Destination Maternity Corp
Form 10-K
December 14, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended September 30, 2010

or

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

For the transition period from to

Commission file number 0-21196

Destination Maternity Corporation

(Exact name of Registrant as specified in its charter)

Delaware	**13-3045573**
(State or other jurisdiction	(IRS Employer

of incorporation or organization)	Identification No.)
456 North Fifth Street,	
Philadelphia, PA	**19123**
(Address of principal executive offices)	(Zip Code)

(215) 873-2200

(Registrant s telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $.01 per share	**The NASDAQ Stock Market LLC**

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

Series B Junior Participating Preferred Stock Purchase Rights

(Title of class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark 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. x

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed using $25.66, the price at which the common equity was last sold as of March 31, 2010 (the last business day of the Registrant s most recently completed second fiscal quarter), was approximately $153,000,000.

On December 6, 2010, there were 6,346,264 shares of the Registrant s common stock, $.01 par value, 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, expected to be held in the second quarter of fiscal 2011, are incorporated by reference into Part III of this Form 10-K.

PART I.

Our fiscal year ends on September 30. All references in this report to our fiscal years refer to the fiscal year ended on September 30 in the year mentioned. For example, our fiscal 2010 ended on September 30, 2010. Unless otherwise indicated, operating data referred to in this report is as of September 30, 2010. As used in this report, retail locations include our stores and leased departments and exclude locations where Kohl s® sells our products under an exclusive product and license agreement, and international franchise locations. As used in this report, stores means our stand-alone stores in the United States, Puerto Rico, Guam and Canada which we operate.

Item 1. Business
Overview

Destination Maternity Corporation (the Company) is the leading designer and retailer of maternity apparel in the United States and is the only nationwide chain of maternity specialty stores. As of September 30, 2010, we operate 1,725 retail locations, including 698 stores in all 50 states, Puerto Rico, Guam and Canada, and 1,027 leased departments located within department stores and baby specialty stores throughout the United States. We are also the exclusive provider of maternity apparel to Kohl s, which operates approximately 1,089 stores throughout the United States. We operate our 698 stores under three retail nameplates: Motherhood Maternity®, A Pea in the Pod® and Destination Maternity®. In addition to our 698 stores, we operate 1,027 maternity apparel departments, which we refer to as leased departments, within leading retailers such as Sears®, Kmart®, Macy s®, Bloomingdale s®, Babies R Us®, Boscov s® and Gordmans®. We are the exclusive maternity apparel provider in each of our leased department relationships. As previously announced, in February 2011 we will significantly expand our leased department relationship with Macy s from our current 115 Macy s locations to over 615 Macy s locations throughout the United States, offering a mix of Motherhood Maternity and A Pea in the Pod branded merchandise. We also are expanding internationally and have entered into exclusive store franchise and product supply relationships in the Middle East and India. As of September 30, 2010, we have 31 international franchised locations, comprised of eight stand-alone stores in the Middle East operated under one of our retail nameplates, and 23 shop-in-shop locations in India, in which we have a Company branded department operated under the Mom & Me retail nameplate owned by our India franchise partner. Finally, we also sell merchandise on the Internet, primarily through DestinationMaternity.com and our various brand-specific websites.

We believe we have maintained our leading position across all major price points of maternity apparel through our four distinct merchandise brands, which enable us to reach a broad range of maternity customers. Through our 698 stores and certain of our leased departments, we offer maternity apparel under our two primary merchandise brands, Motherhood Maternity (Motherhood) at value prices and A Pea in the Pod (Pea) at both contemporary and luxury prices. Our A Pea in the Pod Collection® (Pea Collection) is the distinctive premier maternity line within the A Pea in the Pod brand, featuring exclusive designer label product at luxury prices. We also have two additional value-priced maternity apparel brands: our Oh Baby by Motherhood® collection, which we sell exclusively through Kohl s, and our Two Hearts® Maternity by Destination Maternity® collection, available exclusively at Sears and Kmart stores. Our brands are the exclusive maternity apparel offering in each of these chains.

We believe that one of our key competitive advantages is our ability to fulfill, in a high-service store environment, all of an expectant and nursing mother s clothing needs, including casual and career wear, formal attire, lingerie, sportswear and outerwear, in sizes that cover all trimesters of the maternity cycle. We believe that our vertically-integrated business model enables us to offer the broadest assortment of in-stock, fashionable maternity apparel. We design and contract for the production of approximately 90% of the merchandise we sell using sewing factories located throughout the world, predominantly outside of the United States.

In recent years, we have developed and introduced new multi-brand store concepts to offer merchandise from our various brands in a single location, in order to provide a broader product assortment at multiple price ranges to our customers and to increase average store sales and profitability. We believe the continued rollout of our multi-brand store initiative provides the opportunity for us to improve store operating profit margins over

time by reducing store operating expense percentages through economies of scale, and may increase overall sales in the geographical markets they serve. Our multi-brand stores are operated under our Destination Maternity nameplate, which includes Destination Maternity combo stores (carrying Motherhood Maternity and A Pea in the Pod merchandise) and Destination Maternity superstores, which also carry both our Motherhood and Pea merchandise brands, as well as a significant array of maternity-related products and customer service features. These Destination Maternity stores are larger and have historically had higher average sales than our average store. Opening these Destination Maternity stores will typically involve closing two or more smaller stores and may frequently result in one-time store closing costs resulting primarily from early lease terminations.

We plan to open approximately 10 18 new retail stores during fiscal 2011, of which we expect approximately 9 14 will be new Destination Maternity combo or superstores, with the balance primarily under the Motherhood brand. We estimate that we will close approximately 33 55 stores in fiscal 2011, with approximately 19 27 of these store closings related to the opening of new Destination Maternity stores.

Currently, we operate 36 Motherhood stores in Canada and a Motherhood website under a Canadian URL (MotherhoodCanada.ca). In addition, we believe there is a significant opportunity to develop international sales beyond Canada. We currently have franchise agreements in place in the Middle East and India to expand our business internationally. The initial franchise stores through our arrangement in the Middle East opened during 2009 and, as of September 30, 2010, there are eight of our franchise stores operating in the Middle East. Additionally, beginning during fiscal 2009, we began offering our Motherhood Maternity branded merchandise in maternity shop-in-shops located in our India franchisee s Mom & Me stores. As of September 30, 2010, our merchandise is offered in 23 Mom & Me stores in India.

We believe that our customers, particularly first-time mothers, are entering a new life stage that drives widespread changes in purchasing needs and behavior, thus making our maternity customer and her family a highly-valued demographic for a range of consumer products and services companies. As a result, we have been able to expand and leverage the relationship we have with our customers and generate incremental revenues and earnings by offering other value-added baby and parent-related products and services through a variety of marketing partnership programs utilizing our extensive opt-in customer database and various in-store marketing initiatives.

Destination Maternity Corporation was founded in 1982 as a mail-order maternity apparel catalog. We began operating retail stores in 1985 and completed our initial public offering in 1993. To address multiple price points in maternity apparel and improve operating productivity, we acquired Motherhood and A Pea in the Pod in 1995 and eSpecialty Brands, LLC, or iMaternity , in October 2001. Since the acquisitions of Motherhood and A Pea in the Pod, we have developed and grown these brands along with growing our Destination Maternity brand. Also, since the 1990s we have partnered with other retailers to sell our products through maternity apparel departments within their stores. On December 8, 2008, we changed our corporate name from Mothers Work, Inc. to Destination Maternity Corporation and our Nasdaq® symbol from MWRK to DEST coincident with the name change.

Industry Overview

We are unaware of any reliable external data on the size of the maternity apparel business. We believe that there is an opportunity to grow the industry, and our business, by selling maternity clothes to those pregnant women who currently purchase loose-fitting or larger-sized non-maternity clothing as a substitute for maternity wear. We also believe that our business can grow by reducing the amount of hand-me-down and borrowing associated with maternity apparel, particularly in the value-priced segment. Additionally, although we are not wholly unaffected by external factors (such as fluctuations in the birth rate), we believe that the demand for maternity apparel is relatively stable when compared to non-maternity apparel. Expectant mothers continue to need to replace most of their wardrobe and the current rate of approximately four million United States births per year has remained relatively stable over the last decade. Also, although we are affected by fashion trends, we believe that maternity apparel is less fashion sensitive than women s specialty apparel in general, as demand is driven primarily by the need to replace wardrobe basics as opposed to a desire to add to one s wardrobe in order to meet current fashion trends.

Our Competitive Strengths

We are the leader in maternity apparel. We are the leading designer and retailer of maternity apparel in the United States and are the only nationwide chain of maternity specialty stores. We believe that our brands are the most recognized in maternity apparel. We have established a broad distribution network, with stores in a wide range of geographic areas and retailing venues. In addition, we have a leading position across all major price points of maternity apparel through our retail store nameplates and our merchandise brands. Our exclusive focus on maternity apparel and our leadership position enable us to gain a comprehensive understanding of the needs of our maternity customers and keep abreast of fashion and product developments. We further enhance our leadership position, increase market penetration and build our brands by distributing our products under exclusive leased department and licensed relationships. We are also using the strength of our products, brands and store nameplates in the United States to expand internationally. As of September 30, 2010, we operate 36 stores in Canada and we have 31 international franchised locations, comprised of eight stand-alone stores in the Middle East operated under one of our retail nameplates, and 23 shop-in-shop locations in India, in which we have a Company branded department operated under the Mom & Me retail nameplate owned by our India franchise partner.

We offer a comprehensive assortment of maternity apparel and accessories. A primary consideration for expectant mothers shopping for maternity clothes is product assortment, as pregnant women typically need to replace almost their entire wardrobe. We believe that we offer the widest selection of merchandise in the maternity apparel business. We also offer product for multiple seasons, as pregnant women s clothing needs vary depending on their due date. Our ability to offer a broad assortment of product is due, in large part, to our vertically-integrated business model, which includes our extensive in-house design and contract manufacturing capabilities, as well as our rapid inventory replenishment system.

We are vertically integrated. We design and contract manufacture approximately 90% of the merchandise we sell. We believe that vertical integration enables us to offer the broadest assortment of maternity apparel, to respond quickly to fashion trends and to optimize in-stock levels. We combine our in-house design expertise, domestic and international sourcing capabilities, a rapid inventory replenishment process and extensive proprietary systems to enhance operational and financial results.

We utilize a rapid inventory replenishment system. We are able to offer a wide selection of merchandise in our retail locations due, in large part, to our rapid inventory replenishment system. Our proprietary inventory replenishment system enables us to offer our customers a much broader selection than any of our competitors, without dedicating retail space to back-stock storage. We coordinate the rapid replenishment of inventory for all of our retail locations through our Philadelphia, Pennsylvania distribution centers to meet the individualized needs of our retail locations. Our stores receive shipments from our distribution centers between two and seven times per week. This enables us to maintain a high percentage in-stock merchandise position in each of our stores.

We have proprietary systems that support our business. In order to support our vertically-integrated business model and inventory replenishment system, we have developed a fully integrated, proprietary enterprise resource planning (ERP) system. This system includes our point-of-sale systems, our proprietary merchandise analysis and planning system, our materials requirement planning system, and our web-based, global sourcing and logistics systems. These systems also support our automated picking and sorting systems and other aspects of our logistics infrastructure. We believe that our proprietary systems enable us to offer a broad product assortment, rapidly replenish inventory in our retail locations, and respond quickly to fashion trends.

We are able to obtain prime real estate locations. We believe our ability to lease attractive real estate locations is enhanced due to the brand awareness of our concepts, our multiple price point approach, our highly sought after maternity customer and our real estate management and procurement capabilities. We are the only maternity apparel retailer to provide mall operators with differently priced retail concepts, depending on the mall s target demographics. We are also able to provide a Destination Maternity multi-brand store for malls whose maternity customers seek a wide range of price alternatives. In addition, in the case of multi-mall operators, we have the flexibility to provide several stores across multiple malls. As a result, we have been able

to locate stores in many of what we believe are the most desirable shopping malls in the country and are able to obtain attractive locations within these malls.

We are able to enhance our leadership position by distributing our products under exclusive leased department and licensed relationships. As of September 30, 2010, we operate 1,027 leased departments within leading retailers such as Sears, Kmart, Macy s, Bloomingdale s, Babies R Us, Boscov s and Gordmans. We are also the exclusive provider of maternity apparel to Kohl s pursuant to an exclusive licensed relationship. We believe that we have an opportunity to continue to increase the sales we generate from these ongoing relationships through expanding our relationships with our current partners as well as developing relationships with new partners. Our February 2011 expansion of our leased department relationship with Macy s (through which we will expand from our current 115 Macy s locations to over 615 Macy s locations throughout the United States), and the October 2009 re-launch of our Two Hearts Maternity by Destination Maternity collection in Sears and Kmart are recent examples of how we are continuing to enhance our leadership position through our leased and licensed relationships.

We have a highly experienced management team. We have a management team with significant experience in all aspects of the retail and apparel business, including our Chief Executive Officer & President (CEO), Ed Krell, who has served as a senior executive of the Company for nearly nine years and has nearly 25 years of business experience encompassing apparel, retail, finance and overall management.

Merchandise Brands

We believe that our brands are the most recognized brands in the maternity apparel business. We sell our merchandise under the following four distinct brands:

Brand	Brand Positioning	Typical Apparel Price Range
Motherhood Maternity	Broad assortment of the latest fashions, offering great quality merchandise at everyday low prices	$ 9 $45
A Pea in the Pod	Contemporary, fashion-forward and luxury, offering sophisticated career, as well as fun casual merchandise, including exclusive designer labels	$16 $400
Two Hearts Maternity by Destination Maternity	Select assortment of the latest fashions, offering great quality merchandise at value price points	$ 8 $40
Oh Baby by Motherhood	Select assortment of the latest fashions, offering great quality merchandise at value price points	$ 8 $42 (1)

(1) Kohl s, which sells our Oh Baby by Motherhood brand under an exclusive product and license agreement, sets the prices for this merchandise.

Motherhood Maternity. Our Motherhood Maternity brand serves the value-priced portion of the maternity apparel business, which has the greatest number of customers. The Motherhood brand is positioned with a broad assortment of quality fashion at everyday low prices. We believe that the Motherhood customer shops at moderate-priced department stores and discount stores when she is not expecting.

A Pea in the Pod. Our A Pea in the Pod brand serves both the medium-priced portion and, through our A Pea in the Pod Collection line, the luxury portion of the maternity apparel business. The Pea brand is generally positioned as contemporary, fashion-forward and luxury, with prices ranging from affordable mid-priced to true luxury prices, offering the mom-to-be exceptional contemporary maternity pieces that reflect her uncompromising sense of style in both casual and career apparel. The Pea Collection is the distinctive premier maternity luxury line within the Pea brand, featuring a selection of extraordinary styles along with exclusive designer labels. In our stores which carry A Pea in the Pod brand merchandise, we also offer exclusive maternity versions of select styles from well-known designer and contemporary brands, where we have assisted in

developing these maternity versions. We believe that the typical Pea customer shops at department stores and specialty apparel chains when she is not expecting, with the Pea Collection customer typically shopping at higher-end department stores and luxury designer boutiques when she is not expecting. We believe the Pea brand is the leading luxury maternity brand in the United States. Publicity, including celebrities wearing our clothes, is an important part of the marketing and positioning of the Pea brand.

Two Hearts Maternity by Destination Maternity. Our Two Hearts Maternity by Destination Maternity collection was re-launched in October 2009 at over 600 Sears and Kmart locations throughout the United States through an exclusive leased department relationship, and in September and October 2010 we completed the planned expansion into 217 additional Sears and Kmart locations. This collection delivers the latest in career and casual sportswear as well as dresses, swimwear, lingerie and nursing-friendly sleepwear, all specially designed to complement the pregnant silhouette, with most items priced under $25. The Two Hearts Maternity collection was previously offered in Sears stores from April 2004 through June 2008.

Oh Baby by Motherhood. Our Oh Baby by Motherhood collection was launched in February 2005 at Kohl s stores throughout the United States and on Kohls.com. The Oh Baby by Motherhood collection is available at all Kohl s stores under an exclusive product and license agreement. The collection features a modern assortment of quality fashions, with most items having initial prices (before price promotions) under $40.

Retail Nameplates

We sell maternity apparel through the stores, leased departments and licensed relationships identified in the table below.

Store Nameplate	Description of Target Location	Brand(s) Carried	Typical Apparel Price Range	Average Size (Sq. Ft.)
Stores:				
Motherhood Maternity	Mid-priced and moderate regional malls, strip and power centers, and central business districts	Motherhood	$9 $45	1,800
A Pea in the Pod	Mid-priced and high-end regional malls, lifestyle centers, central business districts and some stand-alone stores in affluent street locations	Pea (including, in some cases, Pea Collection)	$16 $400	2,100
Destination Maternity	Combo stores located in mid-priced regional malls and lifestyle centers	Motherhood; Pea (including, in some cases, Pea Collection)	$9 $400	Combo stores 2,900
	Superstores located primarily in outdoor and power centers and central business districts			Superstores 6,500
Leased Departments:				
Sears	Mid-priced and moderate regional malls	Two Hearts Maternity by Destination Maternity	$8 $40	

Store Nameplate	Description of Target Location	Brand(s) Carried	Typical Apparel Price Range	Average Size (Sq. Ft.)
Kmart	Moderate strip centers and freestanding locations	Two Hearts Maternity by Destination Maternity	$8 $40	
Macy s	Mid-priced regional malls	Motherhood; Pea	$9 $225	
Bloomingdale s	Mall of America	Motherhood; Pea	$9 $195	
Babies R Us	Big box power centers	Motherhood	$9 $45	
Boscov s	Mid-priced and moderate regional malls	Motherhood	$9 $45	
Gordmans	Big box power centers	Motherhood	$9 $45	
Exclusive Licensed Relationship:				
Kohl s	Big box power centers	Oh Baby by Motherhood	$8 $42 (1)	

(1) Kohl s, which sells our Oh Baby by Motherhood brand under an exclusive product and license agreement, sets the apparel price range for this merchandise.

The following table sets forth our store count by nameplate as of September 30, 2010.

	Store Count as of September 30, 2010
Motherhood Maternity	567
A Pea in the Pod	56
Destination Maternity	
Combo stores	49
Superstores	26
Total Destination Maternity stores	75
Total stores	698

Major regional malls with several department stores and a wide range of price points may be able to accommodate a Destination Maternity store, or more than one maternity store. Our retail nameplates provide us with the ability to address multiple price alternatives at a given mall. As of September 30, 2010, we had two of our store concepts in 13 major regional malls. Our preference is, over time and assuming we can obtain a suitable location under acceptable financial terms, to operate one larger-sized multi-brand store under the Destination Maternity nameplate in or near these malls, rather than two smaller single-brand stores.

