack computer analysis of customer preferences to provide a constant flow of merchandise to the Company's stores. The Company strives to maintain an appropriate balance between new merchandise and proven successful styles and utilizes Trend Track's open-to-buy system to plan its domestic and international production to control inventory quantity and mix. These fashions are generally marketed under the Company's A Pea in the Pod(R), Mimi Maternity(R), Steena(R), and Motherhood(R) labels.

Design. The Design department produces samples and patterns for the Company's manufactured products under the guidance of the Merchandising department. The design of a product begins with a review of European and New York trends and current retail trends through fashion reporting service slides and fabric samples. The designers review the Company's best selling items from prior seasons and integrate current fashion ideas from the non-maternity retail market.

Store Inventory Planning. The Company establishes target inventories for each store using its inventory planning system to enhance store merchandise coordination and stock balance, to maintain adequate depth of merchandise by style and to manage close-out merchandise and end-of-season consolidation of merchandise. Integral to the Company's inventory management program are its proprietary methods guided by Real Time Retailing and managed by its TrendTrack information system.

#### Production and Distribution

The Company is responsible for the design and production of approximately 75% of its merchandise including merchandise produced abroad using the Company's designs and merchandise assembled abroad using the "807 operations" described below. The Company obtains fabrics, trim and other supplies from a variety of sources and believes that as the number of the Company's stores increases, there will continue to be adequate sources of fabrics and other supplies to produce a sufficient supply of quality goods in a timely manner and on satisfactory economic terms. The Company's subcontracts its sewing to shops in the Philadelphia metropolitan and surrounding area and works with more than 40 subcontractors. No individual subcontractor represents a material portion of the Company's sewing. In addition, some production is supplied by independent foreign subcontractors, principally in Mexico and the Far East, and the Company continues to seek additional subcontractors

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throughout the world for its sourcing needs. The Company sourcing also includes "807 operations" in the Dominican Republic, Costa Rica, Guatemala and Honduras. "807 operations" refers to articles assembled abroad with components produced in the United States. The Company's 807 operations and production sourced abroad are generally limited to products which are moderate in price and are not time-sensitive with respect to fashion demand (e.g. blue jeans, leggings, T-shirts, etc.). The Company's production and quality assurance team monitors production at each subcontractor's facility in the United States and abroad, to ensure quality control, compliance with its design specifications and timely delivery of finished goods.

Finished garments from subcontractors and other manufacturers are received at the Company's central warehouse in Philadelphia, Pennsylvania, inspected and stored for picking. Shipments to stores are primarily made by common carrier, typically UPS, Airborne, Emery Air Freight or a similar service providing one-or two-day delivery throughout the United States.

That portion of the Company's merchandise imported into the United States is subject to United States duties. The Company cannot predict whether any of the foreign countries in which its products are currently manufactured or any of the countries in which the Company may manufacture its products in the future will be subject to future or increased import restrictions by the U.S. government, including the likelihood, type or effect of any trade restrictions. Trade restrictions, including increased tariffs or decreased quotas, against items sold by the Company could affect the importation of such merchandise generally and, in that event, could increase the cost or reduce the supply of merchandise available to the Company and adversely affect the Company's business, financial condition, results of operations and liquidity. The Company's merchandise flow may also be adversely affected by political or economic instability in any of the countries in which its goods are manufactured, if it affects the production or export of merchandise from such countries; significant fluctuation in the value of the U.S. dollar against foreign currencies; and restrictions on the transfer of funds.

#### Management Information and Control Systems

All of the Company's stores have point-of-sale terminals that provide information used in the Company's custom TrendTrack item and classification tracking system. This system provides daily financial and merchandising information integral to the Company's Real Time Retailing strategy. The TrendTrack system has numerous features designed to integrate the Company's retail operations with its design, manufacturing and financial functions. These features include custom merchandise profiles for each store, daily inventory replenishment, item-tracking providing daily updated selling information for every style, classification open-to-buy and inventory control, as well as daily collection of credit card receipts.

The Company employs a comprehensive materials requirements planning system to manage its production inventories, documentation, work orders and scheduling. This system provides a perpetual raw material inventory, actual job costing, scheduling and bill of materials capabilities.

#### Advertising

The Company's advertising and promotion efforts focus on yellow pages and national and local print advertising. Pea and Mimi Maternity are advertised in magazines such as "Vogue" and "Shape Fit Pregnancy." During 1999, the Company will increase its advertising for Motherhood which is advertised in magazines

such as "Parade", "Parent's Expecting", "Baby Talk" and "Parenting." In addition, the Company produces maternity brochures which are distributed to obstetricians and customers. The customer mailing list, which by nature is constantly changing, is regularly updated through the Company's customer response cards. In fiscal 1999, nursing products will be initially offered through a new mail order brochure. The Company also commenced "banner" advertising on the Internet, and will continue to evaluate opportunities associated therewith.

#### Competition

All aspects of the retail industry, including attracting customers, securing merchandise and locating appropriate retail sites, are highly competitive. In its maternity apparel business, the Company faces competition from various full-price maternity clothing chains, a number of off-price specialty retailers and catalog retailers, as well as from local, regional and national department stores and women's and, to some extent, men's clothing stores. The Company faces competition in the moderate maternity market from retailers such as Target, Kohl's, J.C. Penney, K Mart, Wal-Mart, Mervyn's, Sears and others. Many of these competitors are larger and have significantly greater financial resources than the Company.

#### Employees

At September 30, 1998, the Company had approximately 1,887 full-time and approximately 1,425 part-time employees. None of the Company's employees are covered by a collective bargaining agreement. The Company believes that its relationship with its employees is good.

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#### Executive Officers of the Company

The executive officers of the Company are:

Name ----	Age ---	Position -----
Dan W. Matthias.....	55	Chairman of the Board and Chief Executive Officer
Rebecca C. Matthias.....	45	President, Chief Operating Officer and Director
Thomas Frank.....	42	Chief Financial Officer and Vice President - Finance
Donald W. Ochs.....	57	Senior Vice President - Operations
Lynne M. Wieder.....	38	Senior Vice President - Sales

Dan W. Matthias joined the Company on a full-time basis in 1982 and has served as Chairman of the Board since its inception. From 1983 to 1993 he served as the Company's Executive Vice President, and since January 1993, Mr. Matthias has been the Company's Chief Executive Officer. He had previously been involved in the computer and electronics industry, serving as a director of Zilog, Inc. and serving as the President of a division of a subsidiary of Exxon Corporation.

Rebecca C. Matthias founded the Company in 1982 and has served as a director of the Company and its President since its inception. Since January 1993, Ms. Matthias has served as the Company's Chief Operating Officer. Prior to 1982, she was a construction engineer for the Gilbane Building Company. In 1992, she was chosen as "Regional Entrepreneur of the Year" by Inc. magazine and

Merrill Lynch. Ms. Matthias also serves as a member of the Board of Trustees of Drexel University.

Thomas Frank joined the Company in 1988 and has served the Company as Vice President - Finance since September 1989 and also as Chief Financial Officer since September 1995. Mr. Frank was Sales Audit Manager of the Lane Bryant Division of The Limited, Inc. from 1986 to 1988. Mr. Frank is a Certified Public Accountant.

Donald W. Ochs joined the Company in June 1995 as Senior Vice President - - Operations with over 30 years of experience in apparel manufacturing management, operations and worldwide sourcing of women's specialty clothing. Mr. Ochs was Senior Vice President - Corporate Worldwide Sourcing and Manufacturing at Leslie Fay Companies from October 1993 until joining the Company. From 1989 to 1993, Mr. Ochs was employed by Liz Claiborne, Inc. as Senior Vice President - Manufacturing.

Lynne M. Wieder has been Senior Vice President - Sales since September 1995. Since joining the Company in 1991, she has also served as Director of Stores and Vice President-Stores.

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Ms. Wieder was employed by Gap, Inc. as the Director of Stores for its Hemisphere division from August 1989 to February 1990. Ms. Wieder worked at Ann Taylor from February 1981 to July 1989 and served as Regional Supervisor of Stores in various regions of the United States.

The Company's executive officers are elected annually by the Board of Directors and serve at the discretion of the Board.

Other than the husband and wife relationship between Dan and Rebecca Matthias, there are no family relationships among any of the other executive officers of the Company.

#### Trademarks

The Company owns such rights to the trademarks and service marks as it believes are necessary to conduct its business as currently operated. The Company is the owner, through its wholly-owned subsidiary, Cave Springs, Inc., of the registered trademarks Mothers Work(R), Maternite(R), Maternity Works(R), Steena(R), A Pea in the Pod(R), Maternity Redefined(R) Motherhood(R), Essentiel Body Cream(R), Daniel & Rebecca(R) and Lauren Taylor(R). Additionally, the Company owns the service marks Mimi Maternity(R), Real Time Retailing(R) and the slogan What's Showing is Your Style(R). The Company owns a patent for an adjustable waistband used in skirts, which allows the garment to be loosened during the course of pregnancy and a patent relating to the Essentiel Body Cream product. The Company is not aware of any pending claims of infringement or other challenges to the Company's rights to use its marks in the United States as currently used by the Company.

As part of the Episode Acquisition, the Company entered into a Trademark License Agreement, with an initial term expiring May 31, 2000, with Topy. The Trademark License Agreement gives the Company the exclusive license to use the trademark Episode(R) as a name for the Company's retail stores selling bridge women's apparel and accessories in the United States. The Trademark License Agreement required the Company to pay Topy a royalty of 5% of net sales of products in Episode stores, with maximum royalties not to exceed \$4.5 million. With the cessation of the Company's Episode stores, royalties are no longer accruing and have been settled in full. The Company is terminating this Trademark License Agreement in connection with the termination of its Episode division and will pay off the balance of the licensee fee. The Company will retain, however, the right to use certain license trademarks of Episode in conjunction with its efforts to liquidate Episode inventory.

Item 2. Properties

The Company's principal executive offices, manufacturing and distribution facilities are located at 456 North Fifth Street, Philadelphia, Pennsylvania 19123. This facility consists of approximately 318,000 square feet of which approximately 44,000 square feet is dedicated to office space and the remaining square footage to manufacturing and distribution.

All of the Company's retail stores are leased pursuant to leases that extend for terms averaging from seven to ten years. Certain leases allow the Company to terminate its obligations in

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the event the specified store does not achieve a specified sales volume. Certain leases include clauses that provide for contingent payments based on sales volumes and others contain clauses for escalations of base rent as well as increases in operating costs, marketing costs and real estate taxes. The terms of the Company's leases, excluding leased departments, expire as follows:

Fiscal Year Lease Term Expires -----	Number of Stores -----
1999	47
2000	37
2001	41
2002	49
2003 and later	286

As of September 30, 1998, the Company's operations included 123 leased departments. Generally, start-up and operating costs for a leased department are substantially less than for a stand-alone store. The departments are leased from stores such as Lazarus, Rich's, and Macy's and are generally staffed with Company employees. The inventory of the leased departments is merchandised and owned by the Company. Approximately 64% of the leased departments utilize Company point-of-sale registers to capture sales information, and 100% of the leased departments use such registers to communicate with employees. The Company's leased department arrangements generally have an initial term of one year.

Item 3. Legal Proceedings

In connection with the Pea acquisition, Mothers Work (R.E.), Inc. assumed Pea's outstanding litigation and potential claims. On February 9, 1994, a civil complaint was filed in a United States District Court against Pea and its then-officers and Board of Directors, and its former preferred shareholders.

In October 1997, an agreement in principle to settle the litigation in its entirety was reached. The settlement involved a waiver by Pea's underwriters of a claim of counsel fees under the Company's indemnification undertakings to the underwriters contained in the underwriting agreement for the Pea public offering. Although the Company believed it had very strong defenses against the claim, it was concluded that it would undoubtedly have cost the Company more to prevail than to settle the claim on the terms proposed. Pursuant to the agreement, the Company, along with its Directors' and Officers Liability Insurance Carrier ("Insurance Carrier"), agreed to pay \$2,150,000. As part of the agreement, the Company and the Insurance Carrier, on behalf of some of the defendants, agreed to make an initial payment in October 1997 of \$750,000 and \$550,000 respectively, to an escrow agent for the settlement fund. The final \$850,000 was paid by the Company during fiscal 1998.

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

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currently pending actions of this nature cannot be accurately predicted, in the opinion of management, no liability for any pending action will have a material adverse effect on the financial position of the Company.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

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PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

The Company's common stock is traded on the Nasdaq National Market under the symbol "MWRK."

The following table sets forth, for the fiscal quarters indicated, the high and low sales prices per share for the Company's common stock, as reported on the Nasdaq National Market:

Fiscal 1997 -----	High ----	Low ---
First Quarter	\$13	\$ 9 9/16
Second Quarter	10 1/4	8

Third Quarter	8 3/4	6 3/16
Fourth Quarter	13 1/4	6 3/4

Fiscal 1998  
-----

First Quarter	\$14 3/4	\$ 7
Second Quarter	10	7 1/4
Third Quarter	10 1/4	6
Fourth Quarter	11	7

As of December 11, 1998, there were 80 holders of record and 800 estimated beneficial holders of the Company's common stock.

The Company currently intends to retain any future earnings to fund operations and the continued development of its business and, therefore, does not anticipate paying cash dividends on its common stock in the immediate future. In addition, no dividends may be paid on the Company's common stock until all cumulative and current dividends on the Company's preferred stock (the "Preferred Stock") have been declared and paid in full. Any payment of future dividends will be at the discretion of the Company's Board of Directors and will be based upon certain restrictive financial covenants, earnings, capital requirements and the operating and financial condition of the Company, among other factors, at the time any such dividends are considered. See Note 8 of "Notes to Consolidated Financial Statements" for further discussion on the Preferred Stock dividends.

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#### Item 6. Selected Financial Data

The following selected consolidated financial data as of September 30, 1994, 1995, 1996, 1997 and 1998 and for the years then ended have been derived from the Financial Statements of the Company which have been audited by Arthur Andersen LLP, independent public accountants. The information set forth below should be read in conjunction with the Financial Statements and notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	Year Ended September 30				
	1994	1995	1996	1997	1998
	-----	-----	-----	-----	-----
	(In thousands, except per share and operating data)				
INCOME STATEMENT DATA:					
Net sales	\$58,979	\$106,005	\$199,180	\$246,934	\$298,991
Cost of goods sold	24,945	45,527	88,417	113,886	158,047
Gross profit	34,034	60,478	110,763	133,048	140,944
Selling, general and administrative expenses	30,597	53,835	95,395	124,495	139,322
Restructuring and nonrecurring charges	--	5,427	--	5,617	10,635
Operating income (loss)	3,437	1,216	15,368	2,936	(9,013)
Interest expense, net	347	4,484	12,636	13,252	15,181
Income (loss) before income taxes (benefit) and extraordinary item	3,090	(3,268)	2,732	(10,316)	(24,194)
Income taxes (benefit)	1,244	(847)	1,828	(2,677)	(7,477)
Income (loss) before extraordinary item	1,846	(2,421)	904	(7,639)	(16,717)
Extraordinary item, net of income tax benefit	--	(4,215)	--	--	--
Net income (loss)	1,846	(6,636)	904	(7,639)	(16,717)

Preferred dividends	--	163	978	1,088	1,168
	-----	-----	-----	-----	-----
Net income (loss) applicable to common stockholders	\$1,846	\$ (6,799)	\$ (74)	\$ (8,727)	\$ (17,885)
	=====	=====	=====	=====	=====
Net income (loss) per common share:(1)					
Before extraordinary item	\$ .58	\$ (.83)	\$ (.02)	\$ (2.45)	\$ (5.00)
Extraordinary item	--	(1.35)	--	--	--
	-----	-----	-----	-----	-----
Net income (loss) per common share(1)	\$ .58	\$ (2.18)	\$ (.02)	\$ (2.45)	\$ (5.00)
	=====	=====	=====	=====	=====
Weighted average common shares outstanding(1)	3,186,885	3,120,535	3,269,290	3,562,980	3,577,143
	=====	=====	=====	=====	=====

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	Year Ended September 30				
	1994	1995	1996	1997	1998
	----	----	----	----	----
OPERATING DATA:					
Same-store sales increase (decrease) (2)	2.8%	(0.7%)	8.0%	4.3%	13.4%
Average net sales per gross square foot(3)	\$ 379	\$ 360	\$ 333	\$ 338	\$ 354
Average net sales per store(3)	\$439,133	\$442,113	\$452,446	\$508,001	\$464,080
At end of period:					
Number of stores(4)	168	451	468	587	583
Gross square footage	218,842	643,175	719,930	819,900	737,689

	September 30				
	1994	1995	1996	1997	1998
	----	----	----	----	----
(In thousands)					
BALANCE SHEET DATA:					
Working capital	\$ 8,487	\$ 31,611	\$ 37,435	\$ 32,083	\$ 23,614
Total assets	40,827	148,562	164,613	171,718	172,469
Total long-term and short-term debt	10,470	95,373	103,998	108,112	119,982
Stockholders' equity	19,810	25,537	35,107	26,380	8,750

- 
- (1) See Note 1 of "Notes to Consolidated Financial Statements."
  - (2) Based on stores opened at least 24 months in their current store format.
  - (3) Based on locations in operation during the entire fiscal year.
  - (4) September 30, 1998 excludes 30 Episode stores, which, while owned by the Company, were being operated by a liquidator.

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## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Results of Operations

The following tables set forth, for the periods indicated, the percentages which the items in the Company's Statements of Operations bear to net sales:

Percentage of Net Sales  
Year Ended September 30

	1996	1997	1998
Net sales	100.0%	100.0%	100.0%
Cost of goods sold	44.4	46.1	52.9
Gross profit	55.6	53.9	47.1
Selling, general and administrative expenses	47.9	50.4	46.6
Restructuring and nonrecurring charges	--	2.3	3.5
Operating income(loss)	7.7	1.2	(3.0)
Interest expense, net	6.3	5.4	5.1
Income (loss) before income taxes (benefit)	1.4	(4.2)	(8.1)
Income taxes (benefit)	0.9	(1.1)	(2.5)
Net income (loss)	0.5%	(3.1%)	(5.6%)

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The following table sets forth certain information representing growth in the number of stores and leased maternity departments for the periods indicated:

	Year Ended September 30		
	1996	1997	1998
STORES:			
Beginning of period	451	468	587
Opened	44	152	80
Acquired	21	---	--
Closed	(48)	(33)	(54)
End of period	468	587	613

Included in the 613 stores are 30 Episode stores, which, while owned by the Company at September 30, 1998, were being operated by a liquidator.

In 1998, the Company terminated its Episode operations in two phases. First, in May 1998, the Company closed or converted to maternity stores 21 of its Episode stores, primarily its outlets. Second, the Company ceased operating its remaining Episode stores in September. It contracted with a liquidator to dispose of Episode inventory and is selling or making provision to close the remaining stores on a schedule expected to be completed in the second quarter of fiscal 1999. The Company's results of operations for fiscal 1998 include Episode's operations through the date that the store operations were turned over to a liquidator, and include certain inventory writedowns and restructuring charges taken in conjunction with the cessation of Episode's operations.

Included in the Statements of Operations for fiscal 1997 and fiscal 1998 are the following amounts for the Episode division:

	Year Ended September 30	
	1997	1998
	----	----
Revenues	\$33,665,000	\$45,684,000
Cost of goods sold*	18,869,000	39,275,000
Gross margin	14,796,000	6,409,000
Contribution margin (loss)*	146,000	(22,451,000)
Restructuring charges	--	(10,635,000)

\* Cost of goods sold for 1998 includes \$10,290,000 for writedowns of Episode inventory related to the Episode closing. Contribution margin is comprised of gross margin less cost of store operations, royalties and certain related expenses.

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#### Year Ended September 30, 1998 and 1997

Net Sales. Net sales in fiscal 1998 increased by \$52.1 million or 21.1%, as compared to fiscal year 1997. This increase was primarily due to a \$23.6 million or 13.4% net increase in comparable sales in its core maternity business, a \$16.6 million net increase due to maternity store opening and closing activity, and an \$11.8 million increase in the closed Episode(R) America business. Net sales from the Company's core maternity business increased 18.8% from \$213.2 million in fiscal 1997 to \$253.3 million in fiscal 1998. At September 30, 1998, the Company operated 583 maternity stores and leased departments: 285 operating under the Motherhood store concept, 115 under the Pea/Mimi Maternity concept, 60 under the Maternity Works outlet concept and 123 leased maternity departments. Additionally, the Company had 30 stores in the Episode business being operated on its behalf by a liquidator. Pursuant to an asset transfer agreement with The Wet Seal, Inc., a Delaware corporation, the Company agreed to sell its leasehold rights and interests in most of the remaining Episode stores to The Wet Seal, Inc. All remaining stores are scheduled to be sold or closed by the end of the second quarter of fiscal 1999. At September 30, 1997, the Company operated 587 stores and leased departments: 260 operating under the Motherhood store concept, 41 under the Pea concept, 79 under the Mimi Maternity concept, 51 under the Maternity Works outlet concept, 114 leased maternity departments and 42 under the Episode concept.

Gross Profit. Gross profit as a percentage of net sales decreased to 47.1% in fiscal 1998, as compared to 53.9% in fiscal 1997. This decrease was caused primarily by markdowns taken on the Episode product line and a \$10.3 million charge related to the closure of the Episode business. Additionally, the continued growth of the Motherhood sales as a percentage of total sales has contributed to the decrease in gross profit percentage because Motherhood operates at a lower gross profit percentage than the high end (Pea/Mimi) maternity divisions. The Motherhood stores are experiencing substantial increases in comparable-store sales as market share is driven through lower price points.

Selling, General & Administrative Expenses. Selling, general and administrative expenses increased by \$14.8 million or 11.9% in fiscal 1998 as compared to fiscal 1997; however, as a percentage of net sales decreased from 50.4% to 46.6%. The decrease in selling, general and administrative expenses as a percentage of sales is a function of large increases in comparable store sales combined with an effort to better control costs. In addition, during fiscal 1997 the Company recorded a charge of approximately \$1.0 million under Statement of Financial Accounting Standards No. 121 related to leasehold improvements and furniture and equipment at 16 maternity store locations. The dollar increase in fiscal 1998, as compared to fiscal 1997, was primarily due to increases in store

rents, wages and benefits and operating expenses at the store level, which accounted for \$9.1 million, \$7.7 million and \$3.2 million of the increase, respectively. The increases in wages, benefits and rents at the store level resulted from the increased number of stores opened and the related staffing costs.

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Closing and Restructuring Costs. In May 1998, the Company reported that the Board of Directors had instructed management to restructure the Episode(R) non-maternity bridge women's apparel business to eliminate losses from that business. The initial step of the restructuring resulted in closure or conversion of 21 stores, principally Episode outlets. Additionally, the Company retained an advisor to assist in establishing the extent of restructuring necessary. Subsequently, in September, the Company's management announced that the remaining Episode stores would be sold or closed. Costs associated with the closing of Episode include payoff of royalties, severance, store closings, lawyers fees, inventory and other costs incident to the closing. The aggregate charge for closing the Episode business was \$20.9 million of which \$10.3 million was included in cost of goods sold.

Operating Loss. Operating loss for fiscal 1998 was \$9.0 million as compared to operating income in fiscal 1997 of \$2.9 million. Operations were negative due to losses from the Company's Episode division and the restructuring charges of \$20.9 million in fiscal 1998. Fiscal 1997 operations were negatively impacted by \$9.6 million of restructuring charges related to the maternity business. Exclusive of the restructuring and other unusual charges, operating income decreased 4.8% from \$12.5 million in fiscal 1997 to \$11.9 million in fiscal 1998. Operating income was positive in the core maternity business for fiscal years 1998 and 1997.

Interest Expense, Net. Net interest expense increased by \$1.9 million in fiscal year 1998 compared to fiscal year 1997, and as a percentage of sales, decreased from 5.4% to 5.1%. The dollar increase was primarily due to increased short-term borrowings under the line of credit agreement.

Income Taxes. The effective income tax rate was a benefit of 30.1% in fiscal 1998, as compared to a benefit of 25.9% in fiscal 1997. The change in the effective income tax rate was primarily due to the relationship of non-deductible goodwill amortization to loss before income taxes. See Note 11 of "Notes to Consolidated Financial Statements" for the reconciliation of the statutory federal income tax rate to the Company's effective tax rates in fiscal 1998 and 1997.

Year Ended September 30, 1997 and 1996

Net Sales. Net sales in fiscal 1997 increased by \$47.8 million or 24.0%, as compared to fiscal year 1996. This increase was generated primarily by the \$26.6 million increase in Episode sales, and the \$12.8 million net sales increase derived from new, closed, and converted maternity stores. In addition, a 4.3% increase in maternity same store sales, based on 332 stores, accounted for \$6.6 million in increased sales. At September 30, 1997, the Company had 587 stores and leased departments: 260 operating under the Motherhood store concept, 41 under the Pea concept, 79 under the Mimi Maternity concept, 51 under the Maternity Works outlet concept, 114 leased maternity departments and 42 under the Episode concept. At September 30, 1996, the Company had 468 stores and leased departments: 210 operating under the Motherhood store concept, 39 under the Pea

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concept, 50 under the Mimi Maternity concept, 76 under the Maternite concept, 40

under the Maternity Works outlet concept, 26 leased maternity departments and 27 under the Episode concept.

**Gross Profit.** Gross profit as a percentage of net sales decreased to 53.9% in fiscal 1997, as compared to 55.6% in fiscal 1996. The continued growth of the Motherhood sales as a percentage of overall sales has contributed to the decrease in gross profit percentage because Motherhood operates with a lower gross profit percentage from the high end maternity divisions (Pea and Mimi Maternity). In addition, the decrease in gross profit was partially due to an \$0.8 million charge to write-down inventory related to the Company's restructuring and consolidation of its high end maternity business and an increase in factory overhead. Further, gross margin was impacted by a full year of Episode sales, which have generated lower overall margins than the maternity sales due to the high degree of competition in high end bridge women's apparel. The Company anticipates that its gross margins may decrease further as Motherhood and Episode become a more significant part of the overall operations.

**Selling, General & Administrative Expenses.** Selling, general and administrative expenses increased by \$29.1 million or 30.5% in fiscal 1997 as compared to fiscal 1996 and, as a percentage of net sales, increased from 47.9% to 50.4%. The increase as a percentage of sales was primarily due to higher wages and rents necessary to operate the Episode stores, as compared to the maternity stores, and a \$1.3 million increase in royalty expense to license the Episode trademark. Royalty expense increased due to a full year of Episode sales in fiscal 1997 compared with four months of sales in fiscal 1996. In addition, during fiscal 1997 the Company recorded a charge of approximately \$1.0 million under Statement of Financial Accounting Standards No. 121 related to leasehold improvements and furniture and equipment at 16 store locations. The dollar increase in fiscal 1997, as compared to fiscal 1996, was primarily due to increases in store rents, wages and benefits and operating expenses at the store level, which accounted for \$9.1 million, \$7.7 million and \$3.2 million of the increase, respectively. The increases in wages and benefits and rents at the store level resulted from the increased number of stores opened and acquired and the related staffing costs. In addition, higher advertising, shipping, depreciation and amortization, and corporate wages contributed \$6.2 million to the increase in selling, general, and administrative expenses. These expenses increased due to the continued expansion of operations as a result of new store rollouts.

**Restructuring Costs.** In April 1997, the Company reported that it would combine the Mimi Maternity and Maternite over-lapping product styles and close approximately 30 retail locations serviced by other company stores. Restructuring costs of \$5.6 million, related to the restructuring of the Company's core high end maternity business, were charged in the second quarter of fiscal 1997. The restructuring costs consist primarily of \$2.6 million for the write-off of furniture, fixtures and leasehold improvements, \$1.7 million for lease termination and other costs and \$1.3 million for the write-off of patterns related to over-lapping product styles that will no longer be manufactured by the Company as a result of the Mimi Maternity and Maternite product line consolidation, and thus have no future value.

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**Operating Income.** Operating income in fiscal 1997 was \$2.9 million, or 1.2% of sales, as compared to \$15.4 million, or 7.7% of sales, in fiscal 1996. Fiscal 1997 was impacted by pre-tax charges of \$5.6 million related to restructuring costs as described above, \$2.0 million of other unusual charges for restructuring the Company's core high end maternity business and the operating losses incurred at the Episode division. Other unusual charges consist of \$0.8 million to write down inventory related to the Company's restructuring, \$1.0 million to write down long-lived assets at some of its continuing retail locations and \$0.2 million for certain other costs. Operating income in fiscal 1997 exclusive of restructuring and other unusual charges decreased to \$10.5 million from \$15.4 million in the prior year. This decrease is primarily

attributable to the operating loss in the Episode division. The Company has taken certain initiatives that it believes will help to support the higher selling, general, and administrative expenses of the Episode division. Specifically, the Company continues to introduce new merchandise for the division and provides incentives to sales associates in order to increase Episode revenues. However, there can be no assurances that the Company's actual performance will improve as a result of these steps.

Interest Expense, Net. Net interest expense increased by \$0.6 million in fiscal year 1997 compared to fiscal year 1996, and as a percentage of sales, decreased from 6.3% to 5.4%. The dollar increase was primarily due to short-term borrowings under the line of credit agreement and a reduction of interest income.

Income Taxes. The effective income tax rate was a benefit of 25.9% in fiscal 1997, as compared to a provision of 66.9% in fiscal 1996. The change in the effective income tax rate was primarily due to the relationship of non-deductible goodwill amortization to income (loss) before income taxes. See Note 11 of "Notes to Consolidated Financial Statements" for the reconciliation of the statutory federal income tax rate to the Company's effective tax rates in fiscal 1997 and 1996.

#### Liquidity and Capital Resources

The Company's cash needs have been primarily for debt service, furniture, fixtures and leasehold improvements required to increase the number of retail locations, increased inventories to support the additional locations and building improvements and equipment at its corporate headquarters. In fiscal 1998, the Company's cash sources have primarily been from increases in its borrowings under the line of credit agreement, cash overdrafts and net cash provided by operating activities. At September 30, 1998 the Company had available cash and cash equivalents of \$3.6 million, compared to \$1.7 million at September 30, 1997.

Net cash provided by operating activities was \$0.5 million in fiscal 1998 compared with \$5.2 million in fiscal 1997. The \$0.5 million net cash provided by operating activities in fiscal 1998 includes cash used by the net loss, offset by adjustments for non-cash items of \$24.3 million, less cash used for working capital of \$7.1 million. Non-cash items consisted primarily of \$12.0 million in depreciation and amortization, \$18.2 million of non-cash charges related to closing the Episode business and \$0.9 million provision for deferred rent offset by \$7.5 million of deferred tax benefit

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which will offset future taxable income, but did not generate cash in fiscal 1998. Cash used for working capital in fiscal 1998 consisted of \$4.2 million of Episode assets held for sale, \$7.5 million of prepaid expenses, inventory and accounts receivable offset by a \$2.6 million increase in accounts payable, accrued expenses and other liabilities and a \$2.6 million increase in accrued expenses related to the Episode closure and royalties. In fiscal 1998, inventory levels in the moderate division were increased to facilitate the increasing sales volume.

Net cash used in investing activities decreased from \$12.1 million in fiscal 1997 to \$9.6 million in fiscal 1998. The cash used in investing activities for fiscal 1998 included \$6.9 million used for capital expenditures for new store facilities, primarily Motherhood and Episode, and improvements to existing stores, \$2.5 million for other corporate capital expenditures and \$0.2 million for intangible and other assets. This compares with investing activities for fiscal 1997 of \$11.7 million used for capital expenditures for new store facilities, and \$0.5 million for intangible and other assets.

Net cash provided by financing activities increased \$3.7 million, from

\$7.4 million provided by financing activities in fiscal 1997 to \$11.1 million in fiscal 1997. The \$11.1 million provided by financing activities in fiscal 1998 resulted primarily from \$12 million in borrowings under the line of credit and cash overdraft activity, offset by \$0.9 million in repayment of long-term debt and debt issuance costs. This compares with \$7.4 million provided by financing activities in fiscal 1997 primarily from \$7.9 million in borrowings under the line of credit and cash overdraft activity, partially offset by repayment of \$0.5 million of long-term debt and debt issuance costs.

In April 1998, the Company replaced its existing \$30 million Working Capital Facility with a new Working Capital Facility that expires in April 2001. The new Working Capital Facility increased the Company's borrowing capacity to \$44 million, and reduced interest rates. In addition to the \$44 million available for borrowing and letters of credit, the Company also has an additional \$4 million letter of credit to collateralize an Industrial Revenue Bond. Further, there are no financial covenant requirements unless Aggregate Adjusted Availability, as defined in the Working Capital Facility agreement, falls below \$10 million. In the event that the Aggregate Adjusted Availability falls below \$10 million, then the Company must achieve a Minimum Cash Flow, as defined in the agreement, of not less than zero. Consistent with the previous working capital facility, the new Working Capital Facility is secured by substantially all of the Company's assets. On November 20, 1998 the Company had \$20.7 million in borrowings and \$7.9 million in additional letters of credit issued under the Working Capital Facility, including the \$4.0 million letter of credit collateralizing the Industrial Revenue Bond.

During 1997, the Company restructured its core maternity business by combining the Mimi Maternity and Maternite overlapping product styles and closing 26 stores. In fiscal 1998 this consolidation and the growth in the Motherhood business provided net income which partially offset the net loss produced by the Episode closing and operating losses. In its maternity operations, the Company intends to focus primarily on growing the moderate priced Motherhood business, subject

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to capital and marketplace availability. This business represents the Company's biggest opportunity for growth. Gross margin from Motherhood is typically lower than the remainder of the maternity business and growth in the Motherhood business could result in lower gross margins.

The Company believes that its current cash and working capital positions, available borrowing capacity through the Working Capital Facility and net cash expected to be generated from operations will be sufficient to fund the Company's working capital requirements and required principal and interest payments for fiscal 1999. Based on the Company's fiscal 1999 expansion plan, the Company expects capital expenditures to be less than 60% of the fiscal 1998 amount. There are currently no restrictions on the ability of the Guarantors to transfer funds to the Company in the form of cash dividends, loans or advances other than restrictions imposed by applicable law. The Company believes that the reserves established are sufficient; however, as certain lease terminations remain to be negotiated, no assurance can be given that the Company will not incur additional charges related to such termination.

#### Seasonality

The Company's operations are slightly seasonal with the Company's net sales historically being the lowest in the second fiscal quarter.

#### Inflation

The Company does not believe the relatively moderate levels of inflation which have been experienced in the United States in recent years have had a significant effect on its net sales or profitability. However, there can be no assurance that the Company's business will not be affected by inflation in

the future.

Safe Harbor Statement Under the Private Securities Litigation  
Reform Act of 1995

The Company cautions that any forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) contained in Item 1, Business and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of this Report or made from time to time by management of the Company involve risks and uncertainties, and are subject to change based on various important factors. The following factors, among others, in some cases have affected and in the future could affect the Company's financial performance and actual results and could cause actual results for fiscal 1999 and beyond to differ materially from those expressed or implied in any such forward-looking statements: unanticipated costs associated with the Episode closure, changes in consumer spending patterns, raw material price increases, consumer preferences and overall economic conditions, the impact of competition and pricing, changes in weather patterns, availability of suitable store locations at appropriate terms and consequent changes in store opening plans, continued availability of capital and financing, ability to develop merchandise and ability to hire and train associates,

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changes in fertility and birth rates, political stability, currency and exchange risks and changes in existing or potential duties, tariffs or quotas, postal rate increases and charges, paper and printing costs, and other factors affecting the Company's business beyond the Company's control.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The analysis below presents the sensitivity of the market value of the Company's financial instruments to selected changes in market rates. The range of changes chosen reflects the Company's view of changes which are reasonably possible over a one-year period. The Company's financial instruments consists principally of its debt portfolio. The market value of the debt portfolio is referred to below as the "Debt Value". The Company believes that market risk exposure on other financial instruments is immaterial.

At September 30, 1998, the principal components of the Company's debt portfolio are Senior Unsecured Exchange Notes (the "Notes") and a Line of Credit (the "Line"), both denominated in US dollars. The Notes bear interest at fixed rate of 125/8 %, and the Line of Credit bears interest at a variable rate, which at September 30, 1998 was 8.5%. While a change in interest rates would not affect the interest incurred or cash flows related to the fixed portion of the debt portfolio, the Debt Value would be affected. A change in interest rates on the variable portion of the debt portfolio impacts the interest incurred and cash flows, but does not impact the net financial instrument position.

The sensitivity analysis as it relates to the fixed portion of the Company's debt portfolio assumes an instantaneous 100 basis point move in interest rates from their levels at September 30, 1998 with all other variables held constant. A 100 basis point increase in market interest rates would result in a decrease in the Debt Value of \$0.9 at September 30, 1998. A 100 basis point decrease in market interest rates would result in a \$0.9 increase in the Debt Value at September 30, 1998.

Based on the variable rate debt included in the Company's debt portfolio at September 30, 1998, a 100 basis point increase in interest rates would result in an additional \$0.2 million of interest incurred per year. A 100 basis point decrease would lower interest incurred by \$0.2 million.

Item 8. Financial Statements and Supplementary Data

The Company's consolidated financial statements appear at pages F-1

through F-20, as set forth in Item 14.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

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PART III

Item 10. Directors and Executive Officers of the Registrant

Information concerning directors, appearing under the caption "Election of Directors" in the Company's Proxy Statement (the "Proxy Statement") to be filed with the Securities and Exchange Commission in connection with the Annual Meeting of Stockholders scheduled to be held on January 22, 1999, and information concerning executive officers, appearing under the caption "Item 1. Business - Executive Officers of the Company" in Part I of this Form 10-K, are incorporated herein by reference in response to this Item 10.

Item 11. Executive Compensation

The information contained in the section titled "Executive Compensation" in the Proxy Statement, with respect to executive compensation, and the information contained in the section entitled "Compensation of Directors" with respect to director compensation, are incorporated herein by reference in response to this Item 11.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The information contained in the section titled "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement, with respect to security ownership of certain beneficial owners and management, is incorporated herein by reference in response to this Item 12.

Item 13. Certain Relationships and Related Transactions

The information contained in the section titled "Certain Transactions" of the Proxy Statement, with respect to certain relationships and related transactions, is incorporated herein by reference in response to this Item 13.

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PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) (1) Financial Statements

The financial statements listed in the accompanying Index to

Consolidated Financial Statements are filed as part of this Form 10-K, commencing on page F-1.

- (2) Schedules  
None.
- (3) Exhibits

Exhibit No.	Description
*3.1	Amended and Restated Certificate of Incorporation of the Company (effective March 10, 1993) (Exhibit 3.3 to the Company's Registration Statement on Form S-1, Registration No. 33-57912, dated February 4, 1993 (the "1993 Registration Statement")).
*3.2	By-Laws of the Company (Exhibit 3.5 to the Company's Annual Report on Form 10-K for the year ended September 30, 1993 (the "1993 Form 10-K")).
*4.1	Certificate of Designations for the Series A Cumulative Convertible Preferred Stock of the Company (Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1995 (the "June 1995 10-Q")).
*4.2	Indenture dated as of August 1, 1995 from the Company to Society National Bank, as Trustee (Exhibit 4.1 to the June 1995 10-Q).
*4.3	Specimen certificate representing shares of the Company's common stock with legend regarding Preferred Stock Purchase Rights. (Exhibit 4.2 to the October 1995 8-K).