Motherhood Maternity Stores. Motherhood Maternity is our largest chain with 567 stores as of September 30, 2010. Motherhood is positioned with a broad assortment of quality fashion at everyday low prices. Motherhood stores average approximately 1,800 square feet and are located primarily in mid-priced and moderate regional malls, strip and power centers, and central business districts. Motherhood stores include 84 outlet locations that carry Motherhood-branded merchandise as well as some closeout merchandise. In fiscal 2010, we opened three new Motherhood stores and outlets and closed 27 Motherhood stores and outlets, with 14 of these store closings related to Destination Maternity store openings. As of September 30, 2010, we operated 36 Motherhood stores in Canada and believe that market opportunities may permit us to open additional stores in Canada in the future.

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A Pea in the Pod Stores. As of September 30, 2010, we had 56 A Pea in the Pod stores, averaging approximately 2,100 square feet. Certain of the A Pea in the Pod stores are located in mid-priced regional malls, lifestyle centers and central business districts while others are located in upscale venues, including Beverly Hills, Oak Street, South Coast Plaza, Bal Harbour and Newbury Street. In fiscal 2010, we closed eleven Pea stores, with eight of these store closings related to Destination Maternity store openings.

Destination Maternity Stores. As of September 30, 2010, we had 75 Destination Maternity stores averaging approximately 4,100 square feet, including 49 Destination Maternity combo stores and 26 Destination Maternity superstores.

Destination Maternity Combo Stores. As of September 30, 2010, we had 49 Destination Maternity combo stores. Our combo stores are larger (average of approximately 2,900 square feet) than our single-brand stores, generally have higher average sales volume than our average store and provide the opportunity to improve store operating profit margins over time. A new combo store typically involves closing two stores (often one Motherhood store and one Pea store), although we sometimes close only one store in a given geographical market in situations where we believe we can expand sales through replacing a single-brand store with a Destination Maternity combo store. Store closings will often involve one-time store closing costs resulting primarily from early lease terminations. Based on our internal research, we believe that over the next several years we have the potential to expand the Destination Maternity combo store chain to 70 or more total Destination Maternity combo stores in the United States. In fiscal 2010, we opened five Destination Maternity combo stores.

Destination Maternity Superstores. In March 2004, we opened our first Destination Maternity superstore in Danbury, Connecticut. As of September 30, 2010, we had 26 Destination Maternity superstores. Destination Maternity superstores currently carry both of our primary merchandise brands (Motherhood and Pea), plus a greatly expanded line of maternity-related accessories, nursing products, health and fitness products, books, and body and nutritional products. Certain Destination Maternity superstores also carry our luxury A Pea in the Pod Collection portion of the Pea brand. Our Destination Maternity superstores also typically feature a dedicated learning center area for maternity-related classes, a relax area for husbands and shoppers alike, and an inside play area for the pregnant mom s toddlers and young children, with seven of our superstores also having our Edamame® The Maternity Spa®. These elements combine to give our Destination Maternity superstore not only the largest assortment of maternity apparel and accessories available, but also a unique and engaging atmosphere and experience for the maternity customer. A new Destination Maternity superstore typically involves closing at least two, and sometimes more, single-brand stores, is expected to decrease store operating expense percentages through economies of scale, and may increase overall sales in the geographical areas it serves. Destination Maternity superstores range from nearly 4,000 square feet to approximately 11,000 square feet, with an average of approximately 6,500 square feet for the 26 stores open as of September 30, 2010. In February 2006, we opened our flagship Destination Maternity superstore on the corner of 57th Street and Madison Avenue in New York City s Manhattan borough. This is the largest maternity store in the world, spanning three floors and including our Edamame The Maternity Spa, all of our primary apparel brands, prenatal education and yoga classes, a juice bar with Internet access, relax area and children s play area. As the only national retailer that is solely focused on maternity, we are further differentiating ourselves as the ultimate maternity destination with these large, well-assorted, must visit superstores. We opened four Destination Maternity superstores during fiscal 2010. Based on our internal research, we believe that over the next several years we have the potential to expand the Destination Maternity superstore chain to 50 or more total Destination Maternity superstores in the United States.

Leased Departments. In addition to the stores we operate, we have arrangements with department stores and baby specialty stores, including Sears, Kmart, Macy s, Bloomingdale s, Babies R Us, Boscov s and Gordmans, to operate maternity apparel departments in their stores. We are the exclusive maternity apparel provider in each of our leased department locations. We staff these leased departments at varying levels and maintain control of the pricing terms and the timing and degree of the markdowns of our merchandise that is sold in the leased departments. We operate our leased departments during the same hours and days as the host store

and are responsible for replenishment of the merchandise in the leased departments. These leased departments typically involve the lease partner collecting all of the revenue from the leased department. The revenue is remitted to us, less a fixed percentage of the net sales earned by the lease partner as stipulated in each agreement.

Exclusive Licensed Relationship. Our Oh Baby by Motherhood collection is available at all Kohl s stores under an exclusive product and license agreement. The collection was launched in February 2005 at Kohl s stores throughout the United States and on Kohls.com. As of September 30, 2010, Kohl s operated approximately 1,089 stores throughout the United States.

International. Currently, we operate 36 Motherhood stores in Canada and a Motherhood website under a Canadian URL (MotherhoodCanada.ca).

In October 2008, we announced our planned expansion into six key markets in the Middle East through an international franchise agreement with Multi Trend, a member of the Al-Homaizi Group, to introduce our Destination Maternity, Motherhood Maternity, A Pea in the Pod, and Edamame The Maternity Spa brands into the Middle East. The initial franchise stores through our arrangement in the Middle East opened during 2009 and, as of September 30, 2010, there are eight of our franchise stores operating in the Middle East.

In April 2009, we announced our planned expansion into India through an international franchise agreement with Mahindra Retail, part of the Mahindra Group, to introduce our Motherhood Maternity, Destination Maternity, and A Pea in the Pod retail nameplates into India. We have initially made our Motherhood Maternity product available for sale in maternity shop-in-shops located in Mahindra Retail s Mom & Me stores (which carry infant and children s apparel and non-apparel merchandise, as well as maternity apparel) in India. As of September 30, 2010, our Motherhood Maternity merchandise is offered in 23 Mom & Me stores in India.

We continue to evaluate other international sales opportunities. As our Middle East and India franchise relationships demonstrate, we anticipate that our initial international strategy will consist primarily of franchising, licensing or similar arrangements with foreign partners, although we anticipate that our strategy, particularly over the longer term, may include both licensing arrangements with foreign partners, as well as potentially entering into wholesale joint ventures or developing our own operations in certain countries.

Internet Operations

We sell our merchandise on the Internet primarily at our DestinationMaternity.com website, as well as our brand-specific websites such as Motherhood.com. We also sell our merchandise through our Canadian website, MotherhoodCanada.ca. We believe that many pregnant women use the Internet to find maternity-related information and to purchase maternity clothes. Our websites are therefore important tools for educating existing and potential customers about our brands and driving traffic to our stores. Our DestinationMaternity.com website contains maternity advice and information, related baby product information and editorial content. Our marketing and technology capabilities and the replenishment capabilities of our distribution centers and stores enable us to incorporate Internet design, operations and fulfillment into our existing operations. We believe that our Internet operations represent a growth opportunity for the Company both by increasing Internet sales and by using the Internet to drive store sales. During fiscal 2010, Internet sales increased 32.3% and we look to continue to increase our sales driven by our Internet operations in the future.

Marketing Partnerships

We believe our customers, particularly first-time mothers, are entering a new life stage that drives widespread changes in purchasing needs and behavior, thus making our maternity customer and her family a highly-valued demographic for a range of consumer products and services companies. We have been able to leverage the relationship we have with our customers to earn incremental revenues and expect to expand these revenues through additional marketing partnerships.

We expect to continue to expand and leverage the relationship we have with our customers and earn incremental revenues through a variety of marketing partnership programs utilizing our extensive opt-in customer database and various in-store marketing initiatives, which help introduce our customers to various baby

and parent-related products and services offered by leading third-party consumer products companies. Our current revenues in this area have predominantly been derived from the prenatal portion of our customer database. We are taking steps to update and manage our entire customer database so we can actively market our full customer database to a much broader range of consumer products and services companies that market to families with children.

During fiscal 2010, we discontinued our futuretrust® college savings program. Futuretrust was a MasterCard® based college savings program that enabled members to save for college when they linked their futuretrust MasterCard to a tax advantaged 529 College Savings account. The program did not achieve our objectives for growth and profitability and it depended on the in-store marketing efforts of our store team members. Terminating the program enables our team members to intensify their focus on providing top-notch service to each of our maternity customers. The discontinuation of the futuretrust program did not have any material impact on our results of operations.

Operations

Brand-Specific Operations Teams. To obtain maximum efficiencies, we are organized primarily along functional lines, such as store operations, merchandising, design and production. Our business consists of four merchandise brands, which each require decisions on a brand-specific basis. As such, we have built business teams by brand where the functional leaders within each brand work together. Each brand team is led by the head merchant and includes a brand-specific head designer, head planner and distributor, key production manager, and, where applicable, a director of stores. These teams also include visual, fabric purchasing and other necessary professionals.

Store Operations. The typical maternity customer, especially the first-time mother, seeks more advice and assistance than the typical non-maternity customer. Therefore, we aim to employ skilled and motivated store team members who are trained to provide the high level of service and reassurance needed by our customers. We attempt to provide a boutique level of attentive service that differentiates us from our competitors. Our centralized merchandising and store operations also enable our store team members to focus primarily on selling and maintaining the appearance of the stores. In addition, visual merchants coordinate with the merchandising department to develop floor-sets, design store display windows and define and enhance the product presentation.

The field/store management reporting structure for each chain consists of a director, regional managers, district managers and store managers. These members of field/store management are each eligible to receive incentive-based compensation related to store, district, regional and chain-level performance.

Merchandising, Design and Inventory Planning and Allocation

Merchandising. We strive to maintain an appropriate balance between new merchandise and proven styles, as well as between basic and fashion items. Our merchandising decisions are based on current fashion trends, as well as input from our designers and outside vendors. This information is used in conjunction with the item-specific sales data provided by our proprietary merchandising and replenishment system. Each brand has its own team of merchants, designers and planners. These teams are led by the head merchant of the brand who each report to our Chief Merchandising Officer.

Design. Our design department creates and produces samples and patterns for our contract-manufactured products under the guidance of the merchandising department. The design of our products begins with a review of European and New York runway trends, current non-maternity retail trends, fashion reporting service information and fabric samples. The designers review our best selling items from prior seasons and integrate current fashion ideas from the non-maternity apparel business.

Inventory Planning and Allocation. Our inventory planning and allocation department is responsible for planning future inventory purchases and markdowns, as well as targeting overall inventory levels and turnover. We establish target inventories for each store using our inventory planning system with the goals of optimizing our merchandise assortment and turnover, maintaining adequate depth of merchandise by style and managing

closeout and end-of-season merchandise consolidation. Our proprietary capabilities enable us to continually monitor and respond quickly to consumer demand and are integral to our inventory management program. These capabilities are facilitated by our customized merchandise analysis and planning system, which provides daily product sell-through data and merchandising information.

Production and Distribution

We design and contract for the production of approximately 90% of the merchandise we sell using sewing factories located throughout the world, predominantly outside of the United States, and we continue to seek additional contractors for our sourcing needs. No individual contractor represents a material portion of our sewing. A majority of our merchandise is purchased full package as finished product made to our specifications, typically utilizing our designs. Fabric, trim and other supplies are obtained from a variety of sources. Substantially all of the merchandise produced outside of the United States is paid for in U.S. dollars.

Our production personnel monitor production at contractor facilities in the United States and work with our buying representatives abroad to ensure quality control, compliance with our design specifications and timely delivery of finished goods. This quality control effort is enhanced by our worldwide Internet-based contracting and logistics systems, which include advanced features such as measurement specifications and digital photography. We also use a third-party consulting firm to help monitor working conditions at our contractors facilities on a worldwide basis.

We operate our distribution centers in Philadelphia, Pennsylvania. We own our primary distribution center in Philadelphia, Pennsylvania and lease a facility located in the Philadelphia Naval Business Center in Philadelphia, Pennsylvania, which we use for warehousing, distribution and raw material cutting.

Finished garments from contractors and other manufacturers are received at our primary distribution center in Philadelphia, Pennsylvania. Garments are inspected using statistical sampling methods and stored for picking. Our primary distribution center utilizes sophisticated fulfillment technology to serve as a replenishment center, as opposed to solely a distribution center. This distribution center sends a specific selection that meets individual store needs from our overall inventory, with each store shipped between two and seven times per week. Retail location replenishment decisions are made automatically based upon target inventories established by the planning and allocation department and individual retail location sales data. Our primary distribution center uses several automated systems, including our pick-to-light system for flat-packed goods and our hanging garment sortation system, which speed up deliveries to our retail locations and reduce costs. Freight is routed through zone-skipping, over-the-road carriers and delivered locally by a variety of carriers, and is supplemented by a small percentage of second-day air, providing one to three day delivery to our retail locations.

In November 2003, we were certified to participate in Customs-Trade Partnership Against Terrorism (C-TPAT), a United States Department of Homeland Security sponsored program, with United States Customs and Border Protection (U.S. Customs), through which we implement and monitor our procedures to manage the security of our supply chain as part of the effort to protect the United States and our imported products against potential acts of terrorism. In January 2005, we were certified to participate in the Importer Self Assessment Program (ISA), a U.S. Customs program available only to C-TPAT participants with strong internal controls. Through our participation in the ISA program, we assume responsibility for monitoring our own compliance activities with applicable U.S. Customs regulations in exchange for certain benefits, which may help increase efficiency in importing. These benefits include exemption from certain government audits, increased speed of cargo release from U.S. Customs, front of the line access to U.S. Customs cargo exams, enhanced prior disclosure rights from U.S. Customs in the event of alleged trade violations, availability of voluntary additional compliance guidance from U.S. Customs, and less intrusive government oversight of trade compliance. In February 2010, we were granted Tier 3 Status within the C-TPAT program, the highest level of recognition currently available.

In May 2007, we were accepted to participate in the U.S. Customs and Border Protection s Drawback Compliance Program. The benefits of this program include (i) waiver of prior notice where we do not have to notify U.S. Customs at the time of export of product to Canada and (ii) accelerated payment privileges, with

respect to goods we export from the United States, which we previously imported into the United States, to receive drawback refunds of United States import duties previously paid within 30 days of filing the claim for refund.

Management Information and Control Systems

We believe that our proprietary systems are instrumental to our ability to offer the broadest assortment of maternity apparel merchandise and accomplish rapid replenishment of inventory. We continuously develop, maintain and upgrade our systems and we employ an in-house team of programmers. Our stores have point-of-sale terminals that provide information used in our customized merchandise analysis and planning system. This system provides daily financial and merchandising information that is integral to monitoring trends and making merchandising decisions. Our systems have numerous features designed to integrate our retail operations with our design, manufacturing and financial functions. These features include custom merchandise profiles for each store, rapid inventory replenishment, item-tracking providing daily updated selling information for every style, classification open-to-buy and inventory control, as well as the daily collection of customer payment data, including cash, check, credit card and gift card sales data.

As part of our proprietary enterprise resource planning (ERP) system, we employ a comprehensive materials requirement planning (MRP) system to manage our production inventories, documentation, work orders and scheduling. This system provides a perpetual inventory of raw materials, actual job costing, scheduling and bill of materials capabilities. The foundation of our ERP system is a perpetual inventory of finished goods by SKU and location across all of our retail locations, which interfaces directly with our distribution facility.

Our proprietary, Internet-based point-of-sale system provides real-time access to financial and merchandising information in addition to rapid credit authorization. This point-of-sale system significantly reduces the amount of training required for new sales associates and store managers. In addition, we regularly add new features and functionality to the system, and the system improves our customer relationship management capabilities by enhancing our ability to create customized promotional and marketing strategies.

Given the importance of our management information systems, we have taken extensive measures to ensure their responsiveness and security. Our hardware and communications systems are based on a redundant and multiprocessing architecture, which allows their continued operation on a parallel system in the event that there is a disruption within the primary system. Our main computer system, located at our headquarters in Philadelphia, Pennsylvania, is duplicated by a fully mirrored system in a separate part of the building with a separate power source that is designed to assume full operations should disruption in the primary system occur. In addition, our software programs and data are backed up and securely stored off-site. Our communications links come from two telephone frame rooms and are delivered through underground and aboveground feeds.

Pricing

Our merchandise brands target customers at different price points of the maternity apparel business. Our Motherhood Maternity and Two Hearts Maternity by Destination Maternity brands are positioned as moderate-priced brands, primarily at everyday low prices, while A Pea in the Pod employs both middle level pricing and, through our A Pea in the Pod Collection line, luxury pricing. Our stores do not rely significantly on point-of-sale high/low promotional strategies to drive traffic into the stores. Our price reductions are done at the individual style level and are used to accelerate the sale of slower selling merchandise. Generally, merchandise that is selling slowly is quickly marked down or moved to another store where the item is selling faster. For our leased department relationships, we consider a number of factors in determining pricing, including the target customer base, and we may use alternative pricing strategies to promote sales. The pricing of our Oh Baby by Motherhood merchandise is determined by Kohl s pursuant to the terms of our exclusive product and licensing relationship, with the brand being positioned as a moderate-priced brand. With respect to our international franchise locations, our respective franchisees determine the pricing of merchandise.

Advertising and Marketing

We believe that we drive traffic into our stores through the power of our brands, referrals to friends and family from current and prior customers, our various websites and, perhaps most importantly, our convenient, high-traffic locations in various types of shopping malls and, to a much lesser extent, street locations. Therefore, we have modest advertising and marketing expenditures. Our marketing efforts include publicity, e-mail marketing, web-based advertising, in-store marketing and prenatal consumer-targeted advertising. For our Destination Maternity superstores, we advertise locally prior to each grand opening and continue to advertise both nationally and, at times, locally after the store opens. We advertise one or more of our brands in pregnancy-targeted publications, such as *Fit Pregnancy, Pregnancy*, *BabyTalk, Pregnancy Planner,* and *Parenting Early Years* as well as in other broad-reach publications, such as *People, Cosmopolitan, Glamour* and *People Espanol*. For our luxury A Pea in the Pod brand, we advertise in high-fashion publications, such as *InStyle*. In addition, we utilize our publicity efforts to generate free editorial coverage for all of our brands on broadcast television, radio, the Internet and in magazines and newspapers.

Competition

Our business is highly competitive and characterized by low barriers to entry. The following are several factors important to competing successfully in the retail apparel industry: breadth of selection in sizes, colors and styles of merchandise; product procurement and pricing; ability to anticipate fashion trends and customer preferences; inventory control; reputation; quality of merchandise; store design and location; visual presentation and advertising; and customer service. We face competition in our maternity apparel lines from various sources, including department stores, specialty retail chains, discount stores, independent retail stores and catalog and Internet-based retailers, from both new and existing competitors. Many of our competitors are larger and have substantially greater financial and other resources than us. Our mid- and luxury-priced merchandise faces a highly fragmented competitive landscape that includes locally based, single unit retailers, as well as a handful of multi-unit maternity operations, none of which we believe has more than 10 stores nationwide. In the value-priced maternity apparel business, we currently face competition on a nationwide basis from retailers such as Gap®, JCPenney®, Old Navy®, Target® and Wal-Mart®. All of these competitors also sell maternity apparel on their websites.