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Exhibit No.	Description
*4.4	Amended and Restated Rights Agreement, dated as of March 17, 1997, between the Company and StockTrans, Inc. (incorporated by reference to Exhibit 4.2 to the Company's current report on Form 8-K dated March 17, 1997).
*4.5	Amendment No. 1, dated as of June 4, 1997, to the Amended and Restated Rights Agreement, dated as of March 17, 1997, between the Company and StockTrans, Inc. (Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1997).
*4.6	Registration Rights Agreement, dated as of June 9, 1998, by and among the Company and certain of the Selling Stockholders (Exhibit 4.1 of the Company's Registration Statement on Form S-3, Registration No. 333-59309, dated July 17, 1998).
*4.7	1987 Stock Option Plan (as amended and restated) (Exhibit 4.1 of the Company's Registration Statement on Form S-8, Registration No. 333-59529, dated July 21, 1998).

- \*10.1 Registration Rights and Right of Co-Sale Agreement dated as of May 4, 1992 among the Company, Dan W. Matthias, Rebecca C. Matthias, Meridian Venture Partners, Penn Janney Fund, Inc., Apex Investment Fund, L.P., Meridian Capital Corp., Butcher & Singer/Keystone Venture II, L.P., G-2 Family Partnership, PIISC - Penn Venture Fund, John L. Plummer, Gail G. Davis, Milton S. Stearns Jr., Trustee U/D/T dated 12/20/88, Stevan Simich, Growth Investors, George P. Keeley, Robert E. Brown Jr., Bruce II. Hooper, John J. Serrell, Charles G. Schiess, Terence Kavanagh and Michael B. Staebler (Exhibit 10.8 to the 1993 Registration Statement).
- \*10.2 Voting Agreement dated as of March 12, 1993 among Rebecca C. Matthias, Dan W. Matthias, Elam M. Hitchner III, Keystone Venture II, L.P., G-2 Family Partnership, Penn Janney Fund, Inc., Apex Investment Fund, L.P. and Meridian Venture Partners (Exhibit 10.10 to the 1993 Registration Statement).
- \*10.3 Termination of Voting Agreement dated September 28, 1995 among Rebecca C. Matthias, Dan W. Matthias, Keystone Venture II, L.P., Penn Janney Fund, Inc., G-2 Family Partnership, Hitchner & Associates Profit Sharing Plan,

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Exhibit No. -----	Description -----
*10.4	Meridian Venture Partners and Apex Investment Fund, L.P. (Exhibit 10.31 to the 1995 Registration Statement).
*10.5	1994 Director Stock Option Plan (Exhibit 10.12 to the Company's Annual Report on Form 10-K for the year ended September 30, 1994 (the "1994 Form 10-K")).
*10.6	Non-Competition and Confidentiality Agreement dated January 28, 1993 between the Company and Lynne Wieder (Exhibit 10.39 to the 1993 Registration Statement).
*10.7	Employment Agreement dated as of July 14, 1994 between the Company and Dan W. Matthias (Exhibit 10.25 to the Company's Current Report on Form 8-K dated January 31, 1994 (the "1994 Form 8-K")).
*10.8	Employment Agreement dated as of July 14, 1994 between the Company and Rebecca C. Matthias (Exhibit 10.26 to the 1994 Form 10-K).
*10.9	Registration Rights Agreement dated as of August 1, 1995 among the Company and Morgan Stanley & Co. Incorporated, Wheat, First Securities, Inc. and Janney Montgomery Scott Inc. (Exhibit 10.2 to the June 1995 10-Q).
*10.10	Credit Agreement dated as of August 1, 1995 between the Company, its subsidiaries and Meridian Bank (Exhibit 10.1 to the June 1995 10-Q).
*10.10	Loan Agreement dated September 1, 1995 between Philadelphia Authority For Industrial Development ("PAID") and the Company (Exhibit 10.26 to the

Company's Registration Statement on Form S-1,  
Registration No. 33-97318, dated October 26, 1995  
(the "1995 Registration Statement").

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Exhibit No.	Description
*10.11	Amendment to Credit Agreement dated September 1, 1995 between the Company, its subsidiaries and Meridian Bank (Exhibit 10.28 to the 1995 Registration Statement).
*10.12	Indenture of Trust dated September 1, 1995 between PAID and Society National Bank (Exhibit 10.29 to the 1995 Registration Statement).
*10.13	Variable/Fixed Rate Federally Taxable Economic Development Bond (Mothers Work, Inc.), Series of 1995, in the aggregate principal amount of \$4,000,000 (Exhibit 10.30 to the 1995 Registration Statement).
*10.14	Second Amendment to Credit Agreement dated January 25, 1996 between the Company, its subsidiaries and Meridian Bank (Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1996).
*10.15	Third Amendment to Credit Agreement dated May 31, 1996 between the Company, its subsidiaries and Meridian Bank (Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1996).
*10.16	Asset Purchase Agreement dated April 25, 1996 among the Company, T3 Acquisition, Inc. and Episode USA, Inc. (Exhibit 2.1 of the Company's Current Report on Form 8-K, dated June 17, 1996 (the "June 1996 8-K)).
*10.17	Trademark License Agreement dated May 31, 1996 between the Company and Episode USA, Inc. (Exhibit 10.1 to the June 1996 8-K).
*10.18	Distribution Agreement dated April 25, 1996 among Topy International Limited, T3 Acquisition, Inc. and the Company (Exhibit 10.2 to the June 1996 8-K).

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Exhibit No.	Description
*10.19	Fourth Amendment to Credit Agreement dated September 30, 1996 between the Company, its subsidiaries and Meridian Bank (Exhibit 10.25 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1996).
*10.20	Residential Lease dated June 28, 1996 between the Company and Daniel & Rebecca Matthias (Exhibit 10.27 to the Company's Annual Report on Form 10-K for the

fiscal year ended September 30, 1996).

- \*10.21 First Amendment to Asset Purchase Agreement dated May 31, 1996 by and among the Company, T3 Acquisition, Inc. and Episode USA, Inc. (Exhibit 10.28 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1996).
- \*10.22 Note dated February 14, 1996 from the Company to PIDC Local Development Corporation (Exhibit 10.29 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1996).
- \*10.23 Installment Sale Agreement dated April 4, 1996 by and between PIDC Financing Corporation and the Company (Exhibit 10.30 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1996).
- \*10.24 Open-End Mortgage dated April 4, 1996 between PIDC Financing Corporation and the Pennsylvania Industrial Development Authority ("PIDA") (Exhibit 10.31 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1996).
- \*10.25 Loan Agreement dated April 4, 1996 by and between PIDC Financing Corporation and PIDA (Exhibit 10.32 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1996).
- \*10.26 Fifth Amendment to Credit Agreement, dated January 31, 1997 between the Company, its subsidiaries and CoreStates Bank (Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the Quarter ended December 31, 1996).

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Exhibit No.	Description
*10.27	Sixth Amendment to Credit Agreement, dated April 16, 1997 between the Company, its subsidiaries and CoreStates Bank (Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1997).
*10.28	Seventh Amendment to Credit Agreement, dated July 31, 1997 between the Company, its subsidiaries and CoreStates Bank (Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the Quarter ended June 30, 1997).
*10.29	Eighth Amendment to Credit Agreement, dated September 30, 1997 between the Company, its subsidiaries and CoreStates Bank (Exhibit 10.36 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1997.)
*10.30	Ninth Amendment to Credit Agreement dated January 30, 1998 between the Company, its subsidiaries and CoreStates Bank (Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the Quarter ended December 30, 1997).
*10.31	Loan and Security Agreement dated as of April 24,

1998 by and among, Mothers Work, Inc., Cave Springs, Inc. and Fleet Capital Corporation (Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 1998).

- 10.32            Asset Transfer Agreement dated as of August 31, 1998 by and between the Company, T3 Acquisition, Inc. and The Wet Seal, Inc.
- 21                Subsidiary of the Company.
- 23                Consent of Arthur Andersen LLP.
- 27                Financial Data Schedule for the fiscal year ended September 30, 1998.

-----  
\* Incorporated by reference.

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(b) Reports filed on Form 8-K during the last quarter of fiscal 1998:

The Company filed three reports on Form 8-K during the last quarter of fiscal 1998. On July 15, 1998, the Company filed a report on Form 8-K regarding its increase in net sales for the month of June, 1998, certain additional changes in conjunction with the previously announced restructuring of Episode, and results of operations for the third quarter of fiscal 1998. On September 16, 1998, the Company filed a report on Form 8-K regarding its announcement of the August 28, 1998 appointment of William A. Schwartz, Jr. to its Board of Directors. On September 23, 1998, the Company filed a report on Form 8-K regarding its September 21, 1998 announcement of its plans to close the remaining Episode division stores.

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#### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report to be

signed on its behalf by the undersigned, thereunto duly authorized, in the City of Philadelphia, Commonwealth of Pennsylvania, on the 18th day of December, 1998.

By: /s/ Dan W. Matthias  
-----  
Dan W. Matthias, Chairman of the Board and Chief Executive Officer

By: /s/ Thomas Frank  
-----  
Thomas Frank, Chief Financial Officer, Vice President-Finance and the principal financial officer

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Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons on December 18th, 1998, in the capacities indicated:

/s/ Dan W. Matthias  
-----  
Dan W. Matthias

Chairman of the Board, Chief Executive Officer and Director, the principal executive officer

/s/ Rebecca C. Matthias  
-----  
Rebecca C. Matthias

President, Chief Operating Officer and Director

/s/ Thomas Frank  
-----  
Thomas Frank

Chief Financial Officer, Vice President - Finance and Chief Accounting Officer, the principal financial officer and principal accounting officer

/s/ Verna K. Gibson  
-----  
Verna K. Gibson

Director

/s/ Joseph A. Goldblum                      Director  
-----  
          Joseph A. Goldblum

/s/ Elam M. Hitchner, III                  Director  
-----  
          Elam M. Hitchner, III

/s/ Walter F. Loeb                          Director  
-----  
          Walter F. Loeb

/s/ William L. Rulon-Miller                Director  
-----  
          William L. Rulon-Miller

/s/ William A. Schwartz, Jr.              Director  
-----  
          William A. Schwartz, Jr.

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MOTHERS WORK, INC. AND SUBSIDIARY

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Mothers Work, Inc.:

We have audited the accompanying consolidated balance sheets of Mothers Work, Inc. (a Delaware corporation) and subsidiary as of September 30, 1997 and 1998, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended September 30, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial

statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Mothers Work, Inc. and subsidiary as of September 30, 1997 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1998, in conformity with generally accepted accounting principles.

/s/ Arthur Andersen LLP

Philadelphia, Pa.  
November 9, 1998

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MOTHERS WORK, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS

	September 30	
	1997	1998
	-----	-----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,665,760	\$ 3,623,003
Receivables-		
Trade	2,781,803	3,422,848
Other	164,334	131,940
Inventories	63,812,590	61,678,014
Deferred income taxes	4,050,980	8,846,921
Prepaid expenses and other	2,695,218	5,992,273
	-----	-----
Total current assets	75,170,685	83,694,999
PROPERTY, PLANT AND EQUIPMENT, net	45,373,439	37,334,250
OTHER ASSETS:		
Deferred income taxes	7,235,600	9,918,455
Goodwill, net of accumulated amortization of \$5,641,275 and \$7,868,499	38,752,184	36,524,960
Deferred financing costs, net of accumulated amortization of \$913,748 and \$1,309,971	3,339,759	3,118,042
Other intangible assets, net of accumulated amortization of \$1,452,446 and \$1,721,223	1,351,221	1,154,801
Other assets	494,632	723,558
	-----	-----
Total other assets	51,173,396	51,439,816
	-----	-----
	\$171,717,520	\$172,469,065
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Line of credit	\$ 11,088,000	\$ 23,095,934
Current portion of long-term debt	648,231	464,408
Accounts payable	17,264,704	14,108,610
Accrued expenses	14,087,057	22,411,762
	-----	-----
Total current liabilities	43,087,992	60,080,714
LONG-TERM DEBT	96,375,620	96,421,707
DEFERRED RENT	3,645,651	3,819,998
ACCRUED DIVIDENDS ON PREFERRED STOCK	2,228,700	3,396,916

COMMITMENTS AND CONTINGENCIES (Note 12)

STOCKHOLDERS' EQUITY:

Series A Cumulative convertible preferred stock, \$.01 par value, \$280.4878 stated value, 2,000,000 shares authorized, 41,000 shares issued and outstanding (liquidation value of \$11,500,000)	11,500,000	11,500,000
Series B Junior participating preferred stock, \$.01 par value, 10,000 shares authorized, none outstanding	--	--
Common stock, \$.01 par value, 10,000,000 shares authorized, 3,564,644 and 3,597,997 shares issued and outstanding	35,646	35,980
Additional paid-in capital	27,740,840	27,995,694
Accumulated deficit	(12,896,929)	(30,781,944)
Total stockholders' equity	26,379,557	8,749,730
	\$171,717,520	\$172,469,065
	=====	=====

The accompanying notes are an integral part of these statements.

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MOTHERS WORK, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended September 30		
	1996	1997	1998
	-----	-----	-----
NET SALES	\$199,179,984	\$246,934,331	\$298,990,616
COST OF GOODS SOLD	88,416,648	113,886,439	158,046,917
Gross profit	110,763,336	133,047,892	140,943,699
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	95,394,902	124,494,747	139,322,385
RESTRUCTURING CHARGES	--	5,617,094	10,634,509
Operating income (loss)	15,368,434	2,936,051	(9,013,195)
INTEREST INCOME	228,255	11,339	--
INTEREST EXPENSE	(12,864,351)	(13,263,418)	(15,180,820)
Income (loss) before income taxes (benefit)	2,732,338	(10,316,028)	(24,194,015)
INCOME TAXES (BENEFIT)	1,828,572	(2,676,945)	(7,477,216)
NET INCOME (LOSS)	903,766	(7,639,083)	(16,716,799)
DIVIDENDS ON PREFERRED STOCK	977,500	1,088,284	1,168,216
NET LOSS APPLICABLE TO COMMON STOCKHOLDERS	\$ (73,734)	\$ (8,727,367)	\$ (17,885,015)
	=====	=====	=====
BASIC NET LOSS PER COMMON SHARE	\$ (.02)	\$ (2.45)	\$ (5.00)
	=====	=====	=====
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	3,269,290	3,562,980	3,577,143
	=====	=====	=====

The accompanying notes are an integral part of these statements.

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MOTHERS WORK, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Series A Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total
BALANCE, SEPTEMBER 30, 1995	\$ 11,500,000	\$ 31,222	\$ 18,101,425	\$ (4,095,828)	\$ 25,536,819
Exercise of stock options	--	197	134,350	--	134,547
Tax benefit from exercise of stock options	--	--	227,396	--	117,485
Sales of common stock, net of expenses	--	2,000	4,394,000	--	4,396,000
Issuance of common stock in connection with acquisition	--	2,174	4,993,223	--	4,995,397
Preferred stock dividends	--	--	--	(977,500)	(977,500)
Net income	--	--	--	903,766	903,766
BALANCE SEPTEMBER 30, 1996	11,500,000	35,593	27,740,840	(4,169,562)	35,106,514
Exercise of stock options	--	--	410	--	410
Exercise of common stock warrants	--	53	(53)	--	--
Preferred stock dividends	--	--	--	(1,088,284)	(1,088,284)
Net loss	--	--	--	(7,639,083)	(7,639,083)
BALANCE, SEPTEMBER 30, 1997	11,500,000	35,646	27,740,840	(12,896,929)	26,379,557
Exercise of stock options	--	66	27,458	--	27,524
Stock issued to senior noteholders	--	268	227,396	--	227,664
Preferred stock dividends	--	--	--	(1,168,216)	(1,168,216)
Net loss	--	--	--	(16,716,799)	(16,716,799)
BALANCE, SEPTEMBER 30, 1998	\$ 11,500,000	\$ 35,980	\$ 27,995,694	\$ (30,781,944)	\$ 8,749,730

The accompanying notes are an integral part of these statements.

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MOTHERS WORK, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended September 30		
	1996	1997	1998
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	\$ 903,766	\$ (7,639,083)	\$ (16,716,799)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities-			
Depreciation and amortization	10,161,531	12,169,900	11,991,958
Noncash portion of restructuring charge	--	3,731,102	7,877,310
Writedown of inventory related to restructuring	--	--	10,289,855
Stock issuance charged to interest expense	--	--	227,664
Imputed interest on debt	103,284	117,147	131,418
Deferred tax liability (benefit)	1,444,151	(2,729,709)	(7,478,796)
Amortization of deferred financing costs	418,737	432,172	394,832
Provision for deferred rent	665,749	891,454	867,318
Changes in assets and liabilities, net of effects from purchases of businesses-			
Decrease (increase) in--			
Receivables	2,986,011	(658,111)	(608,651)
Inventories	(15,879,647)	(6,603,091)	(8,155,179)
Prepaid expenses and other	64,014	(873,235)	(3,525,981)
Increase (decrease) in--			
Accounts payable and accrued expenses	(4,283,509)	5,250,559	4,000,395
Accrued store closing	(2,975,657)	--	--
Other liabilities	977,500	1,088,284	1,168,216
Net cash provided by (used in) operating activities	(5,394,070)	5,177,389	463,560
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of business	(2,442,865)	--	--
Purchases of property, plant and equipment	(13,445,841)	(11,699,625)	(9,350,300)
Increase in intangible and other assets	(1,412,008)	(435,866)	(242,075)
Net cash used in investing activities	(17,300,714)	(12,135,491)	(9,592,375)

-- (continued) --

MOTHERS WORK, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS

-- (continued) --

	Year Ended September 30		
	1996	1997	1998
CASH FLOWS FROM FINANCING ACTIVITIES:			
Increase in line of credit and cash overdrafts, net	\$ 8,638,586	\$ 7,928,940	\$ 12,007,934
Proceeds from issuance of long-term debt	2,340,000	--	--
Repayments of long-term debt	(376,464)	(532,929)	(776,286)
Debt issuance costs	(305,930)	(34,994)	(173,114)
Net proceeds from sales of common stock	4,396,000	--	--
Proceeds from exercise of options and warrants	134,547	410	27,524
	-----	-----	-----
Net cash provided by financing activities	14,826,739	7,361,427	11,086,058
	-----	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(7,868,045)	403,325	1,957,243
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	9,130,480	1,262,435	1,665,760
	-----	-----	-----
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 1,262,435	\$ 1,665,760	\$ 3,623,003
	=====	=====	=====

The accompanying notes are an integral part of these statements.

MOTHERS WORK, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Nature of Business

Mothers Work, Inc. was incorporated in Delaware in 1980 and is a specialty retailer and manufacturer of maternity clothing. The Company operates in 613 retail store locations, including 123 leased departments throughout the United States.

Principles of Consolidation

The consolidated financial statements include the accounts of Mothers Work, Inc. and its wholly owned subsidiary, Cave Springs, Inc (collectively, the Company), as of September 30, 1998. All significant intercompany transactions and accounts have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires 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 the financial statements and the reported amounts of revenues and expenses during the reporting period.

Actual results could differ from those estimates.

#### Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents for the purpose of determining cash flows. At September 30, 1998, cash and cash equivalents include cash on hand, cash in the bank and certificates of deposit. Cash overdrafts of \$5,479,526 and \$3,716,615 are included in accounts payable at September 30, 1997 and 1998, respectively.

#### Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. Inventories manufactured by the Company include the cost of materials, freight, direct labor, manufacturing and distribution overhead.

#### Prepaid Expenses and Other

Advertising costs are charged to expense as incurred or the first time the advertising takes place. Catalog costs are deferred and amortized over the period in which the related catalogs are distributed. Advertising and catalog expenses were \$4,448,821, \$5,722,410 and \$4,652,749 in fiscal 1996, 1997 and 1998, respectively.

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#### Property, Plant and Equipment

Property, plant and equipment are stated at cost. Additions or improvements are capitalized, while repairs and maintenance are charged to expense as incurred. Depreciation and amortization are provided over the estimated useful lives of the assets using the straight-line method. The estimated useful lives are forty years for the building, five to ten years for furniture and equipment and the shorter of the estimated useful life or lease term for leasehold improvements.

#### Intangible Assets

Goodwill, leasehold interests and other intangible assets are amortized over twenty years, the lease term and five to ten years, respectively. Amortization of goodwill, leasehold interests and other intangible assets was \$2,614,796, \$2,604,642 and \$2,580,880 in fiscal 1996, 1997 and 1998, respectively.

#### Valuation of Long-Lived Assets

The Company has adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 121, "Accounting for the Impairment of Long-Lived Assets and For Long-Lived Assets to be Disposed Of," at the beginning of Fiscal 1997. SFAS No. 121 requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that full recoverability is questionable. Management evaluates the recoverability of goodwill and other long-lived assets and several factors are used in the valuation including, but not limited to, management's future operating plans, recent operating results and projected cash flows. An impairment is recognized when future net cash flows for each store are expected to be less than the carrying amount of the assets. The fair value of each store asset is determined based on a forecast of expected cash flows.

#### Deferred Debt Issuance Costs

Deferred debt issuance costs are amortized over the terms of the related debt using the effective interest method. Amortization of deferred debt issuance costs was \$418,737, \$432,172 and \$478,998 in fiscal 1996, 1997 and 1998, respectively.

## Deferred Rent

Rent expense on leases is recorded on a straight-line basis over the lease period. The excess of rent expense over the actual cash paid has been recorded as deferred rent.

## Stock-Based Compensation

The Company measures compensation expense for its stock-based employee compensation plans using the intrinsic value method and provides pro forma disclosure of net income and earnings per share as if the fair value-based method had been applied in measuring compensation expense (see Note 10).

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## Basic Net Loss Per Common Share

The Company has presented net loss per common share for fiscal 1996, 1997 and 1998 pursuant to Statement of Financial Accounting Standards (SFAS) No. 128 "Earnings per Share".

Basic net loss per share was computed by dividing net loss applicable to common stockholders by the weighted average number of shares of Common Stock outstanding for each period presented. Diluted net loss per share has not been presented, since the result is anti-dilutive due to the Company's losses.

## Statement of Cash Flows

In fiscal 1996, 1997 and 1998, the Company paid \$12,137,535, \$12,619,836 and \$14,481,028 in interest, respectively. Income taxes refunded in fiscal 1996 were \$2,524,525. Capital lease obligations of \$508,177 were incurred on equipment leases entered into in fiscal 1998.

The following table lists noncash assets that were acquired and liabilities that were assumed as a result of the Episode acquisition in fiscal 1996 (See Note 2) and the finalization of estimates related to the fiscal 1995 acquisition of A Pea in the Pod, Inc. (Pea) and Motherhood Maternity Shops, Inc. (Motherhood) in 1996 (See Note 2):

	Year Ended September 30, 1996 -----
Noncash Assets:	
Inventories	\$ 2,908,666
Property and equipment	4,798,207
Goodwill	2,308,912
Deferred income taxes	1,006,088
Other assets	98,940
	-----
Net noncash assets acquired	11,120,813
Less- Assumed Liabilities:	
Accounts payable and accrued expenses	(3,682,551)
Common stock issued to seller	(4,995,397)
	-----
Net cash used in investing activities	\$ 2,442,865 =====

## Adoption of New Accounting Standards

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income", which requires that an enterprise report, by major components and as a single total, the change in its net assets during the period from non-owner sources; and SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information", which establishes annual and interim reporting standards for an enterprise's operating segments and related disclosures about its products, services, geographic areas and major customers. Adoption of these

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standards will not impact the Company's consolidated financial position, results of operations or cash flows, and any effect will be limited to the form and content of its financial statements and disclosures. Both statements are effective for fiscal years beginning after December 15, 1997, with earlier application permitted.

2. ACQUISITIONS:

On June 1, 1996, the Company assumed leases, acquired associated assets and inventory of 21 stores of Episode USA Inc. (Episode) for \$7.4 million, including transaction costs. Approximately \$2.4 million was paid in cash and \$5 million was paid through the issuance of 217,365 shares of Mothers Work common stock. The purchase price was allocated to the fair value of the net assets acquired under the purchase method of accounting. No goodwill was recorded in this transaction. In connection with the acquisition, the Company entered into a licensing and distribution agreement with the seller, Topy International, Inc. (Topy). During 1998, the Company decided to close its Episode division (See Note 14) and accrued all remaining costs under the licensing and distribution agreements.

During fiscal 1996 the allocation of the purchase price to the net assets acquired in the acquisitions of Pea and Motherhood was finalized. As a result, approximately \$2,309,000 of additional goodwill was recorded.

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3. INVENTORIES:

	September 30	
	1997	1998
Finished goods	\$ 49,937,709	\$ 47,220,460
Work-in-process	4,123,387	5,329,252
Raw materials	9,751,494	9,128,302
	-----	-----
	\$ 63,812,590	\$ 61,678,014
	=====	=====

4. PROPERTY, PLANT AND EQUIPMENT:

September 30

-----

	1997	1998
	-----	-----
Land	\$ 1,400,000	\$ 1,400,000
Building and improvements	8,966,636	9,263,810
Furniture and equipment	19,189,344	19,068,841
Leasehold improvements	38,201,842	34,248,218
	-----	-----
	67,757,822	63,980,869
Accumulated depreciation and amortization	(22,384,383)	(26,646,619)
	-----	-----
	\$ 45,373,439	\$ 37,334,250
	=====	=====

During fiscal 1997, the Company recorded charges under SFAS No. 121 of approximately \$952,000, related to the impairment of leasehold improvements and furniture and equipment at 16 store locations.

5. ACCRUED EXPENSES:

	September 30	
	1997	1998
	-----	-----
Accrued salaries, wages and employee benefits	\$ 4,692,365	\$ 5,690,173
Accrued interest	2,157,217	2,078,157
Accrued sales tax	1,184,461	1,791,090
Accrued restructuring costs	555,065	4,761,321
Other	5,497,949	8,091,021
	-----	-----
	\$ 14,087,057	\$ 22,411,762
	=====	=====

6. LINE OF CREDIT:

In April 1998, the Company replaced its previously existing \$27 million working capital facility with a new \$44 million working capital facility (the Working Capital Facility) that expires in April 2001. The new Working Capital Facility bears interest at the Base Rate, as defined, plus 25 basis points, or LIBOR plus 225 basis points. At September 30, 1998, the

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interest rate was 8.5%. In addition to the \$44 million available for borrowings and letters of credit, the Company has a \$4 million letter of credit that collateralizes an Industrial Revenue Bond (see Note 7). The facility has no financial covenants provided that the Aggregate Adjusted Availability, as defined, does not fall below \$10 million. At September 30, 1998 the Adjusted Aggregate Availability was approximately \$13,742,000 and the Company was in compliance with all non-financial covenants. If the Aggregate Adjusted Availability is less than \$10 million, then the Company must achieve a Minimum Cash Flow, as defined, of not less than zero. Consistent with the previous working capital facility, the Working Capital Facility is secured by substantially all of the Company's assets.

In fiscal 1997 and 1998, the weighted average interest rates were 9.89% and 8.75%, respectively.

7. LONG-TERM DEBT:

	September 30	
	----- 1997 -----	----- 1998 -----
12-5/8% Senior Unsecured Exchange Notes, due 2005 (less unamortized discount)	\$ 90,336,030	\$ 90,467,447
Industrial Revenue Bonds, interest is variable (5.65% at September 30, 1998), principal due annually through 2020 (collateralized by a \$4 million letter of credit).	3,825,000	3,730,000
Mortgage notes:		
Interest at 3%, principal due monthly to 2011 (collateralized by a \$1 million letter of credit and a second mortgage on certain property and equipment at the Company's headquarters).	1,856,339	1,745,114
Interest at 2%, principal due monthly to 2011 (collateralized by certain equipment at the Company's headquarters).	273,882	256,068
Interest at 4.25%, principal due monthly to 2001 (collateralized by certain equipment at the Company's headquarters).	209,363	152,935
Capital lease obligations	313,237	534,966
Other	210,000	--
	-----	-----
	97,023,851	96,886,115
Less- Current portion	(648,231)	(464,408)
	-----	-----
	\$ 96,375,620	\$ 96,421,707
	=====	=====

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Long-term debt maturities as of September 30, 1998 are as follows:

1999	\$ 464,408
2000	500,776
2001	384,745
2002	261,965
2003	275,700
2004 and thereafter	96,531,074
	-----
	98,481,668
Less- Unamortized discount	(1,532,553)
	-----
	\$96,886,115
	=====

In connection with the acquisition of Motherhood on August 1, 1995, the Company sold 12-5/8% Senior Unsecured Notes due 2005 (the Notes) with a face amount of \$92 million. The Notes were issued at 97.934% of their face amount, resulting in an annual effective interest rate of 13%. Interest on the Notes is payable semiannually in cash on February 1 and August 1. The Notes were issued by Mothers Work, Inc. and are unconditionally guaranteed on a senior basis by each subsidiary (see Note 13). The Notes are redeemable at the option of the Company, in whole or in part, at any time on or after August 1, 2000, at 106.250% of their face amount, plus accrued interest, declining ratably to 100% of their

face amount on and after August 1, 2002, plus accrued interest. In November 1995, the Company completed an exchange offer whereby the Notes were exchanged for 12-5/8% Senior Unsecured Exchange Notes due 2005 which have been registered under the Securities Act of 1933.

#### 8. COMMON AND PREFERRED STOCK:

##### Private Placement

On May 31, 1996, the Company completed a private placement of 200,000 shares of its common stock to a number of institutional investors at \$22.25 per share. The Company used the proceeds to pay the cash portion of the purchase price for the Episode assets (see Note 2), to finance the opening of additional stores and for general working capital purposes.

##### Preferred Stock

In connection with the Motherhood acquisition, the Company issued 41,000 shares of Series A Cumulative Convertible Preferred Stock (the Series A Preferred Stock) with a stated value of \$11.5 million. The Series A Preferred Stock has a preference in liquidation equal to the stated value, plus accrued but unpaid dividends. The Company may redeem (but is under no obligation to do so) the Series A Preferred Stock at any time at a price equal to liquidation preference, subject to certain limitations imposed by the Working Capital Facility and the holders of the Notes.

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The holders of the Series A Preferred Stock are entitled to receive annual cash dividends, which are cumulative to the extent not paid, and compound annually at 8.5%, when declared by the Company's Board of Directors, equal to 8.5% of the stated value. No dividends may be paid on common stock or any other shares of capital stock of the Company ranking junior to the Series A Preferred Stock (other than dividends payable in shares of common stock), until all cumulative and current dividends on Series A Preferred Stock have been declared and paid in full. As of September 30, 1998, accrued dividends on the Series A Preferred Stock were \$3,396,916 and are classified as long-term liabilities.

The Series A Preferred Stock is convertible into shares of common stock (i) between August 1, 2000 and November 1, 2006, at an initial conversion rate (subject to adjustments for stock splits, stock dividends, recapitalizations and similar events) equal to ten shares of common stock for each share of Series A Preferred Stock, or (ii) after November 1, 2006, at an initial conversion rate determined by dividing the aggregate stated value of all shares of Series A Preferred Stock to be converted by 90% of the then-market price of the common stock, as defined. After a holder's exercise of the conversion right under (i) above, the Company may only redeem the Series A Preferred Stock from the proceeds of an equity offering. The limitation on this redemption right may only be modified with the consent of the holders of a majority of the outstanding principal amount of the Notes. Upon any conversion, the holder of the Series A Preferred Stock to be converted is entitled to receive payment of all accrued and unpaid dividends in cash unless the Company is prohibited by limitations contained in the Senior Unsecured Exchange Notes. In the case of a conversion under (i) above, if dividends are not paid in cash, the Company will issue a note with interest at the prime rate, payable beginning one year after the date of conversion. The note will be subordinated to the Notes and will be payable only to the extent permitted under the restrictions contained in the Notes. If the note is not paid by August 1, 2003, then all principal and accrued interest may be converted into that number of shares of common stock determined by dividing the amount due by the then-market price, as defined. In the case of a conversion under (ii) above, if accrued dividends are not paid in cash, then such dividends are convertible into common stock on the same basis as the shares of Series A Preferred Stock.

In connection with the Rights Agreement (see Note 9), the Company authorized

10,000 shares of Series B Junior Participating Preferred Stock (the Series B Preferred Stock). The Series B Preferred Stock can be purchased in units equal to one one-thousandth of a share (the Series B Units) under the terms of the Rights Agreement (see Note 9). The holders of the Series B Units are entitled to receive dividends when and if declared on Common Stock. Series B Units are junior to the Common Stock and Series A Preferred Stock for both dividends and liquidations. Each Series B Unit votes as one share of Common Stock.

#### 9. RIGHTS AGREEMENT:

Under the Rights Agreement, the Company has one Right outstanding for each share of Mothers Work common stock now or hereafter outstanding. Under certain limited conditions as defined in the Rights Agreement, each Right entitles the registered holder to purchase from the Company one Series B Unit at \$85 per share subject to adjustment. The rights expire on October 9, 2005 (the Final Expiration Date).

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On March 17, 1997 the Company entered into an amendment to its Rights Agreement, to provide the independent directors of the Company with some discretion in determining when the Distribution Date (as defined in the Rights Agreement) shall occur and the date until which the Rights may be redeemed. In addition, the Amended and Restated Rights Agreement exempts from its operation any person that acquires, obtains the right to acquire, or otherwise obtains beneficial ownership of 10% or more of the then outstanding shares of Company Common Stock without any intention of changing or influencing control of the Company provided that such person, as promptly as practicable, divests himself or itself of a sufficient number of shares of Common Stock so that such person would no longer be an Acquiring Person.

The Rights are not exercisable until the Distribution Date which will occur upon the earlier of (i) ten business days following a public announcement that an Acquiring Person has acquired beneficial ownership of 10% or more of Mothers Work's outstanding common stock, and ten business days following the commencement of a tender offer or exchange offer that would result in a person or group owning 10% or more of Mothers Work's outstanding common stock, or (ii) such later date as may be determined by action of a majority of the independent directors.

The Rights have certain anti-takeover effects. The Rights will cause substantial dilution to a person or group that attempts to acquire the Company without conditioning the offer on the redemption of the Rights. The rights can be mandatorily redeemed by action of a majority of the independent directors at any time prior to the earlier of the Final Expiration Date and the Distribution Date for \$.01 per right.

Upon exercise and the occurrence of certain events as defined in the Rights Agreement, each holder of a Right, except the Acquiring Person, will have the right to receive Mothers Work common stock or common stock of the acquiring company having a value equal to two times the exercise price of the Right.

#### 10. STOCK OPTION PLANS:

The Company has two stock option plans. Under the Director Stock Option Plan, 2,000 options are granted to each director on an annual basis, and have an exercise price equal to fair market value on the grant date, and immediately vest. Under the 1987 Stock Option Plan, as amended and restated, officers and certain employees may be granted options to purchase the Company's common stock at exercise prices equal to the fair market value of the stock at the date of grant or at other prices as determined by the Compensation Committee of the Board of Directors. Up to a total of 1,425,000 options may be issued under the Plans.

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Options generally vest ratably over 5 years. Stock option activity for all plans was as follows:

	Outstanding Options	Weighted-Average Exercise Price
Balance at September 30, 1995	406,047	\$11.07
Granted	222,000	13.86
Exercised	(19,715)	6.82
Canceled	(85,090)	14.24
Balance at September 30, 1996	523,242	11.89
Granted	180,167	10.02
Exercised	(40)	10.25
Canceled	(33,420)	12.07
Balance at September 30, 1997	669,949	11.38
Granted	183,200	8.45
Exercised	(6,569)	4.81
Canceled	(116,771)	10.06
Balance at September 30, 1998	729,809	\$10.85

Options for 264,319, 348,048 and 452,613 shares were exercisable as of September 30, 1996, 1997 and 1998 respectively.

The Company has adopted the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," but has elected to continue to measure compensation expense in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation expense for stock options has been recognized. Had compensation cost for the Company's stock-based compensation plans been determined in accordance with SFAS No. 123, the Company's net loss applicable to common stockholders would have been increased to the pro forma amounts indicated below. The effect of applying SFAS No. 123 in this pro forma disclosure is not indicative of future amounts. SFAS No. 123 does not apply to awards prior to fiscal year ended September 30, 1996. Additional awards in future years are anticipated.

	1996	1997	1998
Net Loss Applicable to Common Stockholders:			
As reported	\$ (73,734)	\$ (8,727,367)	\$ (17,885,015)
Pro forma	(882,560)	(9,218,623)	(18,817,166)
Basic Net Loss per Common Share:			
As reported	\$ (0.02)	\$ (2.45)	\$ (5.00)
Pro forma	(0.27)	(2.59)	(5.26)

The weighted average fair value of the stock options granted during 1996, 1997 and 1998 was \$9.57, \$6.93 and \$6.15, respectively. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	1996	1997	1998
Dividend yield	none	none	none
Expected price volatility	65.2%	65.2%	71.2%
Risk-free interest rates	6.05%	6.12%	6.11%
Expected lives	7 years	7 years	7.1 years

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The following table summarizes information about stock options outstanding at September 30, 1998:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted-Average Remaining Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$1.67 to \$2.27	8,361	0.3	\$1.67	8,361	\$1.67
\$2.28 to \$4.55	9,555	3.1	\$3.09	9,555	\$3.09
\$4.56 to \$6.83	5,180	5.1	\$6.45	4,380	\$6.30
\$6.84 to \$9.10	106,650	9.1	\$8.01	2,100	\$7.42
\$9.11 to \$11.38	372,816	7.1	\$10.24	253,980	\$10.35
\$11.39 to \$13.65	190,427	6.8	\$13.42	142,187	\$13.39
\$13.66 to \$15.92	12,500	7.3	\$14.50	12,200	\$14.50
\$15.93 to \$18.20	7,500	7.3	\$16.50	3,000	\$16.50
\$18.21 to \$18.75	17,000	5.5	\$18.28	16,400	\$18.26
\$1.67 to \$18.75	729,809	7.1	\$10.85	452,163	\$11.38

At September 30, 1998, warrants are outstanding to purchase 140,123 shares of common stock at an exercise price of \$0.01, these warrants expire on April 5, 2002.