Employees

As of September 30, 2010, we had 1,989 full-time and 2,378 part-time employees. None of our employees are covered by a collective bargaining agreement. We consider our employee relations to be good.

Executive Officers of the Company

The following table sets forth the name, age and position of each of our executive officers:

Name	**Age**	**Position**
Edward M. Krell	48	Chief Executive Officer & President
Lisa H. Hendrickson	49	Chief Merchandising Officer
Judd P. Tirnauer	41	Senior Vice President & Chief Financial Officer

Edward M. Krell has served as our Chief Executive Officer and a director since October 1, 2008. Since August 3, 2010, Mr. Krell has also served as the Company s President. From July 2008 until October 1, 2008, Mr. Krell served as our Chief Operating Officer and from May 2007 to July 2008, Mr. Krell served as our Chief Operating Officer & Chief Financial Officer. From November 2003 to May 2007, Mr. Krell served as our Executive Vice President Chief Financial Officer, having served as Senior Vice President Chief Financial Officer from the time he joined us in January 2002 until November 2003. Prior to joining us, Mr. Krell served in various senior financial management positions, including having served as Chief Financial Officer of Mammoth Sports Group, Inc. (an Internet and catalog retailer of golf equipment and accessories) and London Fog Industries, Inc. (a wholesale and retail distributor of rainwear and outerwear). Mr. Krell began his career as an investment banker with Kidder, Peabody & Co. Incorporated and earned an M.B.A. degree from Stanford University and a B.A. degree from Harvard University.

Lisa H. Hendrickson has served as our Chief Merchandising Officer since January 2008. From May 2006 to January 2008, Ms. Hendrickson served as our Vice President of Design, having served as Design Director of Motherhood Maternity from the time she joined us in February 1998 until May 2006. Prior to joining us, Ms. Hendrickson served as the Design Director for Stephanie Queller, a private label sportswear company, from September 1992 to January 1998. Ms. Hendrickson began her career as a Designer with Etcetera, a division of J.G. Hook.

Judd P. Tirnauer has served as our Senior Vice President & Chief Financial Officer since July 2008. From June 2005 to July 2008, Mr. Tirnauer served as our Vice President Finance, having previously served as our Vice President Financial Planning & Analysis since October 2003, and Director of Financial Planning & Analysis since joining us in November 2001. Mr. Tirnauer has earned both a Masters of Business Administration degree and a Juris Doctorate legal degree, and has earned a Certified Public Accountant designation.

Our executive officers are appointed annually by our Board of Directors and serve at the discretion of the Board. There are no family relationships among any of our executive officers.

Intellectual Property

We own trademark and service mark rights that we believe are sufficient to conduct our business as currently operated. We own several trademarks, including Destination Maternity Corporation , A Pea in the Pod®, A Pea in the Pod Collection®, Motherhood®, Motherhood Maternity®, Destination Maternity®, Edamame® The Maternity Spa®, Two Hearts® Maternity, Oh Baby by Motherhood®, Onyx Maternity by Destination Maternity , Motherhood Maternity Outlet®, MaternityMall.com® and iMaternity.com . Additionally, we own the marks Secret Fit Belly®, Mimi Maternity®, Maternity Redefined®, The Art of Maternity , Made With the Earth in Mind , Motherhood Fits You , and Expect Low Prices Every Day®.

In addition, from time to time, we may pursue patent protection for certain maternity apparel related technologies that we develop. For example, in October 2010 we were granted a patent for our Secret Fit Belly. The Secret Fit Belly is made of seamless super stretch fabric that can form part of nearly any type of bottom (such as jeans, pants, shorts and skirts) to provide a better, more comfortable fit and a seamless look.

Seasonality

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

Securities and Exchange Commission Filings

Our Securities and Exchange Commission (SEC) filings are available free of charge on our website, investor.destinationmaternity.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports are posted on our website as soon as practicable after we furnish such materials to the SEC.

Item 1A. Risk Factors

You should consider carefully all of the information set forth or incorporated by reference in this document and, in particular, the following risk factors associated with our business and forward-looking information in this document (see also Forward-Looking Statements included in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations). The risks described below are not the only ones we face. Additional risks not presently known to us or that we do not currently consider significant may also have an adverse effect on us. If any of the risks below actually occur, our business, results of operations, cash flows or financial condition could suffer.

Our performance may be affected by general economic conditions and the continued global financial difficulties.

Our performance is subject to worldwide economic conditions and their impact on levels of consumer spending, which have deteriorated significantly over the past approximately two years and may remain depressed, or be subject to further deterioration. Some of the factors that are having an impact on discretionary consumer spending include general economic conditions, employment, consumer debt, reductions in net worth based on securities market declines, residential real estate and mortgage markets, taxation, healthcare costs, fuel and energy prices, interest rates, credit availability, consumer confidence and other macroeconomic factors.

The worldwide apparel industry is heavily influenced by general economic cycles. Apparel retailing is a cyclical industry that is heavily dependent upon the overall level of consumer spending. Purchases of specialty apparel and related goods tend to be highly correlated with the cycles of the levels of disposable income of consumers. As a result, any substantial deterioration in general economic conditions could adversely affect our net sales and results of operations. Downturns, or the expectation of a downturn, in general economic conditions could adversely affect consumer spending patterns, our sales and our results of operations.

Consumer purchases of discretionary items generally decline during recessionary periods and other periods where disposable income is adversely affected. The downturn in the economy may continue to affect consumer purchases of our merchandise and have an adverse impact on our sales, results of operations and cash flow. Because apparel generally is a discretionary purchase, declines in consumer spending may have a more negative effect on apparel retailers than on other retailers. We may not be profitable if there is a decline in consumer spending.

The turmoil in the financial markets has resulted in extreme volatility in security prices and diminished liquidity and credit availability, and there can be no assurance that our liquidity will not be affected by changes in the financial markets and the global economy. Tightening of the credit markets and recent or future turmoil in the financial markets could also make it more difficult for us to access funds, to refinance our existing indebtedness (if necessary), to enter into agreements for new indebtedness, or to obtain funding through the issuance of our securities.

In addition, the effect from the 2008-2009 credit crisis continues to have a significant negative impact on businesses around the world, and the impact of this crisis on our suppliers cannot be predicted. The inability of suppliers to access liquidity, or the insolvency of suppliers, could lead to their failure to deliver our merchandise. Worsening economic conditions could also result in difficulties for financial institutions (including bank failures) and other parties that we may do business with, which could potentially impair our ability to access financing under existing arrangements or to otherwise recover amounts as they become due under our other contractual arrangements. Additionally, either as a result of or independent of the current financial difficulties and economic weakness in the United States, material fluctuations in currency exchange rates could have a negative impact on our business.

Our comparable retail sales, comparable store sales and quarterly operating results have fluctuated in the past and can be expected to continue to fluctuate in the future and, as a result, the market price of our common stock may fluctuate or decline substantially.

Our comparable retail sales, comparable store sales and quarterly results of operations have fluctuated in the past and can be expected to continue to fluctuate in the future and are affected by a variety of factors, including:

- the opening of new stores and the success of our leased department and licensed relationships;
- the timing of new store openings and leased department and licensed brand business openings;
- the timing of the fulfillment of purchase orders under our product and license arrangements;
- the extent of cannibalization of sales volume of some of our existing retail locations by our new retail locations opened in the same geographic markets or by our Internet sales;
- changes in our merchandise mix;
- any repositioning of our brands;
- general economic conditions and, in particular, the retail sales environment;
- calendar shifts, including shifts of holiday or seasonal periods, or shifts in the number of weekend days occurring in a given month;
- changes in pregnancy rates and birth rates;
- actions of competitors;
- the level of success and/or actions of anchor tenants where we have stores or leased department and licensed relationships;
- fashion trends; and
- weather conditions and seasonality.

If, at any time, our comparable retail sales, comparable store sales or quarterly results of operations decline or do not meet the expectations of investors, the price of our common stock could decline substantially.

Our share price may be volatile and could decline substantially.

The market price of our common stock has been, and is expected to continue to be, volatile, both because of actual and perceived changes in our financial results and prospects and because of general volatility in the stock market. The factors that could cause fluctuations in our share price may include, among other factors discussed in this section, the following:

actual or anticipated variations in the financial results and prospects of our business or other companies in the retail business;

changes in financial estimates by Wall Street research analysts;

actual or anticipated changes in the United States economy or the retailing environment;

changes in the market valuations of other specialty apparel or retail companies;

announcements by our competitors or us;

additions and departures of key personnel;

changes in accounting principles;

the passage of legislation or other developments affecting us or our industry;

- the trading volume of our common stock in the public market;
- changes in economic conditions;
- financial market conditions;
- natural disasters, terrorist acts, acts of war or periods of civil unrest; and
- the realization of some or all of the risks described in this section entitled Risk Factors.

In addition, the stock markets have experienced significant price and trading volume fluctuations from time to time, and the market prices of the equity securities of retailers have been extremely volatile and are sometimes subject to sharp price and trading volume changes. These broad market fluctuations may adversely affect the market price of our common stock.

We may not be successful in expanding our business and opening new stores.

Any future growth depends significantly on our ability to successfully establish and operate new stores (including Destination Maternity combo stores and superstores) and our leased department and licensed relationships on a profitable basis, as well as the success and profitability of our international business, including through franchising relationships. This growth, if it occurs, will place increased demands on our management, operational and administrative resources. These increased demands and operating complexities could cause us to operate our business less effectively, which, in turn, could cause a deterioration in our financial performance and negatively impact our growth. Any planned growth will also require that we continually monitor and upgrade our management information and other systems, as well as our distribution infrastructure.

Our ability to establish and operate new stores and our leased department and licensed relationships successfully depends on many factors, including, among others, our ability to:

- identify and obtain suitable store locations, including mall locations, the availability of which is outside of our control;
- retain existing, expand existing and establish new leased department and licensed relationships;
- negotiate favorable lease terms for stores, including desired tenant improvement allowances;
- negotiate favorable lease terminations for existing store locations in markets where we intend to open new Destination Maternity combo stores or superstores;
- source sufficient levels of inventory to meet the needs of new stores and our leased department and licensed relationships;
- successfully address competition, merchandising and distribution challenges; and
- hire, train and retain a sufficient number of qualified store personnel.

The success and profitability of our international relationships depends on many factors, including, among others:

the ability of our franchisees to identify and obtain suitable store locations, including mall locations, the availability of which is outside of their control;

the ability of our franchisees to negotiate favorable lease terms for stores, including desired tenant improvement allowances;

our ability to source sufficient levels of inventory to meet the needs of our franchisees international operations;

our ability and the ability of our franchisees to successfully address competition, merchandising and distribution challenges; and

the ability of our franchisees to hire, train and retain a sufficient number of qualified store personnel.

There can be no assurance that we will be able to grow our business and achieve our goals. Even if we succeed in establishing new stores, further developing our leased department and licensed relationships and further expanding our international relationships, we cannot assure that these initiatives will achieve planned revenue or profitability levels in the time periods estimated by us, or at all. If any of these initiatives fails to achieve or is unable to sustain acceptable revenue and profitability levels, we may incur significant costs.

Our business, financial condition and results of operations may be materially and adversely impacted at any time by a significant number of competitors.

We operate in a highly competitive environment characterized by few barriers to entry. We compete against department stores, specialty retail chains, discount stores, independent retail stores and catalog and Internet-based retailers. Many of our competitors are larger and have substantially greater financial and other resources than us. Further, we do not typically advertise using television and radio media and thus do not reach customers through means our competitors may use. Our mid- and luxury-priced merchandise faces a highly fragmented competitive landscape that includes locally based, single unit retailers, as well as a handful of multi-unit maternity operations, none of which we believe have more than 10 stores nationwide. In the value-priced maternity apparel business, we face competition on a nationwide basis from retailers such as Gap, JCPenney, Old Navy, Target and Wal-Mart. All of these competitors also sell maternity apparel on their websites. Our business, financial condition and results of operations may be materially and adversely affected by this competition, including the potential for increased competition in the future. For example, the maternity apparel business has previously experienced oversupply conditions due to increased competition in the maternity apparel business, which resulted in a greater level of industry-wide markdowns and markdowns recognized by us on sales from our retail locations. There can be no assurance that these conditions will not occur again or worsen.

Our relationships with third-party retailers may not be successful.

We cannot guarantee successful results from or the continuation of our leased department and licensed relationships with third-party retailers such as Sears, Kmart, Macy s, Bloomingdales, Babies R Us, Boscov s, Gordmans and Kohl s. Under our agreement with Kohl s, subject to certain notice obligations, Kohl s is not obligated to purchase any maternity apparel from us and we are not obligated to sell any maternity apparel to them. Under our agreement with our leased department partners, those partners do not make any promises or representations as to the potential amount of business we can expect from the sale of our product in their stores. We do not control the pricing terms or the timing or degree of the markdowns at Kohl s. The success of our leased department and licensed brand businesses is highly dependent on the actions and decisions of the third-party retailers, which are outside of our control. The retailers could limit the merchandise carried, close stores, go out of business or terminate their agreements with us. Our failure to properly manage our leased department and licensed brand businesses (including any failure by us in timely delivering goods to any third-party retailer or any failure to respond to the actions of or changes in business conditions at third-party retailers) would have a direct impact on the profitability and continuation of these relationships.

We require a significant amount of cash to service our indebtedness, which reduces the cash available to finance any growth and could adversely affect our financial health.

We have a significant amount of indebtedness and we have the ability to incur substantial additional indebtedness in the future. Our ability to make required payments on our indebtedness, as well as to fund our operations and future growth, depends upon our ability to generate cash. Our success in generating cash depends upon the results of our operations, as well as upon general economic, financial, competitive and other factors beyond our control.

Additionally, our substantial indebtedness could have important consequences. For example, it could:

- increase our vulnerability to general adverse economic and industry conditions;

- require us to dedicate a portion of our cash flow from operations to making payments on our indebtedness, thereby reducing the availability of our cash flow to implement our growth strategy, or to fund working capital, capital expenditures and other general corporate needs;

- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- result in higher interest expense in the event of increases in interest rates as some of our debt is, and will continue to be, at variable rates of interest, and our available borrowings under our credit facility, to the extent borrowed in the future, would be at variable rates of interest;
- place us at a competitive disadvantage compared to our competitors that have less debt, or debt at lower interest rates;
- limit our ability to borrow additional funds;
- make it more difficult for us to open new stores or improve or expand existing stores;
- restrict our ability to pay dividends or make distributions to our stockholders;
- require us to pledge all or substantially all of our assets as collateral to secure indebtedness; and
- make it more difficult for us to pursue strategic acquisitions, alliances and partnerships.

If we are unable to meet our expenses and debt obligations, we may need to refinance all or a portion of our indebtedness before the scheduled maturity dates of such debt, sell assets or raise equity. On such maturity dates, we may need to refinance our indebtedness if our operations do not generate enough cash to pay such indebtedness in full and if we do not raise additional capital. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time. We cannot assure you that we would be able to refinance any of our indebtedness, sell assets or raise equity on commercially reasonable terms or at all, which could cause us to default on our obligations and impair our liquidity.

Our variable rate indebtedness subjects us to interest rate risk, which could cause our debt service obligations to increase significantly.

Any borrowings under our credit facility, which could significantly increase in the future, would be at a variable rate. In addition our term loan, with an outstanding balance of $42.9 million as of September 30, 2010, bears interest at a variable rate equal to, at our election, either (i) the prime rate plus 1.00%, or (ii) a LIBOR rate plus the applicable margin. The applicable margin under our term loan was initially fixed at 2.50% through and including the fiscal quarter ended September 30, 2007. Thereafter, the applicable margin for LIBOR rate borrowings is either 2.25% or 2.50%, depending on our Consolidated Leverage Ratio (as defined in the related term loan agreement). Based upon our applicable quarterly Consolidated Leverage Ratios, the applicable margin for LIBOR rate borrowings was 2.50% prior to December 30, 2009 and has been reduced to 2.25% effective from December 30, 2009. In order to mitigate our floating rate interest risk on the variable rate term loan, we entered into an interest rate swap agreement that commenced on April 18, 2007 and expires on April 18, 2012. The interest rate swap agreement enables us to effectively convert an amount of the term loan (equal to the notional amount of the interest rate swap) from a floating interest rate (LIBOR plus 2.50% prior to December 30, 2009, reduced to LIBOR plus 2.25% effective from December 30, 2009, based on our specified leverage ratios), to a fixed interest rate (7.50% prior to December 30, 2009, reduced to 7.25% effective from December 30, 2009, based on our specified leverage ratios). The notional amount of the interest rate swap was $75.0 million at the inception of the swap agreement and decreases over time to a notional amount of $5.0 million at the expiration date. The notional amount of the swap was $27.5 million as of September 30, 2010 and over the next eighteen months decreases as follows: to $20.0 million starting October 18, 2010; to $12.5 million starting April 18, 2011; and to $5.0 million starting October 18, 2011. Regardless of our attempts to mitigate our exposure to interest rate fluctuations through the interest rate swap, we still have exposure for the unswapped amounts of the term loan borrowings, which remain subject to a variable interest rate, as well as any borrowings under our revolving credit facility, which would be subject to a variable interest rate. As a result, an increase in interest rates could result in a substantial increase in interest expense, especially as the swapped amount of the term loan decreases over time and/or if our borrowings under our revolving credit facility increase.

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We are heavily dependent on our management information systems and our ability to maintain and upgrade these systems from time to time.

The efficient operation of our business is heavily dependent on our internally developed management information systems. In particular, we rely on point-of-sale terminals, which provide information to our customized merchandise analysis and planning system used to track sales and inventory. The merchandise analysis and planning system helps integrate our design, manufacturing, distribution and financial functions, and also provides daily financial and merchandising information. Although our software programs and data are backed up and securely stored off-site, our servers and computer systems are located at our headquarters in Philadelphia, Pennsylvania. As a result, our business, financial condition and results of operations could be materially and adversely affected if our servers and systems were inoperable or inaccessible.

From time to time, we improve and upgrade our management information systems. We have a proprietary, Internet-based point-of-sale system. If we are unable to maintain and upgrade our systems or to integrate new and updated systems in an efficient and timely manner, our business, financial condition and results of operations could be materially and adversely affected.

As an apparel retailer, we rely on numerous third parties in the supply chain to produce and deliver the products that we sell, and our business may be negatively impacted by disruptions in the supply chain.