#### 11. INCOME TAXES:

Income taxes (benefit) are comprised of the following:

	Year Ended September 30		
	1996	1997	1998
Current provision (benefit)	\$ 384,421	\$ --	\$ --
Deferred provision (benefit)	1,444,151	(2,676,945)	(7,477,216)
	<u>\$1,828,572</u>	<u>\$ (2,676,945)</u>	<u>\$ (7,477,216)</u>

The reconciliation of the statutory federal rate to the Company's effective income tax rate on the income (loss) before extraordinary item is as follows:

	Year Ended September 30,		
	1996	1997	1998
Statutory tax rate	34.0%	(34.0)%	(34.0)%
State taxes, net of federal benefit	3.7	--	--
Amortization of goodwill	27.3	7.3	3.1
Other	1.9	0.8	--
	<u>66.9%</u>	<u>(25.9)%</u>	<u>(30.9)%</u>

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The deferred tax effects of temporary differences giving rise to the Company's deferred income tax assets are as follows:

	September 30	
	1997	1998
Deferred tax assets:		
Net operating loss carryforwards	\$ 3,400,024	\$7,578,822
Depreciation of property, plant and equipment	3,660,267	6,136,967
Deferred rent	1,234,207	1,285,927
Inventory reserves	687,712	1,006,878
Employee benefit accruals	474,799	303,794
Other accruals	1,045,986	1,909,455
Alternative minimum tax credit carryforward	528,509	528,509
Other	394,591	86,095
	<u>11,426,095</u>	<u>18,836,446</u>
Deferred tax liabilities:		
Prepaid expenses	(111,075)	(32,099)
Other	(28,440)	(38,971)
	<u>\$11,286,580</u>	<u>\$18,765,376</u>

The Company has net operating loss carryforwards for tax purposes of approximately \$23,845,000 which expire in 2009 through 2013, of which \$4,309,000

were acquired in the acquisitions of Pea and Motherhood. The Company also has alternative minimum tax credits of approximately \$529,000 which can be utilized against regular income taxes in the future. While the acquired net operating loss carryforwards are subject to certain annual limitations due to the change in ownership, the Company does not expect the limitations to reduce its ability to ultimately use such carryforwards. The entire tax benefit of the net operating loss carryforwards has been recorded as a deferred income tax asset, as it is more likely than not that it will be realized during the carryforward period. The tax benefit of the acquired net operating loss carryforwards was recorded under the purchase method of accounting.

No valuation allowance has been provided for the net deferred tax assets. Based on the Company's historical levels of taxable income, as adjusted for the restructuring and the nondeductibility of goodwill amortization and the Episode operations, management believes it is more likely than not that the Company will realize the net deferred tax asset at September 30, 1998. Furthermore, management believes the existing net deductible temporary differences will reverse during periods in which the Company generates taxable income. There can be no assurance, however, that the Company will generate taxable earnings or any specific level of earnings in the future.

#### 12. COMMITMENTS AND CONTINGENCIES:

The Company leases its retail facilities and certain equipment under various noncancelable operating leases. Certain of these leases have renewal options. Rent expense, including

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common area maintenance, was \$30,196,546, \$39,022,965 and \$42,738,584 in fiscal 1996, 1997 and 1998, respectively.

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Future minimum lease payments, excluding those related to Episode, as of September 30, 1998 are as follows:

Fiscal 1999	\$ 24,893,680
Fiscal 2000	23,469,509
Fiscal 2001	21,628,888
Fiscal 2002	18,964,225
Fiscal 2003	15,824,882
Fiscal 2004 and thereafter	28,567,507
	-----
	\$133,348,691
	=====

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, in the opinion of the Company, any such liability will not have a material adverse effect on the financial position or operating results of the Company.

In connection with the Pea acquisition, Mothers Work (R.E.), Inc. assumed Pea's outstanding litigation and potential claims. On February 7, 1994, a civil complaint was filed in a United States District Court against Pea and its then-officers and Board of Directors, and its former preferred shareholders.

In October 1997, an agreement in principle to settle the litigation in its entirety was reached. Pursuant to the agreement, Mothers Work, along with its Directors' and Officers Liability Insurance Carrier (Insurance Carrier) agreed to pay \$2,150,000. As part of the agreement, Mothers Work and the Insurance Carrier, on behalf of some of the defendants, agreed to make an initial payment in October 1997 of \$750,000 and \$550,000, respectively, to an escrow agent for the settlement fund once the Stipulation of Settlement is executed. The final \$850,000 was paid by Mothers Work in January 1998.

13. SUBSIDIARY GUARANTORS:

Pursuant to the terms of the indenture relating to the 12-5/8% Senior Unsecured Exchange Notes due 2005, Cave Springs, Inc., a direct subsidiary of Mothers Work, Inc. has, jointly and severally, unconditionally guaranteed the obligations of Mothers Work, Inc. with respect to the Notes. Effective April 22, 1998 the Page Boy Company, Inc. and Mothers Work (R.E.), Inc., the former Guarantors, merged with Mothers Work, Inc. There are no restrictions on the ability of the Guarantor to transfer funds to Mothers Work, Inc. in the form of loans, advances or dividends, except as provided by applicable law.

Accordingly, set forth below is certain summarized financial information (within the meaning of Section 1-02[bb] of Regulation S-X) for the Guarantors, as of and for the year ended September 30, 1997 and 1998:

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	September 30, 1997	September 30, 1998
	-----	-----
Current assets	\$ 4,127,213	\$ 2,865
Noncurrent assets	80,125,458	39,729,143
Current liabilities	3,064,719	--
Noncurrent liabilities	52,539,740	2,520,464

	For the Year Ended September 30,	
	1997	1998
Net sales	\$53,432,799	\$12,997,861
Costs and expenses	39,829,468	59,410
Net income	8,978,198	8,539,372

The summarized financial information for the Guarantor and the former Guarantors has been prepared from the books and records maintained by the Guarantors and the Company. The summarized financial information may not necessarily be indicative of the results of operations or financial position had the Guarantors operated as independent entities. Certain intercompany sales included in the subsidiary records are eliminated in consolidation. Mothers Work, Inc pays all expenditures on behalf of the Guarantor. An amount due to/due from parent will exist at any time as a result of this activity. The summarized financial information includes the allocation of material amounts of expenses such as corporate services, administration and taxes on income. The allocations are generally based on proportional amounts of sales or assets, and taxes on income are allocated consistent with the asset and liability approach used for consolidated financial statement purposes. Management believes these allocation methods are reasonable.

#### 14. RESTRUCTURING CHARGES:

In April 1997, the Company announced a plan to restructure its core maternity business by combining the Mimi Maternity and Maternite overlapping product styles and closing approximately 30 retail locations. Restructuring costs of \$5.6 million were recorded in fiscal 1997 and included approximately \$2.6 for the write-off of furniture, fixtures and leasehold improvements, \$1.7 million for lease termination and other costs and \$1.3 million for the write-off of patterns related to over-lapping product styles that will no longer be manufactured by the Company as a result of the Mimi Maternity and Maternite product line consolidation. At September 30, 1997 and 1998, \$0.6 million and \$0.2 million, respectively, of this restructuring charge remained in accrued expenses. The balances were comprised principally of lease termination fees and other miscellaneous costs.

In addition to the charges discussed above, in March 1997, the Company also recorded a \$0.8 million inventory reserve in cost of goods sold for the

overlapping product lines, a \$0.7 million asset impairment in selling, general and administrative expense for 14 additional facilities and approximately \$0.5 million in selling, general and administrative expense for other occupancy related items.

During fiscal 1997, the Company closed 26 stores in connection with the April 1997 restructuring plan. The Company closed one additional store in fiscal 1998 under this restructuring plan. The net sales and operating income before corporate overhead allocations for the stores closed in fiscal 1997 that are included in the accompanying statement of operations for the year ended September 30, 1997 were \$6,129,576 and \$711,272, respectively.

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In May 1998, the Company announced that, in an effort to eliminate losses from the Episode business, approximately 21 Episode locations would be closed or converted to maternity clothing stores. After initial attempts to eliminate losses from that business were not successful the Company announced in September 1998 that all remaining Episode stores would be closed or converted into maternity clothing stores. In connection with the two announcements, charges totaling \$20,925,000 (\$13,811,000 after consideration of a related tax benefit of \$7,114,000) were recorded, and are reflected in the accompanying consolidated statement of operations as cost of goods sold (\$10,290,000) and restructuring costs (\$10,635,000). The restructuring costs are comprised of \$2.9 million of legal and other fees associated with the transfer of leases, \$7.3 million for losses on fixed assets and leasehold improvements, \$0.2 million for severance, and the remainder for other costs). At September 30, 1998 approximately \$4.6 million of the restructuring costs remains in accrued expenses. Of the \$4.6 million, approximately \$2.1 million relates to losses on purchase commitments for inventory and leasehold improvements, \$2.2 million relates to legal and other fees associated with the transfer of leases, and the remainder is for other miscellaneous charges.

In connection with the closure of the Episode division, the Company signed a definitive agreement to sell 24 of its 30 remaining leasehold locations to The Wet Seal, Inc. for approximately \$2.8 million. The sale, expected to close on December 1, 1998, is subject to customary closing conditions including receipt of required landlord consents and other third party approval. The Company will close or sell the remaining 6 locations by March 31, 1999. At September 30, 1998, the leasehold interests held for sale to Wet Seal are included in prepaid and other assets.

#### 15. EMPLOYMENT AND CONSULTING AGREEMENTS:

The Company has employment agreements with its Chief Executive Officer/Chairman of the Board (CEO), and President/Chief Operating Officer (COO). The CEO and COO have agreements which expire on September 30, 2001. These agreements provide for base compensation of \$350,000 each for fiscal 1999, increasing annually thereafter. On October 1, of each year the term of each agreement automatically extends for successive one year periods extending the expiration date into the third year after the extension. Additionally, the CEO and COO are entitled to an annual cash bonus and stock options based on performance, as defined.

#### 16. RELATED-PARTY ACTIVITY:

The Company paid legal fees of approximately \$680,000, \$470,000 and \$576,000 in fiscal 1996, 1997 and 1998, respectively, to a firm whose partner is a Director of the Company.

#### 17. PROFIT-SHARING PLANS:

The Company has a 401(k) savings plan for full-time employees who have at least

one year of service and are 21 years of age. Employees can contribute up to 15% of their annual salary. The Company may make contributions to the plan, which vest over a five-year period. No Company contributions were made in fiscal 1996, 1997 or 1998.

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In conjunction with the acquisition of Pea, the Company assumed responsibility for Pea's 401(k) Employees' Savings Plan. Employees who have at least one year of service may participate in the plan, and the Company may make contributions to the plan that vest over a four-year period. No Company contributions were made in fiscal 1995 or 1996. The Company terminated this plan in fiscal 1996 by merging the plan into the Mothers Work 401(k) Savings Plan. In conjunction with the acquisition of Motherhood, the Company assumed responsibility for the final distribution and termination of the Motherhood Retirement Savings Plan. The Company expects that final distributions of this plan will be made in fiscal 1999.

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ASSET TRANSFER AGREEMENT

by and between

MOTHERS WORK, INC.

and

THE WET SEAL, INC.

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Dated August 28, 1998

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ASSET TRANSFER AGREEMENT

AGREEMENT (herein called the "Agreement"), made and entered into as of this 31st day of August, 1998, by and between MOTHERS WORK, INC., a Delaware corporation and T3 ACQUISITION, INC., a Delaware corporation (herein individually and collectively called "Seller") and THE WET SEAL, INC., a Delaware corporation (herein called "Buyer").

W I T N E S S E T H:

WHEREAS, Seller is the lessee of a chain of retail stores located in shopping centers, malls and street locations throughout the United States, which it presently operates under the name "Episode"; and

WHEREAS, Seller desires to transfer to Buyer all of Seller's leasehold rights and interests in and to twenty-four (24) of such retail stores, as set forth on Schedule 3.5.1 hereto (each, a "Store" and collectively, the "Stores"), together with (i) all right, title and interest of Seller in and to the leasehold improvements and fixtures located in the Stores, (ii) the furniture, furnishings and equipment (including but not limited to decorations, props, displays, racks, shelving, computers, modems, computer interfaces, "Sensomatic" (or equivalent) equipment and related tags and surveillance equipment and related wiring) located in the Stores and (iii) all right, title and interest of Seller in and to insurance proceeds on account of any damage or destruction of

any of the property described in (i) or (ii) above occurring after the date hereof (except to the extent such proceeds are used to pay, or reimburse Seller for, the costs of such repair or restoration) ((i), (ii) and (iii) being, collectively, "FF&E"), and Buyer desires to acquire same, for the Purchase Price and subject to and in accordance with the terms and conditions set forth herein.

NOW, THEREFORE, the parties hereto agree as follows:

## 1. SUBJECT OF AGREEMENT

1.1. Transferred Assets. Subject to the terms and conditions of this Agreement, Seller shall sell, assign, transfer and convey to Buyer and Buyer shall purchase and acquire from Seller, all of Seller's right, title and interest in and to (i) each of the Store Leases identified on Schedule 3.5.1 (including any security deposited thereunder) and (ii) all FF&E relating to the Store Premises ((i) and (ii) being, collectively, but excluding the Excluded Leases and the FF&E relating thereto, the "Transferred Assets").

1.2. Lease Assignments. Seller, in coordination with Buyer, and in accordance with the provisions of Section 5.5 hereof, shall promptly after the date hereof use its Best Efforts (as defined below) to obtain from the lessor under each Store Lease listed on Schedule 3.5.1 a Lessor's Consent (as defined below). At the Closing, Seller shall assign to Buyer (and Buyer shall assume, pursuant to Section 2.3 hereof) each Store Lease with respect to which a Lessors' Consent shall have been obtained on or before the Closing Date. Each such assignment and assumption shall be evidenced by a Lease Assignment and Assumption mutually executed and delivered by Buyer and Seller in the form of Exhibit B annexed hereto. A Store Lease with respect to which both a Lessor's

Consent is obtained and a Lease Assignment and Assumption is mutually executed and delivered by Buyer and Seller is referred to herein as a "Transferred Lease". In addition, at the Closing Seller shall convey to Buyer the FF&E related to each Transferred Lease that is located in the related Store Premises (and any insurance proceeds on account of damage or destruction thereof after the date of this Agreement except to the extent such proceeds were used to pay, or reimburse Seller for, the costs of such repair or restoration) pursuant to a Bill of Sale in the form of Exhibit C annexed hereto.

1.3. Excluded Assets. The parties acknowledge and agree that Seller is not selling or transferring and Buyer is not buying, receiving or accepting any assets, rights and properties other than the Transferred Assets (any such other assets, rights and properties, the "Excluded Assets"), which Excluded Assets include, without limitation, trademarks and tradenames (including "Episode" and "Daniel and Rebecca"), other intangible assets, inventory accounts receivable, and rights and obligations under license and distribution agreements with Topy International Ltd. and/or its affiliates, all of which are hereby reserved by Seller.

## 2. CONSIDERATION

### 2.1. Purchase Price.

(a) The purchase price to be paid by Buyer to Seller for the Transferred Assets pursuant to this Agreement (the "Purchase Price") shall be \$2,825,000, and shall be paid on the Closing Date.

(b) All payments on account of the Purchase Price or otherwise payable to Seller hereunder shall be paid by wire transfer of immediately available funds to Seller and/or its designees, provided Seller gives Buyer notice of such designees and wiring instructions at least five (5) days prior to the date such payment is due or, if such notice is not given, by certified or official bank check payable directly to the order of Seller.

2.2. Price Adjustments. The Purchase Price shall be reduced, however,

by:

(a) for each Excluded Lease (as defined below), the sum, if any, allocated to such Excluded Lease on Schedule 2.2(a) hereto; and

(b) the amount of any Lease Cure Costs (as defined below) that Buyer may incur on behalf of Seller.

### 2.3. Assumption of Store Leases.

(a) In addition to the payment of the Purchase Price, effective as of the Closing Date Buyer shall assume and agree to pay and perform as and when due all obligations required to be paid or performed on the part of the lessee under each Transferred Lease, for all periods from and after the Closing Date.

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(b) Notwithstanding the foregoing or any other provision to the contrary contained in this Agreement, Buyer shall not be obligated to assume any obligation under any Store Lease (any such Store Lease, and the FF&E relating thereto, an "Excluded Lease") with respect to which (i) the Lessor's Consent is not obtained on or before the Closing Date (subject to Section 5.5.4) or (ii) the Lessor's Consent is obtained, but before the Closing Date there shall occur a default or breach by Seller of the related Store Lease, including but not limited to a breach or default by reason of Seller being (if applicable) a debtor in any bankruptcy or similar proceeding, such breach or default is not waived by the lessor thereunder or cured by Seller before the Closing Date, and Buyer shall elect not to accept an assignment of or assume such Store Lease.

(c) The obligations to be assumed by Buyer with respect to each Transferred Lease are referred to herein collectively as the "Assumed Liabilities". On the Closing Date, Buyer shall execute the Lease Assignment and Assumption with respect to each Transferred Lease to evidence Buyer's assumption of the lessee's obligations under each such Transferred Lease, for all periods from and after the Closing Date.

2.4. Non-Assumption of Liabilities. Except for the Assumed Liabilities, Buyer shall not assume any liabilities or obligations of any kind, nature or description, whether known or unknown, asserted or unasserted, liquidated or unliquidated, direct or indirect, due or to become due, absolute or contingent, of Seller, or relating to the business of Seller whether or not conducted at any of the Store Premises, or relating to the Transferred Assets, including, but not limited to (i) any rents or additional rents or other charges or obligations under any Store Lease relating to any periods prior to the Closing Date (regardless of whether such rents, additional rents, charges or obligations are billed by the lessor or payable by the lessee after the Closing Date), (ii) any rents or additional rents or other charges or obligations under any Excluded Lease, (iii) any liabilities or obligations secured by any Encumbrance on any of the Transferred Assets (all of which Encumbrances are to be released and discharged on the Closing Date as provided in Section 6.2(a)(vi)), and (iv) any liabilities or obligations with respect to any of Seller's employees, including liabilities and obligations under the WARN Act or any similar state or local law (all of the foregoing, the "Non-Assumed Liabilities"). Nothing contained in this Agreement shall require as a condition to Seller's obligations that Seller be released by a lessor from any further liability or obligation under a Store Lease, but the foregoing shall not limit Buyer's indemnification obligation with respect to Assumed Liabilities pursuant to Section 9.3(iii) hereof.

### 3. REPRESENTATIONS AND WARRANTIES OF SELLER

Seller (jointly and severally) represents and warrants, as of the date of this Agreement and as of the Closing Date, as follows:

3.1. Organization; Standing. Seller is a corporation duly organized,

validly existing and in good standing under the laws of the jurisdiction of its incorporation, has all requisite corporate power and authority to own its properties and assets and to carry on its business in the manner now conducted, to execute and deliver this Agreement and all other agreements to be

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executed by it pursuant hereto, and to carry out the provisions of this Agreement, and all other agreements to be executed by it pursuant hereto.

3.2. Execution; Authority; Enforceability. All corporate action on the part of Seller, and their respective officers, directors and stockholders necessary for the authorization, execution and delivery of this Agreement, all other agreements to be executed by Seller pursuant hereto, and the performance of all obligations of Seller hereunder and thereunder has been taken or will be taken prior to the Closing Date; this Agreement and all other agreements to be executed by Seller pursuant hereto have been duly and validly executed and delivered by Seller; and this Agreement and all other agreements to be executed by Seller pursuant hereto constitute valid and legally binding obligations of Seller, enforceable in accordance with their respective terms except (i) as limited by applicable bankruptcy, insolvency, reorganization, moratorium, and other laws of general application affecting enforcement of creditors' rights generally, and (ii) as limited by the availability or non-availability of specific performance, injunctive relief, or other equitable remedies and general principles of equity.

3.3. Governmental Consents. No consent, approval, qualification, order or authorization of, or filing with, any local, state or federal governmental authority is required on the part of Seller in connection with Seller's valid execution, delivery or performance of this Agreement, or any other agreements to be executed by Seller pursuant hereto, which, if not obtained, made or given, could reasonably be expected to have a material adverse effect on Seller's valid execution, delivery or performance of this Agreement, or any other agreements to be executed by Seller pursuant hereto.