If we lose the services of one or more of our significant suppliers or one or more of them fail to meet our product needs, we may be unable to obtain replacement merchandise in a timely manner. If our existing suppliers cannot meet our increased needs and we cannot locate alternative supply sources, we may be unable to obtain sufficient quantities of the most popular items at attractive prices, which could negatively impact our sales and results of operations. We obtain apparel and other merchandise from foreign sources, both purchased directly in foreign markets and indirectly through domestic vendors with foreign sources. To the extent that any of our vendors are located overseas or rely on overseas sources for a large portion of their products, any event causing a disruption of imports, including the imposition of import restrictions, could harm our ability to source product. This disruption could materially limit the merchandise that we would have available for sale and reduce our sales and earnings. The flow of merchandise from our vendors could also be adversely affected by financial or political instability, or war, in or affecting any of the countries in which the goods we purchase are manufactured or through which they flow. Trade restrictions in the form of tariffs or quotas, embargos and customs restrictions that are applicable to the products that we sell also could affect the import of those products and could increase the cost and reduce the supply of products available to us. Any material increase in tariff levels, or any material decrease in quota levels or available quota allocation, could negatively impact our business. Further, changes in tariffs or quotas for merchandise imported from individual foreign countries could lead us to shift our sources of supply among various countries. Any such shift we undertake in the future could result in a disruption of our sources of supply and/or an increase in product costs, and lead to a reduction in our sales and earnings. Supply chain security initiatives undertaken by the United States government that impede the normal flow of product could also negatively impact our business. In addition, decreases in the value of the United States dollar against foreign currencies could increase the cost of products that we purchase from overseas vendors.

We also face a variety of other risks generally associated with relying on vendors that do business in foreign markets and import merchandise from abroad, such as:

- political instability or the threat of terrorism, particularly in countries where our vendors source merchandise;
- enhanced security measures at United States and foreign ports, which could delay delivery of imports;
- imposition of new or supplemental duties, taxes, and other charges on imports;
- delayed receipt or non-delivery of goods due to the failure of foreign-source suppliers to comply with applicable import regulations;
- delayed receipt or non-delivery of goods due to organized labor strikes or unexpected or significant port congestion at United States ports; and

local business practice and political issues, including issues relating to compliance with domestic or international labor standards, which may result in adverse publicity.

The United States may impose new initiatives that adversely affect the trading status of countries where apparel is manufactured. These initiatives may include retaliatory duties or other trade sanctions that, if enacted, would increase the cost of products imported from countries where our vendors acquire merchandise. Any of these factors could have a material adverse effect on our business, financial condition and results of operations.

We could be materially and adversely affected if our distribution operations were disrupted.

To support our distribution of product throughout the world, we operate our main distribution facility and one significantly smaller distribution facility, both in Philadelphia, Pennsylvania. Finished garments from contractors and other manufacturers are inspected and stored for distribution to our stores. We do not have other distribution facilities to support our distribution needs. If our main Philadelphia distribution facility were to shut down or otherwise become inoperable or inaccessible for any reason, we could incur significantly higher costs and longer lead times associated with the distribution of our products to our stores during the time it takes to reopen or replace this facility. In light of our strategic emphasis on rapid replenishment as a competitive strength, a distribution disruption might have a disproportionately adverse effect on our operations and profitability relative to other retailers. In addition, the loss or material disruption of service from any of our shippers for any reason, whether due to freight difficulties, strikes, natural disaster or other difficulties at our principal transport providers or otherwise, could have a material adverse impact on our business, financial condition and results of operations.

We could be materially and adversely affected if we are unable to obtain sufficient raw materials or maintain satisfactory manufacturing arrangements.

We do not own any manufacturing facilities and therefore depend on third parties to manufacture our products. We place our orders for production of merchandise and raw materials by purchase order and do not have any long-term contracts with any manufacturer or supplier. We compete with many other companies for production facilities and raw materials. Furthermore, we have received in the past, and may receive in the future, shipments of products from manufacturers that fail to conform to our quality control standards or environmental standards. We have no ability to control the environmental compliance (including compliance with climate change requirements) of these third-party manufacturers. In such event, unless we are able to obtain replacement products in a timely manner, we may lose sales. If we fail to maintain favorable relationships with these third parties, or if we cannot obtain an adequate supply of quality raw materials on commercially reasonable terms, it could have a material adverse impact on our business, financial condition and results of operations.

Fluctuations in commodity prices could result in an increase in component costs and/or delivery costs.

The results of our business operations could suffer due to significant increases or volatility in the prices of certain commodities, including but not limited to cotton, wool and other ingredients used in the production of fabric and accessories, as well as fuel, oil and natural gas. Increases in prices of these commodities or other inflationary pressures may result in significant cost increases for our raw materials and product components, as well as increases in the cost of distributing merchandise to our retail locations and shipping products to our customers. To the extent we are unable to offset any such increased costs through value engineering and similar initiatives, or through price increases, our profitability, cash flows and financial condition may be adversely impacted. If we choose to increase prices to offset the increased costs, our unit sales volumes could be adversely impacted.

Our stores are heavily dependent on the customer traffic generated by shopping malls.

We depend heavily on locating our stores in prominent locations within successful shopping malls in order to generate customer traffic. We cannot control the development of new shopping malls, the availability or cost of appropriate locations within existing or new shopping malls or the success of existing or new mall stores.

The success of all of our mall stores will depend, in part, on the ability of each mall s anchor tenants, such as large department stores, other tenants and area attractions to generate consumer traffic in the vicinity of our stores, and the continuing popularity of malls as shopping destinations. Many traditional enclosed malls are experiencing significantly lower levels of customer traffic than in the past, driven by overall poor economic conditions as well as the closure of certain mall anchor tenants. Sales volume and mall traffic may be adversely affected by economic downturns in a particular area, the closing of anchor tenants or competition from non-mall retailers and other malls where we do not have stores.

Our success depends on our ability to identify and rapidly respond to fashion trends.

The apparel industry is subject to rapidly changing fashion trends and shifting consumer demands. Accordingly, our success depends on the priority that our target customers place on fashion and our ability to anticipate, identify and capitalize upon emerging fashion trends. Our ability or our failure to anticipate, identify or react appropriately to changes in styles or trends could lead to, among other things, excess inventories and higher markdowns, as well as the decreased appeal of our brands. Particular fashion trends, or an inaccuracy of our forecasts regarding fashion trends, could have a material adverse effect on our business, financial condition and results of operations. For example, in fiscal 2007 we were negatively impacted from the popularity of certain styles in the non-maternity women s apparel market, such as trapeze and baby-doll dresses and tops, which can more readily fit a pregnant woman early in her pregnancy than typical non-maternity fashions.

The failure to attract and retain highly skilled and qualified senior management personnel could have a material adverse impact on our business, financial condition and results of operations.

Our business requires disciplined execution at all levels of our organization in order to timely deliver and display fashionable merchandise in appropriate quantities in our stores. This execution requires experienced and talented management. We currently have a management team with a great deal of experience with us and in apparel retailing. If we were to lose the benefit of this experience, our business, financial condition and results of operations could be materially and adversely affected. On September 30, 2010, Rebecca Matthias, our co-founder, retired from the Company. Under her transition agreement, Ms. Matthias is available to provide consulting services to us, as requested, through September 30, 2012. If we were unable to compensate for the loss of the benefit of Ms. Matthias experience, our business, financial condition and results of operations could be materially and adversely affected.

In addition, as our business expands, we believe that our success will depend greatly on our continued ability to attract and retain highly skilled and qualified personnel. There is a high level of competition for personnel in the retail industry. Like most retailers, we experience significant employee turnover rates, particularly among store sales associates and managers, and our continued growth will require us to hire and train even more new personnel. We therefore must continually attract, hire and train new personnel to meet our staffing needs. We constantly compete for qualified personnel with companies in our industry and in other industries. A significant increase in the turnover rate among our sales associates and managers would increase our recruiting and training costs and could decrease our operating efficiency and productivity. If we are unable to retain our employees or attract, train, assimilate or retain other skilled personnel in the future, we may not be able to service our customers as effectively, which could impair our ability to increase sales and could otherwise harm our business.

Our quarterly operating results and inventory levels may fluctuate significantly as a result of seasonality in our business.

Our business, like that of other retailers, is seasonal. Results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year. Quarterly results may fluctuate materially depending upon, among other things, increases or decreases in comparable retail sales or comparable store sales, the timing of new store openings and new leased department openings, net sales and profitability contributed by new stores and leased departments, the timing of the fulfillment of purchase orders under our product and license arrangements, adverse weather conditions, shifts in the timing of certain holidays and promotions, changes in inventory and production levels and the timing of deliveries of inventory, and changes in our merchandise mix. Our quarterly

net sales have historically been highest in our third fiscal quarter, corresponding to the Spring selling season, followed by our first fiscal quarter, corresponding to the Fall/holiday selling season. Given the historically higher sales level in our third fiscal quarter and the relatively fixed nature of most of our operating expenses and interest expense, we have typically generated a very significant percentage of our full year operating income and net income during our third fiscal quarter. Thus, any factors which result in a material reduction of our sales for the third quarter could have a material adverse effect on our results of operations for our fiscal year as a whole. Seasonal fluctuations in sales also affect our inventory levels, as we usually order merchandise in advance of peak selling periods and sometimes before new fashion trends are confirmed by customer purchases. We must carry a significant amount of inventory, especially before the Fall/holiday and Spring selling seasons. If we are not successful in selling our inventory during this period, we may be forced to rely on markdowns or promotional sales to sell the excess inventory or we may not be able to sell the inventory at all, which could have a material adverse effect on our business, financial condition and results of operations.

Our business depends on sustained demand for maternity clothing and is sensitive to birth rates, women s fashion trends, economic conditions and consumer spending.

Our business depends upon sustained demand for maternity clothing. Our future performance will be subject to a number of factors beyond our control, including demographic changes, fashion trends, economic conditions and consumer spending. If demand for maternity clothing were to decline for any reason, such as a decrease in the number of pregnancies, our operating results could be adversely affected. For example, according to the United States Census Bureau and United States Centers for Disease Control and Prevention, births declined 2.6% in calendar 2009 compared to calendar 2008, and declined 1.6% in calendar 2008 compared to calendar 2007. If this trend were to continue it could negatively affect our business and results of operations. Additionally, our operating results could be adversely affected if certain non-maternity women s apparel fashions have a more pregnancy-friendly fit. For example, in fiscal 2007, we were negatively impacted by the popularity of certain styles in the non-maternity women s apparel market, such as trapeze and baby-doll dresses and tops, which can more readily fit a pregnant woman early in her pregnancy than typical non-maternity fashions. Downturns, or the expectation of a downturn, in general economic conditions could adversely affect consumer spending patterns, our business, financial condition and results of operations. In addition, the specialty apparel retail business historically has been subject to cyclical variations. Consumer purchases of specialty apparel products, including maternity wear, may decline during recessionary periods and at other times when disposable income is lower. Declines in consumer spending patterns may have a more negative effect on apparel retailers than some other retailers. Therefore, we may not be able to maintain our historical sales and earnings, or remain as profitable, if there is a decline in consumer spending patterns. A prolonged economic downturn could have a material adverse impact on our business and results of operations.

If an independent manufacturer violates labor or other laws, or is accused of violating any such laws, or if their labor practices diverge from those generally accepted as ethical, it could harm our business and brand image.

While we maintain policies and guidelines with respect to labor practices that independent manufacturers that produce goods for us are contractually required to follow, and while we have an independent firm and Company employees inspect certain manufacturing sites to monitor compliance, we cannot control the actions of such manufacturers or the public s perceptions of them, nor can we assure that these manufacturers will conduct their businesses using ethical or legal labor practices. Apparel companies can be held jointly liable for the wrongdoings of the manufacturers of their products. While many of our independent manufacturers are routinely monitored by buying representatives, who assist us in the areas of compliance, garment quality and delivery, we do not control the manufacturers business practices or their employees employment conditions, and manufacturers act in their own interest which may be in a manner that results in negative public perceptions of us, and/or employee allegations against us, or court determinations that we are jointly liable. Violations of law by our importers, buying agents, manufacturers or distributors could result in delays in shipments and receipt of goods and could subject us to fines or other penalties, any of which could restrict our business activities, increase our operating expenses or cause our sales to decline.

We may be unable to protect our trademarks and other intellectual property and may be subject to liability if we are alleged to have infringed on another party s intellectual property.

We believe that our trademarks, service marks and other intellectual property are important to our continued success and our competitive position due to their recognition with our customers. We devote substantial resources to the establishment and protection of our trademarks, service marks and other intellectual property. Although we actively protect our intellectual property, there can be no assurance that the actions that we have taken to establish and protect our trademarks, service marks and other intellectual property, including our rights in our management information systems and our proprietary rights in products for which we have applied for or received patent protection (for example, our Secret Fit Belly innovation), will be adequate to prevent imitation of our marks, products or services by others or to prevent others from seeking to block sales of our products as a violation of their trademarks, service marks or other proprietary rights. Also, others may assert rights in, or ownership of, our trademarks and other proprietary rights or may allege that we have or are infringing on their intellectual property rights and we may not be able to successfully resolve these types of conflicts. In addition, the laws of certain foreign countries may not protect our trademarks and proprietary rights to the same extent as do the laws of the United States. We cannot assure you that these registrations will prevent imitation of our name, merchandising concept, store design or private label merchandise, or the infringement of our other intellectual property rights by others. Imitation of our name, concept, store design or merchandise in a manner that projects lesser quality or carries a negative connotation of our brand image could have a material adverse effect on our business, financial condition and results of operations. Additionally, the high expense in both prosecuting and defending against, and potential liability related to, alleged infringements of intellectual property rights could be substantial and could have a material adverse effect on our business, financial condition and results of operations.

If climate change laws or regulations were to become applicable to our business, or if any third party with whom we have a leased or licensed relationship imposed reporting or other obligations on us due to their own compliance programs, we could incur additional expense to meet the requirements and our failure to comply could have a material adverse effect on our business.

With respect to manufacturing within the United States, United States Environmental Protection Agency (EPA) greenhouse gas (GHG) emission reporting rules require certain United States manufacturers to report GHG emissions. These rules are unlikely to require reporting of our third-party contract apparel manufacturers because the amount of emissions from retail stores and apparel manufacturing facilities are currently estimated to be below the EPA reporting threshold. With respect to manufacturing outside of the United States, international treaties, such as the Kyoto Protocol and the Copenhagen Protocol, do not currently require the countries in which our non-United States contract apparel manufacturers are located to control GHG emissions and it is unlikely that climate change requirements in the foreseeable future will require significant GHG emission reductions on our non-United States contract apparel manufacturers. Our manufacturers are required to follow all applicable laws, including climate change laws. If domestic or international laws or regulations were expanded to require GHG emission reporting or reduction by us or our third-party contract apparel manufacturers, or if we engage third-party contract manufacturers in countries that have existing GHG emission reporting or reduction laws or regulations, we would need to expend financial and other resources to comply with such regulations and/or monitor our third-party contract apparel manufacturers compliance with such regulations. In addition, we cannot control the actions of our third-party manufacturers or the public s perceptions of them, nor can we assure that these manufacturers will conduct their businesses using climate change proactive or sustainable practices. Violations of climate change laws or regulations by third parties with whom we do business could result in negative public perception of us and/or delays in shipments and receipt of goods, and could subject us to fines or other penalties, any of which could restrict our business activities, increase our operating expenses or cause our sales to decline.

Some retailers have adopted sustainability or other policies that encourage or require suppliers to report and/or reduce GHG emissions. No third party with whom we have a leased or licensed relationship currently requires us to report GHG emissions to them. However, we expect that certain of these third parties may do so

in the future, which would require us to expend financial and other resources to comply with such requirements. In addition, if such requirements are imposed on us, our relationship with such third parties could be damaged if we were unable to comply.

War or acts of terrorism or the threat of either may negatively impact availability of merchandise and otherwise adversely impact our business.

In the event of war or acts of terrorism, or if either is threatened, our ability to obtain merchandise available for sale may be negatively affected. A substantial portion of our merchandise is imported from other countries. If goods become difficult or impossible to import into the United States, and if we cannot obtain such merchandise from other sources at similar costs, our sales and profit margins may be adversely affected. In the event that commercial transportation is curtailed or substantially delayed, our business may be adversely impacted, as we may have difficulty shipping merchandise to our main distribution facility and retail locations, as well as fulfilling Internet orders.

The terms of our debt instruments impose financial and operating restrictions.

Our credit facility and term loan agreements each contain restrictive covenants that limit our ability to engage in activities that may be in our long term best interests. These covenants limit or restrict, among other things, our ability to:

- incur additional indebtedness;
- pay dividends or make other distributions in respect of our equity securities, or purchase or redeem capital stock, or make certain investments;
- have our subsidiaries pay dividends, make loans or transfer assets to us;
- sell assets, including the capital stock of our subsidiaries;
- enter into any transactions with our affiliates;
- transfer any capital stock of any subsidiary or permit any subsidiary to issue capital stock;
- create liens;
- enter into certain sale/leaseback transactions; and
- effect a consolidation or merger or transfer of all or substantially all of our assets.

These limitations and restrictions may adversely affect our ability to finance our future operations or capital needs or engage in other business activities that may be in our best interests. In addition, our ability to borrow under the credit facility is subject to borrowing base requirements. If we breach any of the covenants in our credit facility or term loan agreements, we may be in default under our credit facility and/or our term loan. If we default, the lenders under our term loan or the lender under our credit facility could declare all borrowings owed to them, including accrued interest and other fees, to be due and payable.

Our charter documents contain certain anti-takeover provisions, and we are entitled to certain other protective provisions under Delaware law.

We are a Delaware corporation and the anti-takeover provisions of Delaware law impose various impediments to the ability of a third party to acquire control of the Company, even if a change of control would be beneficial to our existing stockholders. We also have adopted a stockholder rights plan, commonly known as a poison pill, that entitles our stockholders to acquire additional shares of us, or a potential acquirer of us, at a substantial discount to their market value in the event of an attempted takeover. In addition, our amended and restated certificate of incorporation and by-laws contain provisions that may discourage, delay or prevent a merger or acquisition involving us that our stockholders may consider favorable by, among other things:

- authorizing the issuance of preferred stock, the terms of which may be determined at the discretion of our Board of Directors;

- restricting the ability of stockholders to call special meetings of stockholders; and

- establishing advance notice requirements for nominations for election to our Board of Directors or for proposing matters that can be acted on by stockholders at meetings.

These provisions may also reduce the market value of our common stock.

We do not expect to pay cash dividends in the foreseeable future.

We have not paid any cash dividends on our common stock since our initial public offering and do not anticipate paying cash dividends on our common stock in the foreseeable future. In addition, the terms of each of our credit facility and term loan agreements restrict our ability to declare or pay dividends on our common stock. Even if our ability to pay dividends were not restricted, any future payment of dividends would still be at the discretion of our Board of Directors and would be based upon any applicable restrictive financial covenants, earnings, capital requirements and our financial condition, among other factors, at the time any such dividend is considered.

Any increase in our sales and marketing efforts that target markets outside the United States and Canada would expose us to additional risks associated with international operations.

Although an immaterial amount of our sales are currently derived from international sales outside of Canada, we are actively seeking to expand our international presence, and we have begun to do so through franchise arrangements in the Middle East and India. We may not be successful in these efforts. International operations and sales subject us to risks and challenges that we would otherwise not face if we conducted our business only in the United States. For example, we may depend on third parties to market our products through foreign sales channels, and we may be challenged by laws and business practices favoring local competitors. In addition, our ability to succeed in foreign markets will depend on our ability to protect our intellectual property. We must also adapt our pricing structure to address different pricing environments and may face difficulty in enforcing revenue collection internationally. Emerging markets are a significant focus of our international growth strategy. The developing nature of these markets presents a number of risks. Deterioration of social, political, labor, or economic conditions in a specific country or region and difficulties in staffing and managing foreign operations may also adversely affect our operations or financial results or those of our franchisees. Operations outside the United States may be affected by changes in trade protection laws, policies and measures, and other regulatory requirements affecting trade and investment, including the Foreign Corrupt Practices Act and local laws prohibiting corrupt payments. To the extent we achieve significant sales outside of the United States in the future, we may have significant exposure to fluctuating foreign currency exchange rates.

We could have failures in our system of internal controls.

We maintain a documented system of internal controls which is reviewed and monitored by management, who meet regularly with our Audit Committee of the Board of Directors. We believe we have a well-designed system to maintain adequate internal controls on the business. We cannot assure you that there will not be any control deficiencies in the future. Should we become aware of any control deficiencies, we would report them to the Audit Committee and recommend prompt remediation. We have devoted significant resources to document, test, monitor and improve our internal controls and will continue to do so; however, we cannot be certain that these measures will ensure that our controls are adequate in the future or that adequate controls will be effective in preventing fraud. If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud. Any failures in the effectiveness of our internal controls could have a material adverse effect on our financial condition or operating results or cause us to fail to meet reporting obligations.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

We own our principal executive offices and distribution facility, which is located at 456 North Fifth Street, Philadelphia, Pennsylvania, subject to a mortgage under the terms of which we owe approximately $2.2 million

as of September 30, 2010. This facility consists of approximately 318,000 square feet, of which approximately 45,000 square feet is dedicated to office space and the remaining square footage is used for finished goods warehousing and distribution. On August 26, 2002, we entered into a ten-year lease for a facility located at 2001 Kitty Hawk Avenue, Philadelphia, Pennsylvania in the Philadelphia Naval Business Center. The area leased at this facility, which we use for some finished goods warehousing and distribution, raw material cutting and warehousing, and office space consists of approximately 69,000 square feet of space, of which 5,000 square feet is dedicated to office space. Beginning in 2002 and continuing through fiscal 2010, we leased approximately 12,000 square feet of finished goods warehouse and distribution space in Mississauga, Ontario in Canada. For fiscal 2011 and the forseeable future, we plan to distribute product to our Canadian stores from our distribution facility in Philadelphia, Pennsylvania and, accordingly we allowed our Canada lease to expire on October 31, 2010. From time to time we may also utilize third-party warehousing services in the Philadelphia, Pennsylvania area when we have increased storage requirements. These services essentially operate on a month-to-month basis. We believe that these facilities will be adequate to support our anticipated distribution needs for the near term and, potentially, longer. In the event we need additional space to meet our future distribution needs, we believe that such space would be readily available. Our facilities are subject to state and local regulations that range from building codes to health and safety regulations.

We lease our store premises for initial terms averaging from five to ten years. Certain leases allow us to terminate or reduce our obligations at specified points in time in the event that the applicable store does not achieve a specified sales volume. Some of our store leases also provide for contingent payments based on sales volume, escalations of the base rent, as well as increases in operating costs, marketing costs and real estate taxes.

As of September 30, 2010, the following numbers of store leases are set to expire as listed in the table below. We do not expect the expiration of any leases to have a material adverse impact on our business or operations.

Fiscal Year Leases Expire	**Number of Stores**
2011	107
2012	96
2013	128
2014	146
2015	71
2016 and later	150
Total	698

In addition to the stores we operate, we have arrangements with department and specialty stores, including Sears, Kmart, Macy s, Bloomingdale s, Babies R Us, Boscov s and Gordmans to operate maternity apparel departments in their stores. These leased departments typically involve the lease partner collecting all of the revenue from the leased department. The revenue is remitted to us, less a fixed percentage of the net sales earned by the lease partner as stipulated in the agreement. We provide at least some amount of staffing for each of the leased departments, with the amount varying depending on the specific arrangement. Generally, under each of our leased department agreements, our lease partner has the right to terminate any or all of our rights to operate our leased departments in their stores subject to varying notice requirements.

Item 3. Legal Proceedings

From time to time, we are named as a defendant in legal actions arising from our normal business activities. Litigation is inherently unpredictable and although the amount of any liability that could arise with respect to currently pending actions cannot be accurately predicted, we do not believe that the resolution of any pending action will have a material adverse effect on our financial position or liquidity.

Item 4. (Removed and Reserved)

PART II.

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is traded on the Nasdaq Global Market under the symbol DEST. Prior to December 9, 2008 (before giving effect to our corporate name change), our common stock traded under the symbol MWRK. The following table sets forth for the periods indicated below the reported high and low sales prices of our common stock as reported on the Nasdaq Global Market:

	High	Low
Fiscal Year Ended September 30, 2010:		
Quarter ended December 31, 2009	$ 22.82	$ 16.79
Quarter ended March 31, 2010	25.86	17.56
Quarter ended June 30, 2010	32.54	23.76
Quarter ended September 30, 2010	33.26	24.21
Fiscal Year Ended September 30, 2009:		
Quarter ended December 31, 2008	$ 14.68	$ 5.72
Quarter ended March 31, 2009	8.70	4.42
Quarter ended June 30, 2009	18.13	5.92
Quarter ended September 30, 2009	23.74	16.30

As of December 6, 2010, there were 1,282 holders of record and 1,388 estimated beneficial holders of our common stock.

We have not paid any cash dividends on our common stock since our initial public offering. In addition, the terms of our senior secured Term Loan B due March 13, 2013 (the Term Loan) and our credit facility restrict our ability to declare or pay dividends on our common stock. Even if we were not restricted under the terms of our Term Loan or our credit facility from being able to pay dividends, any future payment of dividends would still be at the discretion of our Board of Directors and would be based upon certain restrictive financial covenants, earnings, capital requirements and our financial condition, among other factors, at the time any such dividend is considered.

Under our Amended and Restated 2005 Equity Incentive Plan (the 2005 Plan), awards may be granted in the form of options, stock appreciation rights, restricted stock or restricted stock units. Up to 700,000 shares of our common stock may be issued in respect of awards under our 2005 Plan, with no more than 350,000 of those shares permitted to be issued in respect of restricted stock or restricted stock units granted under the 2005 Plan.

The following table provides information about purchases by us during the quarter ended September 30, 2010 of equity securities that are registered by us pursuant to Section 12 of the Exchange Act:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program (2)	Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program (2)
July 1 to July 31, 2010				$ 7,000,000
August 1 to August 31, 2010				$ 7,000,000
September 1 to September 30, 2010	119	$ 26.80		$ 7,000,000
Total	119	$ 26.80		$ 7,000,000

(1) Represents shares repurchased directly from an employee to satisfy income tax withholding obligations for such employee in connection with a restricted stock award that vested during the period.

(2) In July 2008, our Board of Directors approved a program to repurchase up to $7.0 million of our outstanding common stock. Under the program, we may repurchase shares from time to time through solicited or unsolicited transactions in the open market or in negotiated or other transactions. In July 2010, our Board of Directors extended its authorization of the program. The program, which would have expired on July 31, 2010, will now be in effect until July 31, 2012. There have been no repurchases of common stock under the program to date.

Stock Price Performance Graph

The graph below compares the cumulative total stockholder return on our Common Stock for the period from September 30, 2005 to September 30, 2010, with the cumulative total return of the Standard & Poor s 500 Index and the Standard & Poor s Apparel Retail Index. The comparison assumes $100 was invested on September 30, 2005 in our Common Stock and in each of the foregoing indices and assumes reinvestment of dividends.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Destination Maternity Corporation, The S&P 500 Index

And The S&P Apparel Retail Index

* $100 invested on September 30, 2005 in stock or index including reinvestment of dividends.
Fiscal year ending September 30:

ion:relative;
bottom:.8ex"> [4]

General Shopping Finance Ltd.	USD	10.000%	11/09/2015	1,239,000	1,251,390[4]
Hypermarcas SA	USD	6.500%	04/20/2021	2,000,000	1,760,000[4]
Mirabela Nickel Ltd.	USD	8.750%	04/15/2018	297,000	265,815[4]
NET Servicos de Comunicacao SA	USD	7.500%	01/27/2020	508,000	581,660
Odebrecht Drilling Norbe VIII/IX Ltd.	USD	6.350%	06/30/2021	1,695,000	1,737,375[5]
OGX Petroleo e Gas Participacoes SA:					
	USD	8.500%	06/01/2018	1,000,000	960,000[5]
	USD	8.500%	06/01/2018	2,332,000	2,238,720[4]
Virgolino de Oliveira Finance Ltd.	USD	10.500%	01/28/2018	1,700,000	1,640,500[5]
					12,579,620
China - 1.61%					
Country Garden Holdings Co. Ltd.	USD	11.125%	02/23/2018	750,000	611,250[4]
Evergrande Real Estate Group Ltd.	USD	13.000%	01/27/2015	260,000	201,500[5]
Kaisa Group Holdings Ltd.	USD	13.500%	04/28/2015	1,192,000	959,560[5]
MIE Holdings Corp.	USD	9.750%	05/12/2016	1,532,000	1,363,480[4]
Texhong Textile Group Ltd.	USD	7.625%	01/19/2016	1,000,000	730,000[5]
West China Cement Ltd.	USD	7.500%	01/25/2016	2,000,000	1,640,000[4]
					5,505,790
Colombia - 0.30%					
Emgesa SA ESP	COP	8.750%	01/25/2021	911,000,000	497,391[4]
Empresas Publicas de Medellin ESP	COP	8.375%	02/01/2021	1,030,000,000	549,752[4]
					1,047,143

Dominican Republic - 0.56%					
Cap Cana SA:					
	USD	10.000%	04/30/2016	3,341,111	668,222[5][7]
	USD	10.000%	04/30/2016	3,621,970	1,267,690[5][7]
					1,935,912
India - 0.05%					
Vedanta Resources PLC	USD	9.500%	07/18/2018	200,000	180,000[5]
Indonesia - 0.62%					
Bakrie Telecom Pte Ltd.	USD	11.500%	05/07/2015	1,876,000	1,181,880[5]
Berau Capital Resources Pte Ltd.	USD	12.500%	07/08/2015	100,000	107,000[5]
BLT Finance BV	USD	7.500%	05/15/2014	1,098,000	433,710[5]
Bumi Investment Pte Ltd.	USD	10.750%	10/06/2017	200,000	196,000[5]
PT Adaro Indonesia	USD	7.625%	10/22/2019	200,000	212,000[5]
					2,130,590

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Stone Harbor Emerging Markets Income Fund — Statement of Investments

November 30, 2011

	Currency	Rate	Maturity Date	Principal Amount *	Market Value (Expressed in U.S. $)
Jamaica - 0.89%					
Digicel Group Ltd.	USD	9.125%	01/15/2015	3,070,000	$ 3,039,300(4)
Kazakhstan - 2.39%					
BTA Bank JSC	USD	10.750%	07/01/2018	9,526,945	3,143,892(5)(8)
KazMunayGas National Co.:					
	USD	8.375%	07/02/2013	991,000	1,050,460(5)
	USD	9.125%	07/02/2018	309,000	372,345(4)
	USD	6.375%	04/09/2021	208,000	219,960(4)
Zhaikmunai LLP	USD	10.500%	10/19/2015	3,441,000	3,389,385(5)
					8,176,042
Mexico - 3.31%					
BBVA Bancomer SA	USD	4.500%	03/10/2016	404,000	399,960(5)
Cemex Espana Luxembourg	USD	9.250%	05/12/2020	1,110,000	765,900(5)
Cemex SAB de CV:					
	USD	5.369%	09/30/2015	3,784,000	2,535,280(1)(4)
	USD	9.000%	01/11/2018	1,260,000	919,800(5)
	USD	9.000%	01/11/2018	2,983,000	2,177,590(4)
Geo Maquinaria	USD	9.625%	05/02/2021	5,033,960	4,530,564(4)
					11,329,094
Peru - 0.89%					
Inkia Energy Ltd.	USD	8.375%	04/04/2021	3,000,000	3,045,000(4)
Russia - 2.16%					
Metalloinvest Finance Ltd.	USD	6.500%	07/21/2016	2,384,000	2,223,080(4)
Russian Agricultural Bank OJSC Via RSHB Capital SA	USD	7.750%	05/29/2018	3,000,000	3,255,000(4)
Vimpel Communications Holdings BV	USD	7.504%	03/01/2022	490,000	427,525(4)
Vimpel Communications Via VIP Finance Ireland Ltd. OJSC	USD	6.493%	02/02/2016	1,600,000	1,504,000(5)
					7,409,605
South Korea - 0.21%					
Export-Import Bank of Korea	USD	4.375%	09/15/2021	715,000	705,991
Turkey - 0.46%					
Yuksel Insaat AS	USD	9.500%	11/10/2015	2,152,000	1,581,720(5)
Ukraine - 4.16%					
Ferrexpo Finance PLC	USD	7.875%	04/07/2016	2,416,000	2,186,480(4)

Metinvest BV	USD	8.750%	02/14/2018	2,268,000	1,978,830(4)
MHP SA	USD	10.250%	04/29/2015	1,410,000	1,304,250(5)
Mriya Agro Holding PLC	USD	10.950%	03/30/2016	4,491,000	4,086,810(4)
National JSC Naftogaz of Ukraine	USD	9.500%	09/30/2014	5,000,000	4,693,750(2)
					14,250,120
United Arab Emirates - 0.57%					
Dubai Holding Commercial Operations MTN Ltd.:					
	EUR	4.750%	01/30/2014	150,000	168,299
	GBP	6.000%	02/01/2017	1,550,000	1,787,367
					1,955,666

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Stone Harbor Emerging Markets Income Fund

Statement of Investments

November 30, 2011

	Currency	Rate	Maturity Date	Principal Amount/Shares*	Market Value (Expressed in U.S. $)
Venezuela - 8.00%					
Petroleos de Venezuela SA:					
	USD	4.900%	10/28/2014	32,635,492	$ 25,374,095 (2)
	USD	5.250%	04/12/2017	3,240,000	2,041,200 (2)
					27,415,295
TOTAL CORPORATE BONDS					106,213,304
(Cost $122,040,208)					
PARTICIPATION NOTES - 3.68%					
Argentina - 1.35%					
Endesa Costanera SA	USD	11.304%	03/30/2012	2,115,430	2,115,430 (1)
Hidroelec el Chocon SA	USD	8.061%	03/01/2015	2,500,000	2,500,000
					4,615,430
Ukraine - 2.33%					
Ukreximbank Biz Finance PLC	USD	8.375%	04/27/2015	8,909,000	7,995,827 (2)(5)
TOTAL PARTICIPATION NOTES					12,611,257
(Cost $13,833,028)					
CREDIT LINKED NOTES - 20.65%					
Argentina - 0.68%					
Cablevision SA	USD	9.375%	02/12/2018	2,515,000	2,313,800 (9)
Brazil - 11.06%					
Nota Do Tesouro Nacional:					
	BRL	10.000%	01/01/2017	19,300,000	10,344,658 (10)
	BRL	10.000%	01/01/2017	38,300,000	20,528,519 (11)
	BRL	10.000%	01/01/2021	3,200,000	1,592,612 (10)
	BRL	10.000%	01/01/2021	4,000,000	2,076,368 (12)
	BRL	10.000%	01/01/2021	6,500,000	3,374,098 (12)
					37,916,255
Colombia - 4.43%					
Titulos de Tesoreria -Series B:					
	COP	10.000%	07/24/2024	1,375,000,000	836,238 (12)
	COP	10.000%	07/24/2024	23,400,000,000	14,334,347 (12)
					15,170,585

Iraq - 4.48%					
Republic of Iraq	JPY	2.447%	01/01/2028	1,846,816,199	15,358,386(1)(13)
TOTAL CREDIT LINKED NOTES					70,759,026
(Cost $72,494,746)					
COMMON STOCK - 2.02%					
Iraq - 2.02%					
Genel Energy PLC	GBP			500,000	6,903,152 (14)

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Stone Harbor Emerging Markets Income Fund

Statement of Investments

November 30, 2011

	Currency	Shares *	Market Value (Expressed in U.S. $)
TOTAL COMMON STOCK			$ 6,903,152
(Cost $8,089,306)			
SHORT TERM INVESTMENTS - 5.57%			
Money Market Mutual Funds - 5.57%			
Dreyfus Treasury Cash Management (0.00004% 7-Day Yield)	USD	19,093,736	19,093,736
TOTAL SHORT TERM INVESTMENTS			19,093,736
(Cost $19,093,736)			
Total Investments - 121.14%			415,094,924
(Cost $442,508,960)			
Liabilities in Excess of Other Assets - (21.14)%			(72,426,750)
Net Assets - 100.00%			$ 342,668,174

* The contract/principal/share amounts of each security is stated in the currency in which the security is denominated. See below.

ARS - Argentine Peso
BRL - Brazilian Real
COP - Colombian Peso
EUR - Euro Currency
GBP - Great Britain Pound
JPY - Japanese Yen
MXN - Mexican Peso
MYR - Malaysian Ringgit
PHP - Philippine Peso
USD - United States Dollar
ZAR - South African Rand

(1) *Floating or variable rate security. Interest rate disclosed is that which is in effect at November 30, 2011.*

(2) *On November 30, 2011, securities valued at $100,478,455 were pledged as collateral for reverse repurchase agreements.*

(3) *Pay-in-kind securities.*

(4) *Security exempt from registration under Rule 144A of the Securities Act of 1933. Total market value of Rule 144A securities amounts to $45,894,640, which represents approximately 13.39% of net assets of the Fund as of November 30, 2011.*

(5) *Securities were purchased pursuant to Regulation S under the Securities Act of 1933, which exempts securities offered and sold outside of the United States from registration. Such securities cannot be sold in the United States without either an effective registration statement filed pursuant to the Securities Act of 1933, or pursuant to an exemption from registration. As of November 30, 2011, the aggregate market value of those securities was $64,444,680, which represents approximately 18.81% of the Fund s net assets.*

(6) *Bank loans generally pay interest at rates which are periodically determined by reference to a base lending rate plus a premium. All loans carry a variable rate of interest. These base lending rates are generally (i) the Prime Rate offered by one or more major United States banks, (ii) the lending rate offered by*

one or more European banks such as the London Interbank Offered Rate (LIBOR) or (iii) the Certificate of Deposit rate. Rate shown represents the weighted average rate at November 30, 2011. Bank Loans, while exempt from registration, under the Securities Act of 1933 (the 1933 Act), contain certain restrictions on resale and cannot be sold publicly. Floating rate bank loans often require prepayments from excess cash flow or permit the borrower to repay at its election. The degree to which borrowers repay, whether as a contractual requirement or at their election, cannot be predicted with accuracy. As a result, the actual remaining maturity may be substantially less than the stated maturity shown.