3.4. No Conflicts. The execution, delivery, and performance by Seller of this Agreement, any other agreements to be executed by Seller pursuant hereto, and the consummation of the transactions contemplated hereby and thereby (a) will not result in a violation or default of any provision of Seller's respective Certificate of Incorporation or By-Laws, (b) will not be in conflict with or constitute, with or without the passage of time or giving of notice, a material violation or default, or give rise to any material obligation, under (i) any mortgage, indenture, agreement, instrument or contract to which Seller is or on the Closing Date will be a party or by which it or any of the Transferred Assets is or on the Closing Date will be bound or (ii) to the Best Knowledge of Seller, any local, state or federal judgment, order, writ, decree, statute, rule or regulation applicable to any of Seller, and (c) will not result in the creation of any material mortgage, lien, charge, adverse claim or other encumbrance, excluding any lien of a lessor under the terms of the applicable Store Lease ("Encumbrance") upon any of the Transferred Assets, or the acceleration of any indebtedness of or any performance required by Seller with respect to any of the Transferred Assets, except, with respect to clauses (b) and (c) above, for the necessity of obtaining Lessor's Consents. As used herein, the term "Best Knowledge of Seller" shall mean the actual knowledge of Dan Matthias, Rebecca Matthias, Thomas Frank, Lynn Weider and Edward Tress.

3.5. Transferred Assets.

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3.5.1. Store Leases. Seller has delivered or made available to Buyer a

true and complete copy of the lease (and each amendment or supplement thereto) covering each Store (each such store, a "Store Premises") under which Seller is the lessee (each such lease, as so amended or supplemented, a "Store Lease"), and has described each Store Lease on Schedule 3.5.1 by listing the name of the current lessee, the name of the current lessor (by developer and by lessor entity) and the location of the Store Premises covered thereby, the date of the Store Lease (and each amendment or supplement thereto), and the amount of any security deposit held by any lessor pursuant to such Store Lease, if any. Except as disclosed on Schedule 3.5.1:

(a) Seller has provided Buyer with a true and complete copy of each Store Lease (including each amendment or supplement thereto), and Seller does not have any rights in or to the related Store Premises under any instrument or document or under any agreement, written or oral, other than such Store Lease;

(b) Seller is the sole lessee under each Store Lease, and Seller has not granted or permitted nor does there exist any sublease, license or other right of occupancy by any third party with respect to any Store Premises;

(c) each Store Lease is in full force and effect, and has not been assigned (as collateral or otherwise), modified, supplemented or amended;

(d) Seller has not received notice of nor to the Best Knowledge of Seller is there any breach or default by the lessee or any event or condition which, upon the giving of notice, passage of time, or both, would constitute such a breach or default, under any Store Lease, and Seller has not given notice of nor to the Best Knowledge of Seller is there any breach of default by the lessor or any event or condition which, upon the giving of notice, passage of time, or both, would constitute such a breach or default, under any Store Lease;

(e) Seller does not have notice of nor to the Best Knowledge of Seller is there any event or occurrence in the nature of a casualty or condemnation which affects any of the Store Premises (or any building or structure in which a Store Premises is located) to such an extent so as to entitle the lessor or the lessee under the applicable Store Lease to terminate such Store Lease;

(f) Seller has timely and properly exercised the renewal options under the Store Leases listed on Schedule 3.5.1(f) annexed hereto, which renewal options were required to be exercised prior to the date of this Agreement in order to renew the term thereof beyond its current expiration date; and

(g) Seller has paid, or will have paid prior to the Closing Date, all costs of labor and materials with respect to all improvements installed by or on behalf of Seller in or about the Store Premises for which Seller was obligated to pay, and there are no mechanics', materialmen's or similar liens against the Store Premises resulting from any non-payment by Seller or any of Seller's agents.

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3.5.2. FF&E. The FF&E situated at each Store Premises and in current use by Seller is, in the aggregate, in operating condition and in a state of repair sufficient for the conduct of normal operations, subject to any damage or destruction by casualty that may occur between the date of this Agreement and the Closing Date. EXCEPT AS PROVIDED IN THIS SECTION 3.5.2, ALL OF THE FF&E IS BEING SOLD AND TRANSFERRED TO BUYER "AS IS" AND "WHERE IS" AND ALL WARRANTIES, EXPRESS OR IMPLIED, INCLUDING WARRANTIES OF MERCHANTABILITY AND FITNESS OF USE, ARE EXCLUDED FROM THE SALE AND TRANSFER OF THE FF&E. SELLER MAKES NO REPRESENTATIONS OR WARRANTIES OF ANY NATURE WITH RESPECT TO THE PHYSICAL CONDITION OF THE FF&E EXCEPT AS SET FORTH IN THE FIRST SENTENCE OF THIS SECTION 3.5.2.

3.6. Title to Transferred Assets. Seller has (except as disclosed on

Schedule 3.6), and on the Closing Date Seller will have, good and marketable title to the Transferred Assets (other than the Store Leases), in each case free and clear of all Encumbrances. With respect to the Store Leases, Seller holds (except as disclosed on Schedule 3.6), and on the Closing Date Seller will hold, a valid leasehold interest in and to the Store Leases, in each case, free and clear of all Encumbrances. There are not, and on the Closing Date there will not be, any outstanding agreements, options, commitments or rights with, to or in any third party to acquire any of the Transferred Assets.

3.7. FIRPTA. Seller is not a "foreign person" as defined in Section 1445(f)(3) of the Internal Revenue Code of 1986, as amended (the "Code"). At each Closing, Seller shall deliver to Buyer the certificate required by Section 1445 of the Code.

3.8. Compliance with Laws. To the Best Knowledge of Seller, the operation, conduct and ownership of the property and business of Seller at each of the Store Premises at all times has been conducted in substantial compliance with all federal, state and local laws, rules, regulations and ordinances, except to the extent that any noncompliance could not reasonably be expected to have a material adverse effect on the Transferred Assets or on Buyer.

3.9. Litigation. Except as disclosed on Schedule 3.9 hereto, there is no action, suit, arbitration or other legal or administrative proceeding pending or, to the Best Knowledge of Seller, any investigation pending or any action, suit, arbitration or other legal or administrative proceeding or investigation currently threatened, (a) with respect to any of the Transferred Assets or which, if adversely determined, would be likely to have a material adverse effect on the Transferred Assets, or (b) that (i) questions the validity of this Agreement or any other agreements to be executed by Seller pursuant hereto or the right of Seller to enter into this Agreement or such other agreements, or to consummate the transactions contemplated hereby or thereby, or (ii) if adversely determined, would be likely to have a material adverse effect on Seller's ability to perform its obligations under this Agreement or any other agreement to be executed by Seller pursuant hereto. Seller is not a party to or subject to any order, writ, injunction, decree, judgment or other restriction of any federal, state, municipal or other governmental department, commission, board, bureau, agency or instrumentality which has or is reasonably likely to have a material adverse effect on Seller's ability to enter into this Agreement or any other agreement to be executed by Seller pursuant hereto, or to consummate the transactions contemplated hereby or thereby.

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3.10. Insurance. Schedule 3.10 sets forth all insurance maintained by Seller with respect to each of the Store Premises and the FF&E. Such insurance coverage is not less than the insurance coverage required to be maintained by Seller pursuant to the Store Leases.

3.11. Financial Statements. The financial statements of Seller included in Seller's quarterly report on Form 10-Q for the fiscal quarter ended June 30, 1998 and annual report on Form 10-K for the fiscal year ended September 30, 1997 comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the Securities and Exchange Commission with respect thereto, have been prepared in accordance with generally accepted accounting principles ("GAAP") applied on a consistent basis during the period covered and fairly present, in all material respects, the financial position of Seller as of the date thereof and the results of operations and changes in financial position for the period then ended (subject, in the case of unaudited statements, to customary audit adjustments).

#### 4. REPRESENTATIONS AND WARRANTIES OF BUYER

Buyer hereby represents and warrants, as of the date of this Agreement and as of the Closing Date, as follows:

4.1. Organization; Standing. Buyer is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware, has all requisite corporate power and authority to own its properties and assets and to carry on its business in the manner now conducted and as proposed to be conducted, to execute and deliver this Agreement and all other agreements to be executed by it pursuant hereto, and to carry out the provisions of this Agreement, and all other agreements to be executed by it pursuant hereto.

4.2. Execution; Authority; Enforceability. All corporate action on the part of Buyer, its officers, directors and stockholders necessary for the authorization, execution and delivery of this Agreement, all other agreements to be executed by Buyer pursuant hereto, the performance of all obligations of Buyer hereunder and thereunder, has been taken or will be taken prior to the Closing Date; this Agreement and all other agreements to be executed by Buyer pursuant hereto have been duly and validly executed and delivered by Buyer; and this Agreement and all other agreements to be executed by Buyer pursuant hereto constitute valid and legally binding obligations of Buyer, enforceable in accordance with their respective terms except (i) as limited by applicable bankruptcy, insolvency, reorganization, moratorium, and other laws of general application affecting enforcement of creditors' rights generally, and (ii) as limited by the availability or non-availability of specific performance, injunctive relief, or other equitable remedies and general principles of equity.

4.3. Governmental Consents. No consent, approval, qualification, order or authorization of, or filing with, any local, state or federal governmental authority is required on the part of Buyer in connection with Buyer's valid execution, delivery or performance of this Agreement, or any of the other agreements to be executed by Buyer pursuant hereto, which, if not obtained, made or given, could reasonably be expected to have a material adverse effect on Buyer's

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valid execution, delivery or performance of this Agreement, or any other agreements to be executed by Buyer pursuant hereto.

4.4. No Conflicts. The execution, delivery, and performance by Buyer of this Agreement, any other agreements to be executed by Buyer pursuant hereto, and the consummation of the transactions contemplated hereby and thereby (a) will not result in a violation or default of any provision of its Certificate of Incorporation or By-Laws, and (b) will not be in conflict with or constitute, with or without the passage of time or giving of notice, a material violation or default, or give rise to any material obligation, under (i) any mortgage, indenture, agreement, instrument or contract to which Buyer is or on the Closing Date will be a party or by which it or any of its material assets is bound or (ii) to the best knowledge of Buyer, any local, state or federal judgment, order, writ, decree, statute, rule or regulation applicable to Buyer.

4.5. Litigation. There is no action, suit, arbitration, or other legal or administrative proceeding pending or, to the best knowledge of Buyer, any investigation pending or any action, suit, arbitration, or other legal or administrative proceeding or investigation currently threatened against Buyer which (a) questions the validity of this Agreement, the agreements to be executed by Buyer pursuant hereto or the right of Buyer to enter into this Agreement or such other agreements, or to consummate the transactions contemplated hereby or thereby, or (b) if adversely determined, would be likely to have a material adverse effect on Buyer's ability to perform its obligations under this Agreement or any other agreements to be executed by Buyer pursuant hereto. Buyer is not a party to or subject to any order, writ, injunction, decree, judgment or other restriction of any federal, state, municipal or other governmental department, commission, board, bureau, agency, or instrumentality which has or is reasonably likely to have a material adverse effect on Buyer's ability to enter into this Agreement or any other agreement to be executed by

Buyer pursuant hereto, or to consummate the transactions contemplated hereby or thereby.

4.6. Financial Statements. The financial statements of Buyer included in Buyer's quarterly report on Form 10-Q for the fiscal quarter ended April 30, 1998 and annual report on Form 10-K for the fiscal year ended January 31, 1998 comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the Securities and Exchange Commission with respect thereto, have been prepared in accordance with GAAP applied on a consistent basis during the period covered and fairly present, in all material respects, the financial position of Buyer as of the date thereof and the results of operations and changes in financial position for the period then ended (subject, in the case of unaudited statements, to customary audit adjustments).

## 5. CONDUCT AND TRANSACTIONS PRIOR TO CLOSING

5.1. Conduct of Business. Except as otherwise required or permitted by this Agreement or with the prior written consent of Buyer, from the date of this Agreement until the Closing Date, Seller: (a) shall conduct its business and operations at each of the Store Premises in accordance with past practice and in the ordinary course of business (other than in connection with or resulting from the transactions contemplated hereby, including the conduct of a liquidation sale

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at each Store Premises to the extent permitted by the applicable Store Lease or Lessor's Consent and such changes in operations as may be required upon announcement of this transaction); (b) shall not commit or permit any act or omission which constitutes a breach or default, or upon the giving of notice, passage of time, or both, would constitute a breach or default, under any Store Lease, and shall promptly give Buyer a copy of any notice that Seller may receive asserting any breach or default or any act or omission which, upon the giving of notice, passage of time, or both, would constitute a breach or default, under any Store Lease; (c) shall not modify, amend, renew (or exercise any option to renew) or cancel any Store Lease (except as otherwise contemplated by this Section 5.1); (d) unless otherwise directed by Buyer, with respect to a Store Lease for which a Lessor's Consent has been obtained prior to the Closing Date, shall timely and properly exercise any renewal or extension option under any Store Lease which is required to be exercised prior to the Closing Date in order to renew or extend the term thereof beyond its current expiration date; (e) shall not sell, transfer, dispose or encumber any of the Transferred Assets; (f) shall maintain the FF&E used by it in a state of repair reasonably sufficient for the conduct of normal operations, ordinary wear and tear and damage or destruction by casualty excepted; and (g) shall continue to maintain all casualty, liability and other insurance described in Schedule 3.10, and shall use its Best Efforts to collect all insurance proceeds on account of any damage or destruction of any FF&E occurring after the date of this Agreement and apply same to the repair or restoration of the FF&E (or transfer such proceeds to Buyer on the Closing Date to the extent not applied).

5.2. Access to Information. From the date of this Agreement until the Closing Date, Seller shall afford Buyer and its attorneys, accountants and other representatives access, on reasonable notice during normal business hours, and in a manner which will not unreasonably interfere with the operation of Seller's business, and at no charge to Buyer, to all of the Store Premises (after September 21, 1998) and to all of Seller's books, files and records directly relating to the Transferred Assets, to cooperate in the inspection and examination thereof, and shall furnish Buyer and its representatives all information with respect to the Transferred Assets as Buyer or its representatives may reasonably request. No such inspection or examination, however, shall constitute a waiver or relinquishment by Buyer of its right to rely upon Seller's representations, warranties, covenants and agreements as made

herein or pursuant hereto. Any information disclosed to Buyer or its representatives in the course of such examination shall be maintained confidentially pursuant to the Confidentiality Agreement dated July 9, 1998 between Seller and Buyer; which Confidentiality Agreement shall survive the execution and delivery of, or any termination of, or Closing under, this Agreement.

### 5.3. Disclosure.

5.3.1. Public Disclosure. From the date of this Agreement until the Closing Date, no party to this Agreement shall directly or indirectly make or cause to be made any public announcement or issue any public notice in any form with respect to this Agreement or the transactions contemplated hereby, without the consent of the other party except if in the opinion of such party's counsel it is required by the securities laws of the United States or the rules of the New York Stock Exchange or the Nasdaq National Market to make such disclosure, including but not

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limited to disclosure made in connection with any registration statement which may be filed by Buyer or Seller. The parties agree that, to their knowledge (and given based on the advice of their respective counsel and the circumstances prevailing at the date of this Agreement), no such public disclosure is required at the date of this Agreement. The parties acknowledge, however, that such public disclosure may be required based on actions of lessors or other persons following the disclosure of this transaction to the lessors under the Store Leases. The parties agree, to the extent practicable, to provide each other with the opportunity to review and make reasonable comment on and to consult with each other regarding any such public announcement (including the timing thereof) in advance thereof.

5.3.2. Confidentiality. Except as otherwise provided in Section 5.3.1, from the date of this Agreement until sixty (60) days after the Closing Date, each party agrees that the terms and conditions of this Agreement shall be kept strictly confidential and shall not, without the prior written consent of the other party, be disclosed or revealed, in any manner whatsoever, directly or indirectly, in whole or in part, to any lessor or other third party (other than such party's financial advisor, attorney, accountant or other representative). The provisions of this Section shall be inoperative as to any information which is or becomes generally available to the public other than as a result of any breach of these provisions by such party or its representatives. In the event that any party or any person to whom such party furnishes any confidential information is requested or becomes legally compelled (by oral questions, interrogatories, request for information or documents, subpoena, criminal or civil investigative demand or similar process) to disclose any confidential information, such party will provide the other party with prompt written notice so that the other party may seek a protective order or other appropriate remedy and/or waive compliance with the provisions hereof, and such party will cooperate with the other party in any effort the other party undertakes to obtain a protective order or other remedy. In the event that such protective order or remedy is not obtained, or that the other party, in its sole discretion, waives compliance with the provisions hereof, such party will furnish only that portion of the information which is legally required and will use its Best Efforts to obtain reliable assurance that confidential treatment will be accorded the information.

5.4. Further Assurances. Subject to the terms and conditions herein provided, each of the parties hereto agrees to use its Best Efforts to take promptly, or cause to be taken, all actions and to do promptly, or cause to be done promptly, all things necessary, proper or advisable under applicable laws to consummate and make effective the transactions contemplated by this Agreement, and to satisfy all of the conditions to the Closing to be satisfied by such party, including using its Best Efforts to obtain all necessary actions or non-actions, extensions, waivers, consents and approvals from all applicable

governmental entities and third parties, and effecting all necessary registrations and filings. As used in this Agreement, "Best Efforts" shall require the diligent pursuance, in good faith, of the course of action or result stated, but shall not require any party to (x) pay any sum or other consideration or incur or assume any liability or obligation that (i) is not otherwise required pursuant to any of the provisions of this Agreement or (ii) is not otherwise required by law or contract, to be paid, incurred or assumed or (y) commence litigation or take any other legal action. Each of the parties hereto agrees not to take any action or fail to take any action

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that would be likely to cause any representation or warranty contained in this Agreement to cease to be true or accurate or that would be reasonably likely to prevent the performance of any covenant or the satisfaction of any condition contained in this Agreement.

#### 5.5. Lessor's Consents.

5.5.1. Best Efforts to Obtain. Seller shall use its Best Efforts to obtain from the lessor under each Store Lease listed on Schedule 3.5.1 (a) an estoppel certificate and (b) a written consent to:

(i) the assignment of the Store Lease from Seller to Buyer, and the assumption of the Store Lease by Buyer;

(ii) the trade name, signage and use that Buyer proposes for the Store Premises;

(iii) the remodeling of the Store Premises as contemplated by Buyer;

(iv) the prospective waiver of the breach or default, if any, that would occur under the Store Lease in the event of any cessation of Seller's operations at the Store Premises during the 15-day period prior to the Closing hereunder and during Buyer's subsequent remodeling of the Store Premises;

(v) the prospective waiver of the breach or default, if any, that would occur under the Store Lease in the event Seller conducts a liquidation sale at the Store Premises during the period between September 21, 1998 and the Closing Date;

(vi) the waiver of any term or provision in the Store Lease or in any other lease to which such lessor or its affiliate and Buyer or its affiliate are parties (a "radius clause") which prohibits the lessee thereunder or any affiliate thereof from operating, or which restricts the right of the lessee thereunder or any affiliate thereof to operate, any retail store in any geographical area, or which includes the sales of any other retail store in the calculation of any percentage or other rent payable under such Store Lease or other lease, to the extent that such radius clause would be violated by or require any additional payment as a result of Buyer operating the Store Premises or any other store that is operated by Buyer or its affiliate as of the date of this Agreement, or for which Buyer or its affiliate has as of the date of this Agreement entered into or is negotiating to enter into or acquire a lease in anticipation of commencing operations (including the Britches chain which Buyer has agreed to acquire);

(vii) the waiver of any term or provision in the Store Lease which provides that a breach or default under any other lease or agreement to which Buyer is not a party, with or without the passage of time or the giving of notice or both, would constitute a breach or default under the Store Lease;

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(viii) the waiver of any term or provision in the Store Lease that would require Seller to remodel the Store Premises prior to the Closing Date or that would require Buyer to remodel the Store Premises at any time during the term of the Store Lease (other than Buyer's initial remodeling upon taking possession of the Store Premises);

(ix) the waiver, in any such case solely by reason of the assignment of the Store Lease to Buyer, of any term or provision in the Store Lease that would allow or entitle the lessor to recapture any of the space covered by the Store Lease, or, except as contemplated by Section 5.5.3(c) below, that would allow or entitle the lessor to receive any consideration received by Seller hereunder, to increase the rent, security or other monetary obligations or to effect any change in the terms of the Store Lease (including terms applicable to space other than the Store Premises) or to take or that would result in any other action that would have a material adverse effect on the lessee's rights or obligations under the Store Lease; and

(x) the waiver of any term or provision in the Store Lease pursuant to which the trading of Buyer's stock on the Nasdaq National Market could be a breach or default under the Store Lease or deemed to be an assignment of the Store Lease,

(the foregoing (a) and (b), collectively, being a "Lessor's Consent"), provided that except for clause (b)(i) Buyer may elect not to request or seek, or to cease requesting or seeking, or to waive, any of the foregoing provisions of the Lessor's Consent in its sole and absolute discretion. Each Lessor's Consent shall be in substantially the form annexed hereto as Exhibit A (subject to revision to reflect the provisions of any specific Store Lease or to eliminate any provision that is not relevant to the specific Store Lease or that Buyer elects not to request or seek or to cease requesting or seeking or to waive), or otherwise reasonably satisfactory in form and substance to Buyer, and shall be validly executed by the relevant lessor. Buyer also agrees not to unreasonably withhold its approval of any customary changes to the estoppel certificate included in the Lessor's Consent that may be requested by a lessor. Seller agrees to deliver a written request for a Lessor's consent to each lessor within three (3) business days after the date of this Agreement.

5.5.2. Buyer's Cooperation. Buyer shall reasonably cooperate with Seller and use its Best Efforts to assist Seller in Seller's efforts to obtain the Lessor's Consents, which cooperation will include providing such publicly available financial and other information concerning Buyer as a lessor may reasonably request. Buyer also shall use its Best Efforts to negotiate commercially reasonable modifications to the terms of a Store Lease with the lessor if necessary in order to obtain a Lessor's Consent. However, Buyer shall not be required to accept or incur any Additional Lease Costs (as defined below), except as provided in Section 5.5.3(c), or to accept any relocation of any existing Store Premises or other premises leased to Buyer or its affiliate or to agree to enter into or assume a lease or to cancel or modify any lease with respect to any other premises leased to Buyer or its affiliate in order to obtain a Lessor's Consent. If requested by a lessor of a Store Premises, Buyer agrees that it will, in lieu of Seller and Buyer executing and delivering a Lease Assignment and Assumption with respect to such Store Lease, enter into a new lease with such lessor for such Store Premises for the same term, rents and other terms and conditions as the existing Store Lease for such Store Premises, with such modifications as Buyer

may agree in accordance with the provisions of this Section 5.5.2. Seller shall from time to time (but not less often than weekly) furnish Buyer with a detailed status report with respect to Seller's efforts to obtain the Lessor's Consents. Buyer will have the right to participate or to have its representative participate at any meeting with a lessor under a Store Lease to discuss the

proposed assignment or the terms of the Lessor's Consent or actions to be taken in connection therewith. If requested by Buyer, Seller will use its Best Efforts to arrange a meeting for Buyer or its representative with any such lessor for the purpose of discussing with the lessor the proposed assignment or the terms of the Lessor's Consent or actions to be taken in connection therewith. Buyer has informed Seller that it intends to convert, and agrees that if required to obtain the applicable Lessor's Consent it will convert, all of the Stores to "ArdenB" stores, except those Stores numbered 713, 720, 723, 759 and 795 listed on Schedule 3.5.1, which Buyer has informed Seller that it intends to convert to "Wet Seal", "Contempo Casuals" or "Limbo Lounge" stores.

#### 5.5.3. Costs.

(a) Except as expressly set forth in this Agreement, neither Buyer nor Seller shall be required or obligated in order to obtain a Lessor's Consent to pay any sum, incur any liability, take any action to satisfy any net worth requirement, provide any third party or affiliate guaranty, or provide any security or additional security.

(b) Seller shall be obligated to pay, and shall pay when due, all rents and additional rents due and owing under each Store Lease relating to all periods prior to the Closing Date with respect to such Store Lease, and Seller shall be obligated to cure, and shall cure when required, any breach or default under each Store Lease relating to all periods prior to the Closing Date with respect to such Store Lease (all of the foregoing, "Lease Cure Costs"). Buyer reserves the right to pay in accordance with Section 10.1 any Lease Cure Costs that are not paid when due by Seller, and to deduct the actual amount of the Lease Cure Costs paid or incurred by Buyer from the Purchase Price as provided in Section 2.2(b). Buyer shall provide Seller with a statement, in reasonable detail, setting forth any Lease Cure Costs paid or incurred by Buyer, concurrent with the deduction of any such Lease Cure Costs from the Purchase Price. If Buyer shall pay or incur any Lease Cure Costs and the Purchase Price is reduced pursuant to Section 2.2(b) as a result thereof, then such Lease Cure Costs shall be an Assumed Liability for purposes of Section 9.3(iii) hereof.

(c) Each of Buyer and Seller agrees to pay, in accordance with the provisions of this Section 5.5.3(c), the following costs and expenses in connection with obtaining Lessor's Consents ("Shared Costs"): (i) fees and expenses (including but not limited to legal and other professional fees) charged by a lessor that are required by the Store Lease or otherwise are reasonable in connection with evaluating a request for a Lessor's Consent, reviewing preliminary design plans for the remodeling of the Store Premises contemplated by Buyer, or making modifications to the Store Lease requested hereunder ("Lessor Fees") and (ii) the amount of any increase in rent, additional rent or other monetary obligation (including cost-of-living adjustments), whether denominated as rent or otherwise, including but not limited to security (other than security deposited or required to have been deposited by Seller prior to the date of this Agreement) or additional security, repayment of tenant allowances or increases in percentage rent (whether by

increasing the percentage, reducing the breakpoint, or otherwise), that (x) is required by the terms of the Store Lease solely by reason of the assignment of the Store Lease to Buyer or (y) whether or not so required by the terms of the Store Lease, is required by the lessor to be paid or incurred in order to obtain a Lessor's Consent (the foregoing (x) and (y), "Additional Lease Costs"), provided that if any Additional Lease Costs are payable after the Closing Date, the reasonably estimated present value thereof as of the Closing Date (calculated using a discount rate of 8%) shall be the amount included in Additional Lease Costs. Buyer shall not be required or obligated to accept or agree to pay any Additional Lease Costs except that, subject to each party's obligation to pay Shared Costs, up to the maximum, pursuant to this Section 5.5.3(c), Buyer shall accept or agree to pay (i) those Additional Lease Costs described in clause (x) above and (ii) those Additional Lease Costs described in

clause (y) above (provided that Buyer shall not be obligated to accept or agree to pay or incur any Additional Lease Costs described in clause (y) above with respect to a Store Lease if and to the extent that, together with Additional Lease Costs described in clause (x) above with respect to that Store Lease, all Additional Lease Costs with respect to that Store Lease shall exceed the amount set forth opposite such Store Lease on Schedule 5.5.3(c) hereto). Seller shall not have the right to pay or incur any Additional Lease Costs without Buyer's consent. Shared Costs shall be paid one-half each by Buyer and Seller, up to a maximum aggregate sum (for both Buyer and Seller) of \$1,000,000 (i.e., \$500,000 for Buyer and \$500,000 for Seller). Any Shared Costs in excess of \$1,000,000 shall be paid solely by Buyer, provided that Buyer shall not be required to pay or incur more than an additional sum of \$500,000. If any party shall pay or incur Shared Costs in excess of the portion payable by such party pursuant to this Section 5.5.3(c), such party shall be reimbursed by the other party promptly upon request therefor, and in any case on or before the Closing Date (except as otherwise provided in Section 5.5.4), or, with respect to Lessor Fees only, upon any termination of this Agreement prior to the Closing Date; subject in all events to each party's maximum obligation to pay Shared Costs pursuant to this Section 5.5.3(c). Neither party shall be required to pay or incur prior to the Closing Date any Shared Costs consisting of Additional Lease Costs.

5.5.4. Excluded Leases. With respect to any Excluded Lease, the following provisions shall apply:

(a) Unless the lessor with respect to such Store Lease has definitively advised the parties on or before the Closing Date that it is unwilling to grant a Lessor's Consent (on terms and conditions acceptable to Buyer), the parties, for a period of sixty (60) days following the Closing Date, shall continue to cooperate with each other and use their Best Efforts to obtain such Lessor's Consent in accordance with the provisions of this Section 5.5.

(b) If the Lessor's Consent is obtained within sixty (60) days after the Closing Date, then (i) the parties shall make the deliveries required by Sections 6.1 and 6.2 with respect to such Store Lease, effective as of the date such Lessor's Consent is received, (ii) Buyer shall pay Seller the portion of the Purchase Price allocated to such Store Lease on Schedule 2.2(a) hereto (which portion previously had been reduced from the Purchase Price in accordance with

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Section 2.2(a)), and (iii) each party shall reimburse the other, as applicable, for any Shared Costs relating to such Store Lease in accordance with Section 5.5.3(c).

## 6. CLOSING

6.1. Closing Date. The closing of the transaction contemplated by this Agreement (herein called the "Closing") shall take place at the offices of Akin, Gump, Strauss, Hauer & Feld, L.L.P., 590 Madison Avenue, New York, New York, at 10:00 a.m. on December 1, 1998, or on such other date as the parties may mutually agree. The date on which the Closing actually occurs is referred to herein as the "Closing Date."

### 6.2. Deliveries by Seller.

(a) At the Closing, Seller shall deliver, cause to be delivered, or, as applicable, execute and deliver to Buyer the following:

(i) an original fully-executed Lessor's Consent with respect to each Store Lease (other than an Excluded Lease);

(ii) vacant, broom-clean possession of each Store Premises (excluding any Store Premises demised under an Excluded Lease), and of the FF&E located in each Store Premises;

(iii) an instrument of assignment and assumption of lease, duly executed by Seller, with respect to each Store Lease with respect to which a Lessor's Consent has been obtained, in substantially the form annexed hereto as Exhibit B, assigning to Buyer all of the right, title and interest of Seller in and to each Store Lease, free and clear of all Encumbrances (each, a "Lease Assignment and Assumption"); provided, however, that if a lessor under a Store Lease shall require a different form of Lease Assignment and Assumption, (x) such form shall be reasonably satisfactory to counsel for Buyer and Seller and (y) notwithstanding the provisions of any form of assignment, as between Buyer and Seller, Buyer shall not be liable for any obligations of the lessee under any Store Lease relating to any period prior to the Closing Date and Seller shall not be liable for any obligations of the lessee under any Store Lease relating to any period on or after the Closing Date, except as may be otherwise expressly set forth in this Agreement;

(iv) a bill of sale, in substantially the form annexed hereto as Exhibit C, duly executed by Seller, conveying to Buyer all of the right, title and interest of Seller in the FF&E, free and clear of all Encumbrances (the "Bill of Sale");

(v) to the extent in Seller's possession, originals or copies of all Store Leases and all books, records, contracts, agreements, plans, blueprints, operating manuals, warranties and other papers and documents relating to the Transferred Assets;

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(vi) original releases, termination statements or similar instruments as necessary to release, discharge and terminate any Encumbrances on or with respect to any of the Transferred Assets (whether or not disclosed on Schedule 3.6);

(vii) a certified check to the order of Buyer (or a credit against payment of the Purchase Price) in the amount of any unapplied insurance proceeds included in the FF&E and an executed assignment of Seller's right to receive any unpaid or uncollected insurance proceeds included in the FF&E;

(viii) a certified check to the order of Buyer (or a credit against payment of the Purchase Price) in the amount equal to any net Shared Costs to be reimbursed by Seller to Buyer pursuant to Section 5.5.3(c);

(ix) the amount of the net prorations in favor of Buyer pursuant to Section 6.4 hereof; and

(x) all other agreements, instruments, certificates, resolutions, opinions and other documents required to be delivered by Seller on or before the Closing pursuant to this Agreement.

### 6.3. Deliveries by Buyer.

(a) At the Closing, Buyer shall deliver, cause to be delivered, or, as applicable, execute and deliver, to Seller the following:

(i) the Purchase Price to be delivered pursuant to Section 2.1 (subject to adjustment pursuant to Section 2.2);

(ii) the Lease Assignment and Assumption, duly executed by Buyer, with respect to each Store Lease with respect to which a Lessor's Consent has been obtained;

(iii) the amount of the net prorations in favor of Seller and security deposits payable to Seller pursuant to Sections 6.4 and 6.5 hereof;

(iv) the amount equal to any net Shared Costs to be reimbursed by Buyer to Seller pursuant to Section 5.5.3(c); and

(v) all other agreements, instruments, certificates, resolutions, opinions and other documents required to be delivered by Buyer on or before the Closing pursuant to this Agreement.

6.4. Prorations. On the Closing Date, the parties shall pro-rate as of the Closing Date all rents, additional rents and other charges under the respective Store Leases (other than the Excluded Leases). If bills for rents, additional rents or other charges under Store Leases relating to periods prior to the Closing Date have not been received or such prorations otherwise cannot be

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determined at the time provided above, then such prorations shall be determined and made as soon as practicable following the date that such prorations are determinable.

6.5. Security Deposits. On the Closing Date, Buyer shall pay Seller an amount equal to any unapplied cash security deposit held by a lessor under any Transferred Lease. If a security deposit held by a lessor is in the form of a letter of credit, Buyer shall deliver to such lessor either cash or a replacement letter of credit conforming to the provisions of the Store Lease (in which case the parties shall arrange for the release by such lessor of the letter of credit deposited by Seller).

#### 7. CONDITIONS TO BUYER'S OBLIGATIONS AT CLOSING

The obligations of Buyer under this Agreement are subject to the fulfillment on or before the Closing of each of the following conditions, the waiver of which shall not be effective against Buyer unless Buyer gives its consent in writing thereto:

7.1. Representations and Warranties. The representations and warranties of Seller contained in Section 3 shall be true in all material respects on and as of the Closing with the same effect as though such representations and warranties had been made on and as of the date of the Closing (or on the date when made in the case of any representation or warranty which expressly relates to an earlier date), except (a) as otherwise expressly permitted by this Agreement and (b) for changes in such representations and warranties which would not have (i) a material adverse effect on any Store Lease or, taken as a whole, on the FF&E or (ii) a material adverse effect on Seller's valid execution, delivery or performance of this Agreement, or any other agreements to be executed by Seller pursuant hereto.

7.2. Performance. Seller shall have performed and complied in all material respects with all agreements, obligations and conditions contained in this Agreement that are required to be performed or complied with by it on or before the Closing.

7.3. Compliance Certificate. Buyer shall have received at the Closing certificates executed by a senior executive officer of Seller certifying (a) that the conditions specified in Sections 7.1, 7.2, 7.7 and 8.6 have been fulfilled, and (b) the status of Seller's efforts to obtain the Lessor's Consents as of the Closing Date.

7.4. Proceedings and Documents. All corporate and other proceedings in connection with the authorization of the transactions contemplated at the Closing and all documents incident thereto shall be reasonably satisfactory in form and substance to Buyer's counsel, which shall have received all such counterpart original and certified or other copies of such documents as it may reasonably request.

7.5. Opinion of Seller's Counsel. Buyer shall have received from Pepper Hamilton LLP, counsel for Seller, an opinion, dated the date of the Closing, in substantially the form annexed as Exhibit D.

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7.6. No Action or Proceeding. No claim, action, suit, investigation or other proceeding shall be pending which, if adversely determined, would (i) result in an order, writ, injunction or decree prohibiting Buyer from consummating, (ii) grant relief from or against Buyer with respect to, or (iii) render it unlawful for Buyer as of the Closing Date to consummate, the transactions contemplated by this Agreement.

7.7. No Material Adverse Effect. Between the date of this Agreement and the Closing Date, there shall not have occurred any event or condition which has had or may reasonably be expected to have a material adverse effect on all or any material portion of the Transferred Assets.

7.8. Lessor's Consents. The parties shall have received Lessor's Consents with respect to not less than nineteen (19) of the Store Leases (not including Merchandise Mart, with respect to which a Lessor's Consent shall not be required pursuant to this Section 7.8).

#### 8. CONDITIONS TO SELLER'S OBLIGATIONS AT CLOSING

The obligations of Seller to Buyer under this Agreement are subject to the fulfillment on or before the Closing of each of the following conditions, the waiver of which shall not be effective against Seller unless Seller gives its consent in writing thereto:

8.1. Representations and Warranties. The representations and warranties of Buyer contained in Section 4 shall be true in all material respects on and as of the Closing with the same effect as though such representations and warranties had been made on and as of the Closing (or on the date when made in the case of any representation or warranty which expressly relates to an earlier date), except for changes in such representations and warranties which would not have a material adverse effect on Buyer's valid execution, delivery or performance of this Agreement, or any other agreements to be executed by Buyer pursuant hereto.

8.2. Performance. Buyer shall have performed and complied in all material respects with all agreements, obligations and conditions contained in this Agreement that are required to be performed or complied with by it on or before the Closing.

8.3. Compliance Certificate. Seller shall have received at the Closing a certificate executed by a senior executive officer of Buyer certifying that the conditions specified in Sections 8.1, 8.2 and 7.6 have been fulfilled.

8.4. Proceedings and Documents. All corporate and other proceedings in connection with the authorization of the transactions contemplated at the Closing and all documents incident thereto shall be reasonably satisfactory in form and substance to Seller's counsel, which shall have received all such counterpart original and certified or other copies of such documents as it may reasonably request.

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8.5. Opinion of Buyer's Counsel. Seller shall have received from Akin, Gump, Strauss, Hauer & Feld, L.L.P., counsel for Buyer, an opinion, dated the

date of the Closing, in substantially the form annexed as Exhibit E.

8.6. No Action or Proceeding. No claim, action, suit, investigation or other proceeding shall be pending which, if adversely determined, would (i) result in an order, writ, injunction or decree prohibiting Seller from consummating, (ii) grant relief from or against Seller with respect to, or (iii) render it unlawful for Seller as of the Closing Date to consummate, the transactions contemplated by this Agreement.

8.7. Lessor's Consents. The parties shall have received Lessor's Consents with respect to not less than nineteen (19) of the Store Leases (not including Merchandise Mart, with respect to which a Lessor's Consent shall not be required pursuant to this Section 8.7).

## 9. SURVIVAL; INDEMNIFICATION

9.1. Survival Past Closing. Any investigation or examination by Buyer of the business, properties or affairs of the Seller or of the Transferred Assets shall not affect the representations and warranties of Seller contained in Section 3, and the representations and warranties of Seller contained in Section 3 shall survive the Closing for a period of two (2) years, except with respect to the provisions of Sections 3.2 and 3.6 which shall survive until the expiration of any applicable statute of limitations. Any investigation or examination by Seller of the business, properties or affairs of Buyer shall not affect the representations and warranties of Buyer contained in Section 4, and the representations and warranties of Buyer contained in Section 4 shall survive the Closing for a period of two (2) years.

9.2. Indemnification by Seller. From and after the Closing Date, Seller (jointly and severally) shall indemnify, defend and hold harmless Buyer, and each of its officers, directors, parent, subsidiaries and affiliates, from and against any and all liabilities, losses, damages, claims, fines, penalties, costs and expenses (including, without limitation, reasonable attorneys' and accounting fees) incurred by Buyer or any of its officers, directors, parent, subsidiaries or affiliates, arising out of or resulting from (i) any breach of any representation or warranty made by Seller contained in this Agreement, (ii) the nonperformance of any covenant or obligation to be performed by Seller under this Agreement, or (iii) any failure of Seller to pay and perform any Non-Assumed Liabilities.