(7) *Security is currently in default/non-income producing.*

(8) *Step bond. Coupon increases periodically based upon a predetermined schedule. Interest rate disclosed is that which is in effect at November 30, 2011.*

(9) *The underlying security is issued by Deutsche Bank AG London.*

(10) *The underlying security is issued by JP Morgan Chase.*

(11) *The underlying security is issued by Barclays Bank PLC.*

(12) *The underlying security is issued by Citigroup Global Markets.*

(13) *The underlying security is issued by Merrill Lynch.*

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Stone Harbor Emerging Markets Income Fund

Statement of Investments

November 30, 2011

(14) *Non-income producing security.*

(15) *This security has been valued by management at its fair value determined in good faith pursuant to procedures approved by the Board of Trustees. Total market value of fair valued securities amounts to $10,939,500 which represents approximately 3.19% of net assets as of November 30, 2011.*

Common Abbreviations:

AS	-	Anonim Sirket is the Turkish term for Incorporation.
BV	-	Besloten Vennootschap, a Dutch private limited liability company.
ESP	-	Empresa de Servicios Publicos is the Colombian term for Public Service Company.
JSC	-	Joint Stock Company.
LLP	-	Limited Liability Partnership.
Ltd.	-	Limited.
MTN	-	Medium Term Note.
OJSC	-	Open Joint Stock Company.
PLC	-	Public Limited Co.
Pte.	-	Private.
SA	-	Generally designates corporations in various countries, mostly those employing the civil law.
SAB de CV	-	A variable capital company.

OUTSTANDING FORWARD FOREIGN CURRENCY CONTRACTS

Contract Description	Contracted Amount	Purchase/Sale Contract	Settlement Date	Current Value	Unrealized Appreciation/ (Depreciation)
EUR	22,556,816	Sale	12/28/2011	$ 30,318,492	$ 142,812
GBP	6,217,000	Sale	12/28/2011	9,751,270	101,121
JPY	1,235,841,000	Sale	12/28/2011	15,947,385	126,714
					$ 370,647
EUR	10,599,468	Sale	12/28/2011	$ 14,246,686	$ (2,485)
					$ (2,485)

The counterparty on all forward foreign currency contracts is JPMorgan Chase & Co.

CREDIT DEFAULT SWAP CONTRACTS ON FOREIGN GOVERNMENT ISSUES - Buy Protection[1]

Counterparty	Reference Obligation	Notional Amount	Market Value	Upfront Premiums Paid	Fixed Deal Rate	Maturity Date	Unrealized Depreciation
Goldman Sachs	Bolivarian Republic of Venezuela	$ (25,000,000)	$ 159,825	$ 625,000	5.00%	09/20/2012	$ (465,175)

(1) *If the Fund is a buyer of protection and a credit event occurs, as defined under the terms of that particular swap agreement, the Fund will either (i) receive from the seller of protection an amount equal to the notional amount of the swap and deliver the referenced obligation or (ii) receive a net settlement amount in the form of cash or securities equal to the notional amount of the swap less the recovery value of the referenced obligation.*

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Stone Harbor Emerging Markets Income Fund — Statement of Investments

November 30, 2011

REVERSE REPURCHASE AGREEMENTS

Counterparty	Interest Rate	Trade Date	Value
Merrill Lynch, Pierce, Fenner & Smith	0.750%	02/28/2011	$ 7,936,875
Merrill Lynch, Pierce, Fenner & Smith	0.900%	04/1/2011	4,972,500
Merrill Lynch, Pierce, Fenner & Smith	0.050%	04/1/2011	1,863,000
Merrill Lynch, Pierce, Fenner & Smith	0.700%	04/4/2011	21,888,000
Credit Suisse First Boston	0.500%	04/4/2011	5,144,147
Goldman Sachs & Co.	0.300%	08/24/2011	9,722,745
Goldman Sachs & Co.	0.300%	08/24/2011	4,113,104
Barclays Capital	0.700%	10/6/2011	3,617,820
UBS	0.300%	10/18/2011	15,750,000
Goldman Sachs & Co.	0.250%	11/29/2011	2,313,520
Credit Suisse First Boston	0.500%	11/29/2011	2,138,141
Credit Suisse First Boston	0.500%	11/29/2011	2,075,489
Credit Suisse First Boston	0.250%	11/29/2011	1,816,560
Credit Suisse First Boston	0.950%	11/29/2011	1,799,172
Credit Suisse First Boston	0.950%	11/29/2011	1,787,549
Credit Suisse First Boston	0.750%	11/29/2011	1,638,600
Goldman Sachs & Co.	0.400%	11/29/2011	1,302,718
Goldman Sachs & Co.	0.350%	11/29/2011	1,290,067
Credit Suisse First Boston	0.750%	11/29/2011	1,082,708
Credit Suisse First Boston	0.850%	11/29/2011	835,800
			$ 93,088,515

All agreements can be repurchased on demand at value plus accrued interest.

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Stone Harbor Emerging Markets Income Fund

Statement of Assets & Liabilities

November 30, 2011

ASSETS:	
Investments at value[1]	$ 415,094,924
Cash	244,140
Foreign currency, at value (Cost $589,118)	578,395
Unrealized appreciation on forward foreign currency contracts	370,647
Swap premiums paid	625,000
Receivable from broker	1,180,000
Receivable for investments sold	23,973,154
Interest receivable	11,296,995
Prepaid and other assets	1,907
Total Assets	453,365,162
LIABILITIES:	
Payable for reverse repurchase agreements	93,088,515
Interest due on reverse repurchase agreements	207,550
Payable for investments purchased	16,099,434
Unrealized depreciation on forward foreign currency contracts	2,485
Unrealized depreciation on credit default swap contract	465,175
Payable for swap contract payments	250,000
Payable to advisor	354,241
Payable to administrator	53,621
Payable for trustee fees	15,591
Other payables	160,376
Total Liabilities	110,696,988
Net Assets	$ 342,668,174
NET ASSETS CONSIST OF:	
Paid-in capital	$ 370,573,247
Distribution in excess of net investment income	(182,366)
Accumulated net realized loss on investments, securities sold short, credit default swap contracts and foreign currency transactions	(88,928)
Net unrealized depreciation on investments, credit default swap contracts and translation of assets and liabilities denominated in foreign currencies	(27,633,779)
Net Assets	$ 342,668,174
PRICING OF SHARES:	
Net Assets	$ 342,668,174
Shares of beneficial interest outstanding (unlimited number of shares, par value of $0.001 per share authorized)	15,557,578
Net assets value, offering and redemption price per share	$ 22.03
[1]Cost of Investments	$ 442,508,960

See Notes to Financial Statements.

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Stone Harbor Emerging Markets Income Fund — Statement of Operations

For the Period December 22, 2010 (Inception) to November 30, 2011

INVESTMENT INCOME:	
Interest	$ 36,575,464
Total Investment Income	36,575,464
EXPENSES:	
Investment advisory fees	4,173,374
Administration fees	627,653
Interest on reverse repurchase agreements	800,373
Custodian fees	82,158
Audit fees	67,616
Printing fees	50,139
Legal fees	80,000
Trustee fees	61,842
Transfer agent fees	18,501
Insurance fees	31,088
Other	40,260
Total Expenses	6,033,004
Net Investment Income	30,542,460
REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS:	
Net realized gain/(loss) on:	
Investments	(5,394,907)
Securities sold short	17,416
Credit default swap contracts	(361,111)
Foreign currency transactions	2,684,392
Net realized loss	(3,054,210)
Change in unrealized appreciation/(depreciation) on:	(27,168,604)
Investments	(27,414,036)
Credit default swap contracts	(465,175)
Translation of assets and liabilities denominated in foreign currencies	245,432
Net change	(27,633,779)
Net Realized and Unrealized Loss on Investments	(30,687,989)
Net Decrease in Net Assets Resulting from Operations	$ (145,529)

See Notes to Financial Statements.

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Stone Harbor Emerging Markets Income Fund — Statement of Changes in Net Assets

		For the Period December 22, 2010 (Inception) to November 30, 2011
OPERATIONS:		
Net investment income	$	30,542,460
Net realized gain/(loss) on investments:		
Investments		(5,394,907)
Securities sold short		17,416
Credit default swap contracts		(361,111)
Foreign currency transactions		2,684,392
Net change in unrealized appreciation/(depreciation) on investments, credit default swaps and translation of assets and liabilities denominated in foreign currencies		(27,633,779)
Net decrease in net assets resulting from operations		(145,529)
DISTRIBUTIONS TO SHAREHOLDERS:		
From net investment income		(27,759,544)
Net decrease in net assets from distributions to shareholders		(27,759,544)
CAPITAL SHARE TRANSACTIONS:		
Proceeds from sales of shares, net of offering costs of $765,000		364,522,500
Net asset value of common shares issued to stockholders from reinvestment of dividends		5,950,747
Net increase in net assets from capital share transactions		370,473,247
Net Increase in Net Assets		342,568,174
NET ASSETS:		
Beginning of period		100,000
End of period (including undistributed net investment loss of ($182,366)	$	342,668,174
OTHER INFORMATION:		
Share Transactions:		
Beginning shares		4,188
Shares issued in connection with initial public offering		15,300,000
Shares issued as reinvestment of dividends		253,390
Shares outstanding -end of period		15,557,578

See Notes to Financial Statements.

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Stone Harbor Emerging Markets Income Fund

Statement of Cash Flows

For the Period December 22, 2010 (Inception) to November 30, 2011

CASH FLOWS FROM OPERATING ACTIVITIES:	
Net decrease in net assets from operations	$ (145,529)
Adjustments to reconcile net decrease in net assets from operations to net cash used by operating activities:	
Purchase of investment securities	(1,059,746,251)
Proceeds from disposition of investment securities	627,712,990
Net purchases of short term investment securities	(19,093,736)
Net payments on credit default swap contracts	(736,111)
Proceeds from securities sold short transactions	(5,500,000)
Cover securities sold short transactions	5,517,416
Premium amortization	1,672,075
Discount accretion	(6,322,665)
Net realized (gain)/loss on:	
Investments	5,394,907
Securities sold short	(17,416)
Credit default swap contracts	361,111
Net change in unrealized appreciation/(depreciation) on:	
Investments	27,414,036
Credit default swap contracts	465,175
Translation of assets and liabilities denominated in foreign currencies	(357,439)
Increase in receivable from broker	(1,180,000)
Increase in interest receivable	(11,296,995)
Increase in prepaid and other assets	(1,907)
Increase in payable to advisor	354,241
Increase in payable to administrator	53,621
Increase in payable for trustee fees	15,591
Increase in other payables	160,376
Increase in interest due on reverse repurchase agreements	207,550
Net Cash Used in Operating Activities	(435,068,960)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Cash received from reverse repurchase agreements	370,882,209
Cash payments made on reverse repurchase agreements	(277,793,694)
Proceeds from sale of shares	365,287,500
Offering costs paid for sale of shares	(765,000)
Cash distributions paid	(21,808,797)
Net Cash Provided by Financing Activities	435,802,218
Effect of exchange rates on cash	(10,723)
Net increase in cash	722,535
Cash and foreign currency, beginning of period	$ 100,000
Cash and foreign currency, end of period	$ 822,535
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:	
Cash paid during the period for interest on reverse repurchase agreements:	$ 592,823
Noncash financing activities not included herein consist of reinvestment of dividends and distributions of :	$ 5,950,747

See Notes to Financial Statements.

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Stone Harbor Emerging Markets Income Fund — Financial Highlights

For a share outstanding throughout the period presented

	For the Period December 22, 2010 (Inception) to November 30, 2011
Net asset value - beginning of period	$ 23.88
Income/(loss) from investment operations:	
Net investment income	1.99 (1)
Net realized and unrealized loss on investments	(1.99)
Total income/(loss) from investment operations	
Less distributions to common shareholders:	
From net investment income	(1.80)
Total distributions	(1.80)
Capital share transactions:	
Common share offering costs charged to paid-in capital	(0.05)
Total capital share transactions	(0.05)
Net Decrease in Net Asset Value	(1.85)
Net asset value - end of period	$ 22.03
Market price - end of period	$ 22.38
Total Return - Net Asset Value(2)	(0.47%)
Total Return - Market Price(2)	(3.41%)
Ratios/Supplemental Data:	
Net assets, end of period (in thousands)	$ 342,668
Ratio of expenses to average net assets	1.76% (3)
Ratio of net investment income to average net assets	8.90% (3)
Ratio of expenses to average managed assets(4)	1.45% (3)
Portfolio turnover rate	157%

(1) *Calculated using average shares.*

(2) *Total investment return is calculated assuming a purchase of common share at the opening on the first day and a sale at closing on the last day of each period reported. Dividends and distributions, if any, are assumed for purposes of this calculation to be reinvested at prices obtained under the Fund s dividend reinvestment plan. Total investment returns do not reflect brokerage commissions, if any, and are not annualized.*

(3) *Annualized.*

(4) *Average managed assets represent net assets applicable to common shares plus average amount of borrowings during the period.*

See Notes to Financial Statements.

Stone Harbor Emerging Markets Income Fund Notes to Financial Statements

November 30, 2011

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Stone Harbor Emerging Markets Income Fund (the Fund) is a newly organized, non-diversified, closed-end management investment company registered under the 1940 Act. The Fund was organized as a Massachusetts business trust on September 10, 2010, pursuant to an Agreement and Declaration of Trust governed by the laws of The Commonwealth of Massachusetts (the Declaration of Trust). The Fund commenced operations on December 22, 2010. Prior to that, the Fund had no operations other than matters relating to its organization and the sale and issuance of 4,188 shares of beneficial interest (Common Shares) in the Fund to the Stone Harbor Investment Partners (the Adviser) at a price of $23.88 per share. The Fund s common shares are listed on the New York Stock Exchange (the Exchange) and trade under the ticker symbol EDF.

The Fund s primary investment objective is to maximize total return, which consists of income on its investments and capital appreciation. The Fund will normally invest at least 80% of its net assets (plus any borrowings made for investment purposes) in emerging markets securities. Emerging markets securities include fixed income securities and other instruments (including derivatives) that are economically tied to emerging market countries that are denominated in the predominant currency of the local market of an emerging market country or whose performance is linked to those countries markets, currencies, economies or ability to repay loans. A security or instrument is economically tied to an emerging market country if it is principally traded on the country s securities markets or if the issuer is organized or principally operates in the country, derives a majority of its income from its operations within the country or has a majority of its assets within the country.

The Fund is classified as non-diversified under the 1940 Act. As a result, it can invest a greater portion of its assets in obligations of a single issuer than a diversified fund. The Fund may therefore be more susceptible than a diversified fund to being adversely affected by any single corporate, economic, political, or regulatory occurrence.

The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements. The policies are in conformity with accounting principles generally accepted in the United States of America (GAAP). The preparation of the financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

(a) Investment Valuation: Debt securities, including bank loans and linked notes, are generally valued at the mean between the bid and asked prices provided by independent pricing services or brokers that are based on transactions in debt obligations, quotations from dealers, market transactions in comparable securities and various other relationships between securities. Equity securities for which market quotations are available are generally valued at the last sale price or official closing price on the primary market or exchange on which they trade. Publicly traded foreign government debt securities are typically traded internationally in the over-the-counter market, and are valued at the mean between the bid and asked prices as of the close of business of that market. When prices are not readily available, or are determined not to reflect fair value, such as when the value of a security has been significantly affected by events after the close of the exchange or market on which the security is principally traded, but before the Fund calculates its net asset value, the Fund may value these investments at fair value as determined in accordance with the procedures approved by the Fund s Board of Trustees. Short-term obligations with maturities of 60 days or less are valued at amortized cost, which approximates market value. Money market mutual funds are valued at their net asset value.

A three-tier hierarchy has been established to measure fair value based on the extent of use of observable inputs as compared to unobservable inputs for disclosure purposes and requires additional disclosures about these valuations measurements. Inputs refer broadly to the assumptions that market participants would use in pricing a security. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the security developed based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity s own assumptions about the assumptions market participants would use in pricing the security developed based on the best information available in the circumstances.

The three-tier hierarchy is summarized as follows:

Level 1	Unadjusted quoted prices in active markets for identical assets or liabilities that the Fund has the ability to access.
Level 2	Observable inputs other than quoted prices included in level 1 that are observable for the asset or liability, either directly or indirectly. These inputs may include quoted prices for the identical instrument on an inactive market, prices for similar instruments, interest rates, prepayment speeds, credit risk, yield curves, default rates, and similar data.
Level 3	Unobservable inputs for the asset or liability, to the extent relevant observable inputs are not available, representing the Fund s own assumptions about the assumptions a market participant would use in valuing the asset or liability, and would be based on the best information available.

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Stone Harbor Emerging Markets Income Fund

Notes to Financial Statements
November 30, 2011

The following is a summary of the Fund s investment and financial instruments based on the three tier hierarchy as of November 30, 2011:

Investments in Securities at Value*	Level 1 - Quoted and Unadjusted Prices	Level 2 - Other Significant Observable Inputs	Level 3 - Significant Unobservable Inputs	Total
Stone Harbor Emerging Markets Income Fund				
Sovereign Debt Obligations	$	$ 186,763,184	$	$ 186,763,184
Bank Loans		1,811,765	10,939,500	12,751,265
Corporate Bonds		106,213,304		106,213,304
Participation Notes		12,611,257		12,611,257
Credit Linked Notes		70,759,026		70,759,026
Common Stocks	6,903,152			6,903,152
Short Term Investments	19,093,736			19,093,736
Total	$ 25,996,888	$ 378,158,536	$ 10,939,500	$ 415,094,924
Other Financial Instruments**				
Assets				
Forward Foreign Currency Contracts	$	$ 370,647	$	$ 370,647
Liabilities				
Forward Foreign Currency Contracts		(2,485)		(2,485)
Credit Default Swap Contracts		(465,175)		(465,175)
Total	$	$ (97,013)	$	$ (97,013)

* *For detailed Country descriptions, see accompanying Statement of Investments.*

** *Other financial instruments are derivative instruments not reflected in the Statement of Investments.*

There were no significant transfers in or out of Levels 1 and 2 during the period.

The following is a reconciliation of assets in which significant unobservable inputs (Level 3) were used in determining fair value:

Investments in Securities at Value	Balance as of November 30, 2010	Accrued Discount/ Premium	Realized Gain/(Loss)*	Change in Unrealized Depreciation*	Net Purchases	Transfer in and/or (out) of Level 3	Balance as of November 30, 2011	Net Change in Unrealized Depreciation Included in the Statement of Operations Attributable to Level 3 Investments Still Held at November 30, 2011
Bank Loans	$	$ 883,171	$	$ (1,930,500)	$ 11,986,829	$	$ 10,939,500	$ (1,930,500)
Total	$	$ 883,171	$	$ (1,930,500)	$ 11,986,829	$	$ 10,939,500	$ (1,930,500)

* *Realized gain/(loss) and change in unrealized depreciation are included in the related amounts on the investment in the Statement of Operations.*

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

(b) Security Transactions and Investment Income: Security transactions are accounted for on a trade date basis. Interest income, adjusted for amortization of premium and accretion of discount, is recorded on the accrual basis. Dividend income is recorded on the ex-dividend date. Foreign dividend income is recorded on the ex-dividend date or as soon as practical after the Fund determines the existence of a dividend declaration after exercising reasonable due diligence. The cost of investments sold is determined by use of the specific identification method. To the extent any issuer defaults on an expected interest payment, the Fund s policy is to generally halt any additional interest income accruals and consider the realizability of interest accrued up to the date of default.

(c) Foreign Currency Translation: The books and records of the Fund are maintained in U.S. dollars. Investment valuations and other assets and liabilities initially expressed in foreign currencies are converted each business day into U.S. dollars based upon current exchange rates. Prevailing foreign exchange rates may generally be obtained at the close of the NYSE (normally, 4:00 p. m. Eastern time).

November 30, 2011

The portion of realized and unrealized gains or losses on investments due to fluctuations in foreign currency exchange rates is not separately disclosed and is included in realized and unrealized gains or losses on investments, when applicable.

(d) Foreign Securities: The Fund may directly purchase securities of foreign issuers. Investing in securities of foreign issuers involves special risks not typically associated with investing in securities of U.S. issuers. The risks include possible revaluation of currencies, the ability to repatriate funds, less complete financial information about companies and possible future adverse political and economic developments. Moreover, securities of many foreign issuers and their markets may be less liquid and their prices more volatile than those of securities of comparable U.S. issuers.

(e) Leverage: The Fund may borrow from banks and other financial institutions and may also borrow additional funds by entering into reverse repurchase agreements or the issuance of debt securities (collectively, Borrowings) in an amount that does not exceed 33 1/3% of the Fund s Total Assets immediately after such transactions. It is possible that following such Borrowings, the assets of the Fund will decline due to market conditions such that this 33 1/3% limit will be exceeded. In that case, the leverage risk to Common Shareholders will increase.

In a reverse repurchase agreement, the Fund sells to a financial institution a security that it holds with an agreement to repurchase the same security at an agreed - upon price and date. A reverse repurchase agreement involves the risk that the market value of the security sold by the Fund may decline below the repurchase price of the security. The Fund will segregate assets determined to be liquid by the investment adviser or otherwise cover its obligations under reverse repurchase agreements. For the period ended November 30, 2011, the average amount of reverse repurchase agreements outstanding was $78,658,207 at a weighted average interest rate of 0.62%.

(f) Risk Exposure and the Use of Derivative Instruments: The Fund s investment objectives not only permit the Fund to purchase investment securities, they also allow the Fund to enter in various types of derivatives contracts. In doing so, the Fund will employ strategies in differing combinations to permit it to increase, decrease, or change the level or types of exposure to market factors. Central to those strategies are features inherent to derivatives that may make them more attractive for this purpose than equity or debt securities; they require little or no initial cash investment, they can focus exposure on only certain selected risk factors, and they may not require the ultimate receipt or delivery of the underlying security (or securities) to the contract. This may allow the Fund to pursue its objectives more quickly and efficiently than if the Fund were to make direct purchases or sales of securities capable of effecting a similar response to market factors.

Market Risk Factors: In pursuit of its investment objectives, the Fund may seek to use derivatives to increase or decrease its exposure to the following market risk factors, among others:

Interest Rate Risk. Interest rate risk refers to the fluctuations in value of fixed-income securities resulting from the inverse relationship between price and yield. For example, an increase in general interest rates will tend to reduce the make value of already issued fixed-income investments, and a decline in general interest rates will tend to increase their value. In addition, debt securities with longer maturities, which tend to have higher yields, are subject to potentially greater fluctuations in value from changes in interest rates than obligations with shorter maturities.

Credit Risk. Credit risk relates to the ability of the issuer to meet interest and principal payments, or both, as they come due. In general, lower-grade, higher-yield bonds are subject to credit risk to a greater extent than lower-yield, higher-quality bonds.

Foreign Exchange Rate Risk. Foreign exchange rate risk relates to the change in the U.S. dollar value of a security held that is denominated in a foreign currency. The U.S. dollar value of a foreign currency denominated security will decrease as the dollar appreciates against the currency, while the U.S. dollar value will increase as the dollar depreciates against the currency.

Equity Risk. Equity risk relates to the change in value of equity securities as they relate to increases or decreases in the general market.

The Fund s use of derivatives can result in losses due to unanticipated changes in these risk factors and the overall market. In instances where the Funds are using derivatives to decrease, or hedge, exposures to market risk factors for securities held by the Fund, there are also risks that those derivatives may not perform as expected resulting in losses for the combined or hedged positions.

Derivatives may have little or no initial cash investment relative to their market value exposure and therefore can produce significant gains or losses in excess of their cost. This use of embedded leverage allows the Fund to increase its market value exposure relative to it net assets and can substantially increase the volatility of the Fund s performance.

Additional associated risks from investing in derivatives also exist and potentially could have significant effects on the valuation of the derivative and the Fund. Typically, the associated risks are not the risks that the Fund is attempting to increase or decrease exposure to, per its investment objectives, but are the additional risks from investing in derivatives.

Examples of these associated risks are liquidity risk, which is the risk that the Fund will not be able to sell or close out the derivative in a timely manner, and counterparty credit risk, which is the risk that the counterparty will not fulfill its obligation to the Fund. Associated risks can be different for each type of derivative and are discussed by each derivative type below and in the notes that follow.

Forward Foreign Currency Contracts: The Fund may engage in currency transactions with counterparties to hedge the value of portfolio securities denominated in particular currencies against fluctuations in relative value, to gain or reduce exposure to certain currencies, or to generate income or gains. A forward foreign currency contract is an agreement between two parties to buy and sell a currency at a set price on a future date. The contract is marked-to-market daily and the change in value is recorded by the Fund as an unrealized gain or loss. When a forward foreign currency contract is extinguished, through either delivery or offset by entering into another forward foreign currency contract, the Fund records a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value of the contract at the time it was extinguished.

Forward foreign currency contracts involve elements of market risk in excess of the amounts reflected in the Statement of Assets and Liabilities. The Fund bears the risk of an unfavorable change in the foreign exchange rate underlying the forward foreign currency contract. Risks may also arise upon entering into these contracts from the potential inability of the counterparties to meet the terms of their contracts.

Credit Default Swaps: The Fund may enter into credit default swap contracts for hedging purposes, to gain market exposure or to add leverage to their portfolios. When used for hedging purposes, a Fund would be the buyer of a credit default swap contract. In that case, the Fund would be entitled to receive the par (or other agreed upon) value of a referenced debt obligation, index or other investment from the counterparty to the contract in the event of a default by a third party, such as a U.S. or foreign issuer, on the referenced debt obligation. In return, the Fund would pay to the counterparty a periodic stream of payments over the term of the contract provided that no event of default has occurred. If no default occurs, the Fund would have spent the stream of payments and received no benefit from the contract. When the Fund is the seller of a credit default swap contract, it receives the stream of payments but is obligated to pay upon default of the referenced debt obligation. As the seller, the Fund would effectively add leverage to its portfolio because, in addition to its total assets, the Fund would be subject to investment exposure on the notional amount of the swap.

In addition to the risks applicable to derivatives generally, credit default swaps involve special risks because they are difficult to value, are highly susceptible to liquidity and credit risk, and generally pay a return to the party that has paid the premium only in the event of an actual default by the issuer of the underlying obligation, as opposed to a credit downgrade or other indication of financial difficulty.

The Following is a summary of the fair valuations of derivative instruments categorized by risk exposure:

Fair Values of derivative instruments on the Statement of Assets and Liabilities as of November 30, 2011:

	Asset Derivatives		**Liability Derivatives**	
Derivative Risk Exposure	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Foreign Exchange Contracts	Unrealized appreciation on forward currency contracts	$ 370,647	Unrealized depreciation on forward currency contracts	$ (2,485)
Credit Contracts	N/A		Unrealized depreciation on credit default swap contracts	(465,175)
Total		$ 370,647		$ (467,660)

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Stone Harbor Emerging Markets Income Fund Notes to Financial Statements

November 30, 2011

The effect of derivative instruments on the Statement of Operations for the period ended November 30, 2011:

Derivative Risk Exposure	Location of Gain/(Loss) On Derivatives Recognized in Income	Realized Gain/(Loss) On Derivatives Recognized in Income	Change in Unrealized Gain/(Loss) On Derivatives Recognized in Income
Foreign Exchange Contracts	Net realized gain/(loss) on: Foreign currency transactions/Change in unrealized appreciation/(depreciation) on: Translation of assets and liabilities denominated in foreign currencies	$ 2,817,725	$ 368,162
Credit Contracts	Net realized gain/(loss) on: Credit default swap contracts/Net change in unrealized appreciation/(depreciation) of: Credit default swap contracts	(361,111)	(465,175)
Total		$ 2,456,614	$ (97,013)

Credit Linked Notes: The Fund may invest in credit linked notes to obtain economic exposure to high yield, emerging markets or other securities. Investments in a credit linked note typically provide the holder with a return based on the return of an underlying reference instrument, such as an emerging market bond. Like an investment in a bond, investments in credit-linked securities represent the right to receive periodic income payments (in the form of distributions) and payment of principal at the end of the term of the security. In addition to the risks associated with the underlying reference instrument, an investment in a credit linked note is also subject to the risk that the counterparty will be unwilling or unable to meet its obligations under the note. Because credit linked notes are derivatives, an investment in these instruments is generally subject to the risks associated with derivatives.

(g) Loan Participations and Assignments: The Fund may invest in loans arranged through private negotiation between one or more financial institutions. The Fund s investment in any such loan may be in the form of a participation in or an assignment of the loan. In connection with purchasing participations, the Fund generally will have no right to enforce compliance by the borrower with the terms of the loan agreement relating to the loan, nor any rights of set-off against the borrower and the Fund may not benefit directly from any collateral supporting the loan in which it has purchased the participation.

The Fund assumes the credit risk of the borrower, the lender that is selling the participation and any other persons interpositioned between the Fund and the borrower. In the event of the insolvency of the lender selling the participation, the Fund may be treated as a general creditor of the lender and may not benefit from any set-off between the lender and the borrower.

(h) Leverage Risk: Leverage creates risks for Common Shareholders, including the likelihood of greater volatility of NAV per share and market price of, and dividends paid on, the Common Shares. There is a risk that fluctuations in the interest rates on any Borrowings held by the Fund may adversely affect the return to the Common Shareholders. If the income from the securities purchased with the proceeds of leverage is not sufficient to cover the cost of leverage, the return on the Fund will be less than if leverage had not been used, and therefore the amount available for distribution to the Common Shareholders as dividends and other distributions will be reduced.

The Fund may choose not to use leverage at all times. The amount and composition of leverage used may vary depending upon a number of factors, including economic and market conditions in the relevant emerging market countries, the availability of relatively attractive investment opportunities not requiring leverage and the costs and risks that the Fund would incur as a result of leverage.

(i) Credit and Market Risk: The Fund invests in high yield and emerging market instruments that are subject to certain credit and market risks. The yields of high yield and emerging market debt obligations reflect, among other things, perceived credit and market risks. The Fund s investment in securities rated below investment grade typically involves risks not associated with higher rated securities including, among others, greater risk related to timely and ultimate payment of interest and principal, greater market price volatility and less liquid secondary market trading. The consequences of political, social, economic or diplomatic changes may have disruptive effects on the market prices of investments held by the Fund. The Fund s investment in non-dollar denominated securities may also result in foreign currency losses caused by devaluations and exchange rate fluctuations. Investments in derivatives are also subject to credit and market risks.

(j) Distributions to Shareholders: The Fund intends to make a level dividend distribution each month to common shareholders. The level dividend rate may be modified by the Board of Trustees from time to time. Any net capital gains earned by the Fund are distributed at least annually. Income and long-term capital gain distributions are determined in accordance with federal income tax regulations, which may differ from GAAP. Distributions to shareholders are recorded by the Fund on the ex-dividend date.

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Stone Harbor Emerging Markets Income Fund

Notes to Financial Statements
November 30, 2011

(k) Classifications of Distributions: Net investment income (loss) and net realized gain (loss) may differ for financial statement and tax purposes. The character of distributions made during the year from net investment income or net realized gains may differ from its ultimate characterization for federal income tax purposes. Also, due to the timing of dividend distributions, the fiscal year in which amounts are distributed may differ from the fiscal year in which the income or realized gain was recorded by a Fund.

The tax character of the distributions paid by the Fund during the period ended November 30, 2011 was as follows:

Ordinary Income	$	27,759,544
Total	$	27,759,544

As of November 30, 2011, the components of distributable earnings on a tax basis were as follows:

Undistributed Ordinary Income	$	263,067
Unrealized Appreciation/(Depreciation)		(27,908,628)
Cumulative Effect of Other Timing Difference*		(259,512)
Total	$	(27,905,073)

* *Other temporary differences due to timing, consist primarily of mark-to-market on forward foreign currency contracts and credit default swap adjustments.*

The tax components of distributable earnings are determined in accordance with income tax regulations which may differ from the composition of net assets reported under accounting principles generally accepted in the United States. Accordingly, for the period ended November 30, 2011, certain differences were reclassified. These differences were primarily due to the differing tax treatment of certain investments and the amounts reclassified did not affect net assets.

The reclassifications were as follows:

Paid-in Capital	$	
Undistributed Net Investment Income	$	(2,965,282)
Accumulated Net Realized Loss	$	2,965,282

(l) Federal and Other Taxes: No provision for income taxes is included in the accompanying financial statements, as the Funds intend to distribute to shareholders all taxable investment income and realized gains and otherwise comply with Subchapter M of the Internal Revenue Code applicable to regulated investment companies.

The Fund evaluates tax positions taken (or expected to be taken) in the course of preparing the Fund s tax returns to determine whether these positions meet a more-likely-than-not standard that, based on the technical merits, have more than a fifty percent likelihood of being sustained by a taxing authority upon examination. A tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements.

Management of the Fund analyzes all open tax years, as defined by the Statute of Limitations, for all major jurisdictions, including federal tax authorities and certain state tax authorities. As of the period ended November 30, 2011, the Fund did not have a liability for any unrecognized tax benefits. The Fund s federal and state income and federal excise tax returns for all tax years since inception are subject to examination by the

Internal Revenue Service and state departments of revenue.

On December 22, 2010, the Regulated Investment Company Modernization Act of 2010 (the Modernization Act) was signed into law. The provisions of the Modernization Act are generally effective for tax years beginning after the date it was signed into law, therefore the enacted provisions will apply to the Fund for the fiscal year ending November 30, 2012. The Modernization Act is the first major piece of legislation affecting regulated investment companies (RICs) since 1986 and it modernizes several of the federal income and excise tax provisions related to RICs. Some highlights of the enacted provisions are as follows:

New capital losses may now be carried forward indefinitely, and retain the character of the original loss. Under pre-enactment law, capital losses could be carried forward for eight years, and carried forward as short-term capital losses, irrespective of the character of the original loss.

The Modernization Act contains simplification provisions, which are aimed at preventing disqualification of a RIC for inadvertent failures of the asset diversification and/or qualifying income tests. Additionally, the Modernization Act exempts RICs from the preferential dividend rule, and repealed the 60-day designation requirement for certain types of paythrough income and gains.

Stone Harbor Emerging Markets Income Fund Notes to Financial Statements

November 30, 2011

Finally, the Modernization Act contains several provisions aimed at preserving the character of distributions made by a RIC during the portion of its taxable year ending after October 31 or December 31, reducing the circumstances under which a RIC might be required to file amended Forms 1099 to restate previously reported distributions.

2. MANAGEMENT FEES, TRUSTEE FEES, ADMINISTRATION FEES, CUSTODY FEES AND TRANSFER AGENT FEE

The Adviser receives a monthly fee at the annual rate of 1.00% of the average daily value of the Fund s total assets (including any assets attributable to any leverage used) minus the Fund s accrued liabilities (other than Fund liabilities incurred for any leverage) (Total Assets).

ALPS Fund Services, Inc. (ALPS) serves as administrator to the Fund. Under the administration agreement, ALPS is responsible for calculating the net asset value of the common shares and generally managing the administrative affairs of the Fund. ALPS receives a monthly fee at an annual rate of 0.15% of the average daily value of the Fund s Total Assets.

The Bank of New York Mellon serves as the Fund s custodian. Mellon Investor Services LLC, an affiliate of The Bank of New York Mellon, serves as the Fund s transfer agent.

During the reporting period, the Fund paid each Trustee who is not a director, officer, employee, or affiliate of Stone Harbor or ALPS, a fee of $5,000 per quarterly meeting of the Board of Trustees and $250 for each additional meeting in which that Trustee participated. The Fund will also reimburse independent Trustees for travel and out-of-pocket expenses incurred in connection with such meetings.

3. SECURITIES TRANSACTIONS

During the period ended November 30, 2011, there were purchase and sale transactions (excluding short term securities) of $1,075,845,685 and $651,686,144, respectively.

On November 30, 2011, based on cost of $442,783,809 for federal income tax purposes, aggregate gross unrealized gains for all securities in which there is an excess of value over tax cost was $2,350,809 and aggregate gross unrealized losses for all securities in which there is an excess of tax cost over value was $(30,039,694), resulting in a net unrealized loss of $(27,688,885).

4. APPLICATION OF RECENT ACCOUNTING PRONOUNCEMENTS

In May 2011, the FASB issued ASU No. 2011-04 Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in GAAP and the International Financial Reporting Standards (IFRSs). ASU No.2011-04 amends FASB ASC Topic 820, Fair Value Measurements and Disclosures , to establish common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and IFRSs. ASU No.2011-04 is effective for fiscal years beginning after December 15, 2011 and for interim periods within those fiscal years. Management is currently evaluating the impact these amendments may have on the Fund s financial statements.

5. INDEMNIFICATIONS

In the normal course of business, the Fund enters into contracts that contain a variety of representations which provide general indemnifications. The Fund s maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the Fund that have not yet occurred.