9.3. Indemnification by Buyer. From and after the Closing Date, Buyer shall indemnify, defend and hold harmless Seller, and each of its officers, directors, subsidiaries and affiliates, from and against any and all liabilities, losses, damages, claims, fines, penalties, costs and expenses (including, without limitation, reasonable attorneys' and accounting fees) incurred by Seller or its officers, directors, parent, subsidiaries or affiliates arising out of or resulting from (i) any breach of any representation or warranty made by Buyer contained in this Agreement, (ii) the nonperformance of any covenant or obligation to be performed by Buyer under this Agreement, or (iii) any failure of Buyer to pay and perform any of the Assumed Liabilities.

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9.4. Limitation. Any claim for indemnification asserted pursuant to Sections 9.2(i) or 9.3(i) shall be subject to the limitation that the Indemnitor (as hereinafter defined) shall not be obligated to indemnify any one or more Indemnitees (as hereinafter defined) with respect to such claim unless and until the aggregate amount of all claims against Indemnitor exceed \$25,000, whereupon Indemnitor shall be subject to a claim for indemnification for the amount of such claim or claims in excess of \$25,000.

9.5. Indemnification Procedures. (a) If either party shall receive notice of any matter which such party, or any of its officers, directors, parent, subsidiaries or affiliates (any of the foregoing, an "Indemnitee"), has determined has given or could give rise to a right of indemnification under this

Agreement, the Indemnitee shall promptly give the indemnifying party (the "Indemnitor") written notice of such claim, stating the amount of the loss, if known, and method of computation thereof, all with reasonable particularity and including documentary proof, if available, and containing a reference to the provisions of this Agreement in respect of which such right of indemnification is claimed or arises; provided, however, that failure to so notify the Indemnitor shall not relieve the Indemnitor from any liability which it may have on account of the claim, except to the extent the Indemnitor shall have been prejudiced by such failure.

(b) If an Indemnitee shall receive notice of any claim by a third party which is or may be subject to indemnification, the Indemnitee shall promptly give the Indemnitor written notice of such claim; provided, however, that failure to so notify the Indemnitor shall not relieve the Indemnitor from any liability which it may have on account of the claim, except to the extent the Indemnitor shall have been prejudiced by such failure. In such event the Indemnitee shall permit the Indemnitor, at its option, to participate in the defense of such third party claim by counsel of its own choice and at its own expense. If, however, the Indemnitor acknowledges in writing its obligation to indemnify the Indemnitee hereunder against all losses that may result from such claim, then the Indemnitor shall be entitled, at its option, to assume and control the defense of such claim by counsel of its own choice and at its own expense; provided that the Indemnitor and its counsel shall proceed with diligence and good faith with respect thereto. Notwithstanding the foregoing, the Indemnitee shall have the right to employ separate counsel in any such claim or proceeding and the fees and expenses of such counsel shall be at the expense of such Indemnitor if: (i) the Indemnitor has failed to promptly assume the defense and employ counsel or (ii) the named parties to any such claim or proceeding (including any impleaded parties) include such Indemnitee and any of the Indemnitors, and such Indemnitee shall have been advised by its counsel that there is a conflict of interest between the Indemnitor and the Indemnitee with respect to such claim or proceeding or with respect to any legal defense which may be available; provided, however that the Indemnitors shall not in such event be responsible here-under for the fees and expenses of more than one firm of separate counsel in connection with any claim or proceeding.

(c) In the event the Indemnitor exercises its right to undertake the defense of any claim by a third party, the Indemnitee shall cooperate with the Indemnitor in such defense and make available to the Indemnitor witnesses, pertinent records, materials and information in its possession or under its control relating thereto as are reasonably requested by the Indemnitor.

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Similarly, in the event the Indemnitee is, directly or indirectly, conducting the defense against any claim by a third party, the Indemnitor shall cooperate with the Indemnitee in such defense and make available to the Indemnitee witnesses, pertinent records, materials and information in its possession or under its control relating thereto as are reasonably requested by the Indemnitee. No claim by a third party may be settled by the Indemnitor without the written consent of the Indemnitee, which consent shall not be unreasonably withheld or delayed; provided, however, that the Indemnitor may settle such claim without the consent of the Indemnitee so long as the settlement includes a written release of the Indemnitee, in form and substance reasonably satisfactory to the Indemnitee, from the claim by the third party claimant. No claim by a third party which is being defended in good faith by the Indemnitee alone, or jointly with the Indemnitor, shall be settled by the Indemnitee without the written consent of the Indemnitor, which consent shall not be unreasonably withheld; provided, however, that the Indemnitee may settle such claim without the consent of the Indemnitor so long as the settlement includes a written release of the Indemnitor, in form and substance reasonably satisfactory to the Indemnitor, from the claim by the Indemnitee and the third party claimant.

10.1. Non-Assumed Liabilities. Seller shall pay and discharge, promptly when due (including all Lease Cure Costs relating to periods prior to the Closing Date), all Non-Assumed Liabilities. If, at Buyer's option, any Non-Assumed Liabilities (including any Lease Cure Costs) relating to the Transferred Assets are paid or discharged by Buyer, Seller shall reimburse Buyer therefor to the extent paid or discharged by Buyer, upon presentation by Buyer of invoices and other documentation reasonably satisfactory to Seller indicating the amounts due (except to the extent the Purchase Price is reduced pursuant to Section 2.2(b)). Notwithstanding the foregoing, Buyer shall not pay or discharge any Non-Assumed Liabilities without the prior written consent of Seller, which consent shall not be unreasonably withheld or delayed, unless the failure to pay or discharge such Non-Assumed Liabilities (including any Lease Cure Costs) could reasonably be expected to have a material adverse effect on Buyer or any of the Store Leases or, taken as a whole, the FF&E, or on the ability of the parties to consummate the transactions contemplated by this Agreement (including the ability of the parties to obtain Lessor's Consents), in which case Buyer shall give notice of such payment or discharge to Seller but no consent of Seller shall be required. To the extent practicable, Buyer will give Seller prior notice of its intention to pay or discharge any Non-Assumed Liabilities (with respect to which Seller's consent is not required hereunder) and the opportunity to settle such matter with the third party prior to payment or discharge thereof by Buyer. The provisions of this Section 10.1 are for the sole benefit of Buyer and its successors, assigns, subsidiaries and affiliates and are not intended, nor shall they be construed, to confer any rights upon any third party.

10.2. Assumed Liabilities. Following the Closing Date, Buyer shall pay and discharge, promptly when due, all of the Assumed Liabilities. Buyer shall pay or discharge such Assumed Liabilities or, at Seller's option, reimburse Seller therefor to the extent paid or discharged by Seller, upon presentation by Seller of invoices and other documentation reasonably satisfactory to Buyer indicating the amounts due. Notwithstanding the foregoing, Seller shall not pay or discharge any Assumed Liabilities without the prior written consent of Buyer, which consent shall

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not be unreasonably withheld or delayed, unless the failure to pay or discharge such Assumed Liabilities could reasonably be expected to have a material adverse effect on Seller, in which case Seller shall give notice of such payment or discharge to Buyer but no such consent shall be required. To the extent practicable, Seller will give Buyer prior notice of its intention to pay or discharge any Assumed Liabilities (with respect to which Buyer's consent is not required hereunder) and the opportunity to settle such matter with the third party prior to payment or discharge thereof by Seller. The provisions of this Section 10.2 are for the sole benefit of Seller and its successors, assigns and affiliates and are not intended, nor shall they be construed, to confer any rights upon any third party.

10.3. Records. After the Closing Date, the parties shall cooperate fully with each other and make available to the other in a timely fashion such files, books and records and other information (relating to the Transferred Assets) as may be reasonably required by any such party for any proper business purpose that is not inconsistent with the terms of this Agreement, including but not limited to any litigation, proceeding or investigation with or involving a third party.

10.4. Further Assurances. Upon request of either party, at any time or from time to time after the Closing Date, the other party will, at no cost to the other party, promptly execute, acknowledge and deliver or cause to be executed, acknowledged and delivered all such other and further instruments, documents or assurances, and promptly do or cause to be done all such other and further things, as may be necessary or required in order to further and more fully consummate the transactions contemplated by this Agreement. Without limiting the generality of the foregoing, Seller agrees that at any time or from

time to time after the Closing Date, upon request of Buyer, Seller will, at no cost to Seller, execute, acknowledge and deliver such other and further instruments of conveyance and transfer and take such other action as Buyer may reasonably require to vest more effectively in Buyer title to any of the Transferred Assets, and Buyer shall reimburse Seller's out-of-pocket expenses in connection therewith.

10.5. Store Lease Renewals. Buyer agrees that in the event that, after the Closing Date, Buyer exercises any renewal or extension option contained as of this date in any Store Lease to extend the term thereof beyond its current expiration date, it will use its Best Efforts (as defined in this Agreement) to obtain the Lessor's release of Seller with respect to any obligations of the lessee under the Store Lease during such renewal or extension term.

## 11. TERMINATION OF AGREEMENT

11.1. Events of Termination. This Agreement may be terminated, and the transactions contemplated hereby may be abandoned, at any time prior to the Closing Date: (i) by the mutual written consent of Seller and Buyer; (ii) by Buyer, if Seller breaches in any material respect any of its representations, warranties, covenants or agreements contained in this Agreement and such breach is not cured to the reasonable satisfaction of Buyer within ten (10) days after notice of such breach is given to Seller; (iii) by Seller, if Buyer breaches in any material respect any of its representations, warranties, covenants or agreements contained in this Agreement and such breach is not cured to the reasonable satisfaction of Seller within ten (10) days after notice of such breach is given to Buyer; or (iv) by either Buyer or Seller, if for any reason (including the failure of any of

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the conditions to Closing to be fulfilled) other than the breach of this Agreement by the terminating party the Closing has not occurred on or prior to December 31, 1998. Each party agrees to give the other notice of any breach (or alleged breach) promptly upon becoming aware thereof.

11.2. Effect of Termination. In the event that either party shall elect to terminate this Agreement pursuant to Section 11.1, this Agreement shall forthwith terminate and have no further effect, and neither party shall have any further obligation or liability hereunder (except with respect to those provisions hereof which by their terms expressly survive any termination of this Agreement). Notwithstanding the foregoing, the termination of this Agreement pursuant to any provision hereof shall not relieve any party of any liability for a breach of any representation or warranty, or nonperformance of any covenant or obligation hereunder; and any such termination shall not be deemed to be a waiver of any available remedy for any such breach or nonperformance.

## 12. NOTICES

Unless otherwise provided, any notice required or permitted under this Agreement shall be given in writing and shall be deemed effectively given upon actual receipt by the party (but not necessarily the individual person) to be notified. Any notice shall be sent by personal delivery, by a nationally recognized overnight courier service or by registered or certified mail, postage prepaid, or by facsimile transmission, and addressed to the party to be notified at the address indicated below for such party, or at such other address as such party may designate upon written notice to the other parties.

In the case of Seller:

Mothers Work, Inc.  
456 North Fifth Street  
Philadelphia, PA 19123  
Attn: Dan W. Matthias,  
Chairman and CEO

Facsimile No.: 215-625-6931

With a copy to:

Pepper Hamilton LLP  
3000 Two Logan Square  
Philadelphia, PA 19103-2799  
Attn: Elam M. Hitchner, III, Esq.  
Facsimile No.: 215-981-4750

In the case of Buyer:

The Wet Seal, Inc.  
26972 Burbank

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Foothill Ranch, CA 92610  
Attn: Edmond S. Thomas, President  
Facsimile No.: 714-770-8609

With a copy to:

Akin, Gump, Strauss, Hauer & Feld, L.L.P.  
590 Madison Avenue  
New York, NY 10022  
Attn: Alan Siegel, Esq.  
Steven H. Scheinman, Esq.  
Facsimile No.: 212-872-1002

### 13. MISCELLANEOUS

13.1. Entire Agreement. This Agreement and the documents referred to herein constitute the entire agreement among the parties with respect to the subject matter hereof, supersede all prior agreements and understandings, written or oral, among the parties with respect thereto (including without limitation the Letter of Intent between Seller and Buyer dated August 7, 1998), and no party shall be liable or bound to any other party in any manner by any promises, conditions, warranties, representations, or covenants except as specifically set forth herein or therein.

13.2. Amendments and Waivers. Any term of this Agreement may be amended and the observance of any term of this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively), only by an instrument in writing and signed by the party against whom such amendment or waiver is sought to be enforced.

13.3. Successors and Assigns. Except as otherwise expressly provided herein, the terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective successors and permitted assigns of the parties. Neither party shall have the right to assign this Agreement or any of its rights or obligations hereunder without the prior written consent of the other. Notwithstanding the foregoing, Buyer shall have the right, upon notice to Seller, to assign its rights and obligations under this Agreement to any affiliate of Buyer, provided (i) such affiliate assumes the obligations of Buyer hereunder, (ii) no such assignment shall release Buyer from any obligations hereunder, (iii) Buyer shall guarantee all obligations of the assignee under any agreement required to be executed and delivered by Buyer to Seller pursuant thereto, and (iv) if necessary in order to obtain a Lessor's Consent, Buyer shall guarantee the obligations of any such affiliate that are assumed pursuant to any Store Lease. Nothing in this Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and assigns any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.

13.4. Governing Law. This Agreement, including the validity hereof and the rights and obligations of the parties hereunder, and all amendments and supplements hereof and all waivers

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and consents hereunder, shall be construed in accordance with and governed by the domestic substantive laws of the State of New York without giving effect to any choice of law or conflicts of law provision or rule that would cause the application of the domestic substantive laws of any other jurisdiction.

13.5. Severability. If any provisions of this Agreement as applied to any part or to any circumstance shall be adjudged by a court to be invalid or unenforceable, the same shall in no way affect any other provision of this Agreement, the application of such provision in any other circumstances or the validity or enforceability of this Agreement.

13.6. Captions. The table of contents, headings and captions used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

13.7. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

13.8. Bulk Sales. The parties hereby waive compliance with any bulk sales law which may be applicable to the transactions contemplated by this Agreement.

13.9. Transaction Taxes. Each of Seller and Buyer shall pay, when due, one-half of any sales or transfer tax required to be paid in connection with the transfer of the Transferred Assets pursuant to this Agreement. The parties shall cooperate with each other with respect to the filing of all sales and transfer tax returns required to be filed with respect to the transactions contemplated by this Agreement, and shall make such joint filings as may reasonably be requested by either party.

13.10. Finders' Fees. Each party represents that it neither is nor will be obligated for any advisory or finders' fee or commission or other compensation in connection with this transaction, other than compensation payable by Seller to Financo, Inc. (the "Advisor") pursuant to separate agreement. Buyer agrees to indemnify and hold harmless Seller from any liability for any commission or compensation in the nature of an advisory or finders' fee (and the costs and expenses of defending against such liability or asserted liability) for which Buyer or any of Buyer's officers, employees, or representatives is responsible. Seller agrees to indemnify and hold harmless Buyer from any liability for any commission or compensation in the nature of an advisory or finders' fee (and the costs and expenses of defending against such liability or asserted liability) for which Seller or any of Seller's respective officers, employees, or representatives is responsible, including any compensation payable to the Advisor. The provisions of this Section 13.10 shall survive any termination of this Agreement.

13.11. Expenses. Irrespective of whether the Closing is effected, and except as provided in Section 5.5.3(c) hereof or otherwise expressly provided herein or therein, each party shall pay all costs and expenses (including, but not limited to, legal and accounting fees and

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expenses) that it incurs with respect to the negotiation and execution of this

Agreement and any other agreements to be executed pursuant hereto, and the performance of any covenants to be performed by such party and satisfaction of any conditions to be satisfied by such party which are contained herein or therein. Without limiting the generality of the foregoing, Seller shall pay the costs of filing or recording any releases, termination statements or similar instruments necessary to discharge any Encumbrances on or with respect to any of the Transferred Assets. The provisions of this Section 13.11 shall survive any termination of this Agreement.

13.12. Attorneys' Fees. If any action at law or in equity is necessary to enforce or interpret the terms of this Agreement or any other agreement or document to be executed or delivered pursuant hereto, the prevailing party shall be entitled to reasonable attorneys' fees, costs and disbursements in addition to any other relief to which such party may be entitled.

13.13. Remedies. In case any one or more of the covenants and/or agreements set forth in this Agreement shall have been breached by any party hereto, the party or parties entitled to the benefit of such covenants or agreements may, except as may otherwise be expressly provided in this Agreement, proceed to protect and enforce their rights either by suit in equity and/or by action at law, including, but not limited to, an action for damages as a result of any such breach and/or an action for specific performance of any such covenant or agreement contained in this Agreement. The rights, powers and remedies of the parties under this Agreement are cumulative and not exclusive of any other right, power or remedy which such parties may have under any other agreement or law. No single or partial assertion or exercise of any right, power or remedy of a party hereunder shall preclude any other or further assertion or exercise thereof.

13.14. Authority. The persons executing this Agreement on behalf of each party represent that they have been duly authorized to execute this Agreement and bind the respective party hereto, and each party shall deliver to the other within seven (7) business days after the date of this Agreement a certified copy of the resolution of its Board of Directors authorizing the execution and delivery of this Agreement.

13.15. Defined Terms. The following terms used in this Agreement shall have the meanings set forth in the corresponding Sections or subsections of this Agreement:

"Additional Lease Costs"	Section 5.5.3(c)
"Advisor"	Section 13.10
"Agreement"	Head Paragraph
"Assumed Liabilities"	Section 2.3(c)
"Best Efforts"	Section 5.4
"Best Knowledge of Seller"	Section 3.4
"Bill of Sale"	Section 6.2
"Closing"	Section 6.1
"Closing Date"	Section 6.1
"Code"	Section 3.7
"Encumbrance"	Section 3.4

"Excluded Assets"	Section 1.3
"Excluded Lease"	Section 2.3(b)
"FF&E"	Second "WHEREAS" Clause
"Non-Assumed Liabilities"	Section 2.4
"GAAP"	Section 3.11
"Lease Assignment and Assumption"	Section 6.2
"Lease Cure Costs"	Section 5.5.3(b)
"Lessor's Consent"	Section 5.5
"Lessor Fees"	Section 5.5.3(c)

"Non-Assumed Liabilities"	Section 2.4
"Purchase Price"	Section 2.1(a)
"radius clause"	Section 5.5.1
"Seller"	Head Paragraph
"Shared Costs"	Section 5.5.3(c)
"Stores"	Second "WHEREAS" Clause
"Store Lease"	Section 3.5
"Store Premises"	Section 3.5
"Transferred Assets"	Section 1.1
"Transferred Lease"	Section 1.2

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IN WITNESS WHEREOF, the parties hereto have executed this Asset Transfer Agreement as of the date first above written.

MOTHERS WORK, INC.

By: /s/ Dan W. Matthias

-----  
Name: Dan W. Matthias  
Title: Chairman and  
Chief Executive Officer

T3 ACQUISITION, INC.

By: /s/ Rebecca C. Matthias

-----  
Name: Rebecca C. Matthias  
Title: President

THE WET SEAL, INC.

By: /s/ Edmond S. Thomas

-----  
Name: Edmond S. Thomas  
Title: President and Chief  
Operating Officer

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SUBSIDIARIES OF THE COMPANY

Name of Subsidiary -----	Jurisdiction of Incorporation -----	Name Under Which Subsidiary Does Business -----
Cave Springs, Inc.	Delaware	Cave Springs

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our report included in this Form 10-K, into the Company's previously filed Registration Statements File Nos. 33-64580, 333-2404, 333-3480, 333-12321, 333-27611, 333-59529 and 333-59309.

Arthur Andersen LLP

Philadelphia, PA  
December 18, 1998

<ARTICLE>

5

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE COMPANY'S ANNUAL 10-K FOR THE PERIOD ENDED SEPTEMBER 30, 1998 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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