Stone Harbor Emerging Markets Income Fund

Summary of Dividend Reinvestment Plan

November 30, 2011 (Unaudited)

Unless the registered owner of Common Shares elects to receive cash by contacting Mellon Investor Services LLC (the Plan Administrator), all dividends declared on Common Shares will be automatically reinvested by the Plan Administrator for shareholders in the Fund s Automatic Dividend Reinvestment Plan (the Plan), in additional Common Shares. Common Shareholders who elect not to participate in the Plan will receive all dividends and other distributions in cash paid by check mailed directly to the shareholder of record (or, if the Common Shares are held in street or other nominee name, then to such nominee) by the Plan Administrator as dividend disbursing agent. Participation in the Plan is completely voluntary and may be terminated or resumed at any time without penalty by notice if received and processed by the Plan Administrator prior to the dividend record date; otherwise such termination or resumption will be effective with respect to any subsequently declared dividend or other distribution. Such notice will be effective with respect to a particular dividend or other distribution (together, a Dividend). Some brokers may automatically elect to receive cash on behalf of Common Shareholders and may re-invest that cash in additional Common Shares.

The Plan Administrator will open an account for each Common Shareholder under the Plan in the same name in which such Common Shareholder s Common Shares are registered. Whenever the Fund declares a Dividend payable in cash, non-participants in the Plan will receive cash and participants in the Plan will receive the equivalent in Common Shares. The Common Shares will be acquired by the Plan Administrator for the participants accounts, depending upon the circumstances described below, either (i) through receipt of additional unissued but authorized Common Shares from the Fund (Newly Issued Common Shares) or (ii) by purchase of outstanding Common Shares on the open market (Open-Market Purchases) on the NYSE or elsewhere. If, on the payment date for any Dividend, the closing market price plus estimated brokerage commissions per Common Share is equal to or greater than the NAV per Common Share, the Plan Administrator will invest the Dividend amount in Newly Issued Common Shares on behalf of the participants. The number of Newly Issued Common Shares to be credited to each participant s account will be determined by dividing the dollar amount of the Dividend by the NAV per Common Share on the payment date; provided that, if the NAV is less than or equal to 95% of the closing market value on the payment date, the dollar amount of the Dividend will be divided by 95% of the closing market price per Common Share on the payment date. If, on the payment date for any Dividend, the NAV per Common Share is greater than the closing market value plus estimated brokerage commissions, the Plan Administrator will invest the Dividend amount in Common Shares acquired on behalf of the participants in Open-Market Purchases.

In the event of a market discount on the payment date for any Dividend, the Plan Administrator will have until the last business day before the next date on which the Common Shares trade on an ex-dividend basis or 30 days after the payment date for such Dividend, whichever is sooner (the Last Purchase Date), to invest the Dividend amount in Common Shares acquired in Open-Market Purchases. It is contemplated that the Fund will pay monthly income Dividends. If, before the Plan Administrator has completed its Open-Market Purchases, the market price per Common Share exceeds the NAV per Common Share, the average per Common Share purchase price paid by the Plan Administrator may exceed the NAV of the Common Shares, resulting in the acquisition of fewer Common Shares than if the Dividend had been paid in Newly Issued Common Shares on the Dividend payment date. Because of the foregoing difficulty with respect to Open-Market Purchases, the Plan provides that if the Plan Administrator is unable to invest the full Dividend amount in Open-Market Purchases during the purchase period or if the market discount shifts to a market premium during the purchase period, the Plan Administrator may cease making Open-Market Purchases and may invest the uninvested portion of the Dividend amount in Newly Issued Common Shares at the NAV per Common Share at the close of business on the Last Purchase Date provided that, if the NAV is less than or equal to 95% of the then current market price per Common Share, the dollar amount of the Dividend will be divided by 95% of the market price on the payment date for purposes of determining the number of shares issuable under the Plan.

The Plan Administrator maintains all shareholders accounts in the Plan and furnishes written confirmation of all transactions in the accounts, including information needed by shareholders for tax records. Common Shares in the account of each Plan participant will be held by the Plan Administrator on behalf of the Plan participant, and each shareholder proxy will include those shares purchased or received pursuant to the Plan. The Plan Administrator will forward all proxy solicitation materials to participants and vote proxies for shares held under the Plan in accordance with the instructions of the participants.

In the case of Common Shareholders such as banks, brokers or nominees which hold shares for others who are the beneficial owners, the Plan Administrator will administer the Plan on the basis of the number of Common Shares certified from time to time by the record shareholder s name and held for the account of beneficial owners who participate in the Plan.

There will be no brokerage charges with respect to Common Shares issued directly by the Fund. However, each participant will pay a pro rata share of brokerage commissions incurred in connection with Open-Market Purchases. The automatic reinvestment of Dividends will not relieve participants of any federal, state or local income tax that may be payable (or required to be withheld) on such Dividends. Participants that request a sale of Common Shares through the Plan Administrator are subject to brokerage commissions.

The Fund reserves the right to amend or terminate the Plan. There is no direct service charge to participants with regard to purchases in the Plan;however, the Fund reserves the right to amend the Plan to include a service charge payable by the participants.

All correspondence or questions concerning the Plan should be directed to the Plan Administrator at 1-866-390-3910.

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Stone Harbor Emerging Markets Income Fund Additional Information

November 30, 2011 (Unaudited)

FUND PORTFOLIO HOLDINGS

The Fund files its complete schedule of portfolio holdings with the Securities and Exchange Commission (the SEC) for the first and third quarters of each fiscal year on Form N-Q. The Fund s Form N-Q will be available (1) on the Fund s website located at http://www.shiplpcef.com, (2) on the SEC s website at http://www.sec.gov, or (3) they may be reviewed and copied at the SEC s Public Reference Room in Washington DC (call 1-800-732-0330 for information on the operation of the Public Reference Room).

PROXY VOTING

The policies and procedures used to determine how to vote proxies relating to securities held by the Fund is available (1) without charge, upon request, by calling 1-877-206-0791, (2) on the Fund s website located at http://www.shiplpcef.com, or (3) on the SEC s website at http://www.sec.gov. Information regarding how the Fund voted proxies relating to portfolio securities during the most recent twelve-month period ended June 30 is available by August 31 of each year (1) without charge, upon request, by calling 1-877-206-0791, (2) on the Fund s website located at http://www.shiplpcef.com, or (3) on the SEC s website at http://www.sec.gov.

SENIOR OFFICER CODE OF ETHICS

The Fund files a copy of its code of ethics that applies to the Fund s principal executive officer, principal financial officer or controller, or persons performing similar functions, with the SEC as an exhibit to its annual report on Form N-CSR. This will be available on the SEC s website at http://www.sec.gov.

This report, including the financial information herein, is transmitted to the shareholders of Stone Harbor Emerging Markets Income Fund for their information. It is not a prospectus, circular or representation intended for use in the purchase of shares of the Fund or any securities mentioned in this report.

Notice is hereby given in accordance with Section 23(c) of the Investment Company Act of 1940, as amended, that from time to time the Fund may purchase its common shares in the open market.

Information on the Fund is available at www.shiplpcef.com or by calling the Fund s shareholder servicing agent at 1-866-390-3910.

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Stone Harbor Emerging Markets Income Fund

Trustees & Officers

November 30, 2011 (Unaudited)

The business and affairs of the Fund are managed under the direction of its Board of Trustees. The Board of Trustees approves all significant agreements between a Fund and the persons or companies that furnish services to the Fund, including agreements with its distributor, investment adviser, administrator, custodian and transfer agent. The day-to-day operations of the Fund are delegated to the Fund s Adviser and administrator.

The name, age and principal occupations for the past five years of the Trustees and officers of the Funds are listed below, along with the number of portfolios in the Fund complex overseen by and the other directorships held by each Trustee. Except as otherwise noted, the address of each Trustee and officer is c/o Stone Harbor Investment Partners LP, 31 W. 52nd Street, 16th Floor, New York, New York 10019. The Fund s Statement of Additional Information includes additional information about the Trustees and is available without a charge, upon request, by calling 1-866-699-8158.

INDEPENDENT TRUSTEES

Name, Age and Address	**Position(s) Held with the Fund**	**Term of Office And Length of Time Served**[1]	**Principal Occupation(s) During Past 5 Years**	**Number of Portfolios in Fund Complex Overseen by Trustee**[2]	**Other Directorships Held by Trustee**	**Experience, Qualifications, Attributes, Skills for Board Membership**
Alan Brott Age: 69	Chairman of Audit Committee; Trustee/Nominee	Trustee: Since 2010 Term Expires: 2012	Columbia University Graduate School of Business Associate Professor, 2000-Present; Consultant, 1991-Present.	5	Stone Harbor Investment Funds, Grosvenor Registered Multi- Strategy Fund, Excelsior Multi- Strategy Hedge Fund of Funds and Excelsior Private Markets Fund II	Significant experience on Board of Trustees of the Fund and/or other business organizations; academic experience; significant public accounting experience, including significant experience as a partner at a public accounting firm.
Heath B. McLendon Age: 78	Trustee	Trustee: Since 2010 Term Expires: 2013	Citigroup Chairman of Equity Research Oversight Committee (retired December 31, 2006).	5	Stone Harbor Investment Funds	Significant experience on Board of Trustees of the Fund and/or other business organizations; executive experience in the mutual fund

						industry.
Patrick Sheehan Age: 64	Trustee	Trustee: Since 2010 Term Expires: 2014	Retired; formerly, Citigroup Asset Management Managing Director and Fixed Income Portfolio Manager, 1991-2002.	5	Stone Harbor Investment Funds	Significant experience on Board of Trustees of the Fund and/or other business organizations; experience in the financial industry, including executive and portfolio management experience.

INTERESTED TRUSTEE

Name, Age and Address	Position(s) Held with the Fund	Term of Office And Length of Time Served[1]	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Trustee[2]	Other Directorships Held by Trustee	Experience, Qualifications, Attributes, Skills for Board Membership
Thomas W. Brock* Age: 64	Chairman; Trustee/Nominee	Trustee: Since 2010 Term Expires: 2012	Stone Harbor Investment Partners LP Chief Executive Officer, 2006- Present; Columbia University Graduate School of Business Adjunct Professor, 1998-2006.	5	Stone Harbor Investment Funds; Liberty All Star Funds two closed-end funds.	Significant experience on Board of Trustees of the Fund and/or other business organizations; continuing experience as Chief Executive Officer of Stone Harbor Investment Partners LP; other financial and academic experience.

(1) Each Trustee serves until retirement, resignation or removal from the Board. The current retirement age is 80.

(2) For purposes of this table, the Stone Harbor Fund Complex includes the Stone Harbor Emerging Markets Income Fund (the Fund) and all of the Stone Harbor Investment Funds, which share an investment adviser with the Fund.

* Mr. Brock is an interested Trustee because of his position with Stone Harbor.

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Stone Harbor Emerging Markets Income Fund — Trustees & Officers

November 30, 2011 (Unaudited)

OFFICERS

Name & Age	Position with the Fund	Term of Office and Length of Time Served[1]	Principal Occupation(s) During Past Five Years	Other Directorships by Trustee
Peter J. Wilby Age: 53	President	Since November 2010	Co-portfolio manager of the Funds; since April 3, 2006, Chief Investment Officer of Stone Harbor Investment Partners LP; prior to April 3, 2006, Chief Investment Officer North American Fixed Income; joined Citigroup or its predecessor firms in 1989.	N/A
Pablo Cisilino Age: 44	Executive Vice President	Since November 2010	Co-portfolio manager of Emerging Markets Debt Fund; since July 1, 2006, Senior Portfolio Manager of Stone Harbor Investment Partners LP; from June 1, 2004 to July 1, 2006, Executive Director for Sales and Trading in Emerging Markets at Morgan Stanley Inc; prior to June 1, 2004, Vice President for local markets and FX sales and trading, Goldman Sachs; joined Goldman Sachs in 1994.	N/A
James E. Craige Age: 44	Executive Vice President	Since November 2010	Co-portfolio manager of Emerging Markets Debt Fund; since April 3, 2006, Senior Portfolio Manager of Stone Harbor Investment Partners LP; prior to April 3, 2006, Managing Director and Senior Portfolio Manager at Salomon Brothers Asset Management Inc.; joined Salomon Brothers Asset Management Inc. in 1992.	N/A
Thomas K. Flanagan Age: 58	Executive Vice President	Since November 2010	Co-portfolio manager of Emerging Markets Debt Fund; since April 3, 2006, Senior Portfolio Managerof Stone Harbor Investment Partners LP; prior to April 3, 2006, Managing Director and Senior Portfolio Manager at Salomon Brothers Asset Management Inc.; joined Salomon Brothers Asset Management Inc. in 1991.	N/A
David Oliver Age: 52	Executive Vice President	Since November 2010	Co-portfolio manager of Emerging Markets Debt Fund; since June 1, 2008 Senior Portfolio Manager of Stone Harbor, from 1986 to June 1, 2008 Managing Director in Emerging Market sales and trading Citigroup.	N/A
Jeffrey S. Scott Age: 52	Chief Compliance Officer	Since November 2010	Since April 3, 2006, Chief Compliance Officer of Stone Harbor Investment Partners LP; from October 2006 to March 2007, Director of Compliance, New York Life Investment Management LLC; from July 1998 to September 2006, Chief Compliance Officer, Salomon Brothers Asset Management Inc.	N/A

[1] Officers are typically elected every year, unless an officer early retires, resigns or is removed from office.

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Stone Harbor Emerging Markets Income Fund

Trustees & Officers
November 30, 2011 (Unaudited)

OFFICERS (continued)

Name & Age	Position with the Fund	Term of Office and Length of Time Served[1]	Principal Occupation(s) During Past Five Years	Other Directorships by Trustee
James J. Dooley Age: 56	Treasurer	Since November 2010	Since April 3, 2006, Head of Operations, Technology and Finance of Stone Harbor Investment Partners LP; from August 2004 to March 2006, Senior Operations Manager of Institutional Asset Management, Citigroup Asset Management; from October 2002 to August 2004, Managing Director,Global Operations & Application Development, AIG Global Investment Group;from May 2001 to September 2002, President and Chief Operating Officer, Financial Technologies International.	N/A
Adam J. Shapiro Age: 48	Secretary; Anti-Money Laundering Officer	Since November 2010	Since April 3, 2006, General Counsel of Stone Harbor Investment Partners LP; from April 2004 to March 2006, General Counsel, North American Fixed Income, Salomon Brothers Asset Management Inc.; from August 1999 to March 2004, Director of Product and Business Development, Citigroup Asset Management.	N/A
Patrick D. Buchanan Age: 39	Assistant Treasurer	Since November 2010	Since October 15, 2007, Senior Fund Controller for ALPS Fund Services, Inc.; from February 2005 to October 2007, Director of Accounting for Madison Capital Management LLC; from August 2003 to February, 2005, Manager of Fund Accounting for Janus Capital Group	N/A

[1] Officers are typically elected every year, unless an officer early retires, resigns or is removed from office.

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INVESTMENT ADVISER
Stone Harbor Investment Partners LP
31 W. 52nd Street 16th Floor
New York, New York 10019

ADMINISTRATOR & FUND ACCOUNTANT
ALPS Fund Services, Inc.
1290 Broadway, Suite 1100
Denver, Colorado 80203

TRANSFER AGENT & CUSTODIAN
The Bank of New York Mellon
One Wall Street
New York, New York 10286

LEGAL COUNSEL
Ropes & Gray LLP
1211 Avenue of the Americas
New York, New York 10036

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
Deloitte & Touche LLP
555 17th Street, Suite 3600
Denver, Colorado 80202

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Item 2. **Code of Ethics.**

(a) The registrant, as of the end of the period covered by the report, has adopted a code of ethics that applies to the registrant s principal executive officer, principal financial officer, principal accounting officer or controller or any persons performing similar functions on behalf of the registrant.

(b) Not Applicable.

(c) During the period covered, by this report, no amendments were made to the provisions of the code of ethics adopted in 2 (a) above.

(d) During the period covered by this report, no implicit or explicit waivers to the provision of the code of ethics adopted in 2 (a) above were granted.

(e) Not Applicable.

(f) The registrant s Code of Ethics is attached as Exhibit 12.A.1 hereto.

Item 3. **Audit Committee Financial Expert.**

The registrant s Board of Trustees has determined that the registrant has as least one audit committee financial expert serving on its audit committee. The Board of Trustees has designated Alan Brott as the registrant s audit committee financial expert. Mr. Brott is independent as defined in paragraph (a)(2) of Item 3 to Form N-CSR.

Mr. Brott has significant public accounting experience, including significant experience as a partner at a public accounting firm.

Item 4. **Principal Accounting Fees and Services.**

(a) Audit Fees: The aggregate fees billed for professional services rendered by the principal accountant for the audit of the registrant's annual financial statements or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for the fiscal period December 22, 2010 (inception) through November 30, 2011 were $62,500.

(b) Audit-Related Fees: The aggregate fees billed for the fiscal period December 22, 2010 (inception) through November 30, 2011 for assurance and related services by the principal accountant that are reasonably related to the performance of the audit of the registrant's financial statements and are not reported under paragraph (a) of this Item were $11,000.

(c) Tax Fees: The aggregate fees billed for the fiscal period December 22, 2010 (inception) through November 30, 2011 for professional services rendered by the principal accountant for tax compliance, tax advice, and tax planning were $4,505.

(d) All Other Fees: The aggregate fees billed for the fiscal period December 22, 2010 (inception) through November 30, 2011 for products and services provided by the principal accountant, other than the services reported in paragraphs (a) through (c) of this Item were $0.

(e)(1) Audit Committee Pre-Approval Policies and Procedures: All services to be performed by the Registrant's principal auditors must be pre-approved by the registrant's audit committee.

(e)(2) No services described in paragraphs (b) through (d) were approved pursuant to paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X.

(f) Not applicable.

(g) The aggregate non-audit fees billed by the registrant s accountant for services rendered to the registrant, and rendered to the registrant s investment adviser, and any entity controlling, controlled by, or under common control with the adviser that provides ongoing services to the registrant for the fiscal period December 22, 2010 (inception) through November 30, 2011 were $0.

(h) Not applicable.

Item 5. **Audit Committee of Listed Registrant.**

The registrant has a separately designated standing audit committee established in accordance with Section 3 (a)(58)(A) of the Exchange Act and is comprised of the following members:

Alan Brott, Chairman

Heath McLendon

Patrick Sheehan

Item 6. **Schedule of Investments.**

(a) Schedule of Investments in securities of unaffiliated issuers as of the close of the reporting period is included as part of the Report to Stockholders filed under Item 1 of this Form N-CSR.

(b) Not applicable.

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Item 7. **Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies.**

Attached, as Exhibit Item 7, is a copy of the registrant s policies and procedures.

Item 8. **Portfolio Managers of Closed-End Management Investment Companies**.

(a)(1) As of: February 6, 2012

Name	Position(s) Held with the Fund	Term of Office And Length of Time Served	Principal Occupation(s) During Past 5 Years
Peter J. Wilby	President and Chief Executive Officer	Since 2010	Co-portfolio manager of Fund; Since April 2006, Chief Investment Officer of Stone Harbor; Prior to April 2006, Chief Investment Officer North American Fixed Income and senior portfolio manager responsible for directing investment policy and strategy for all emerging markets and high yield fixed income portfolios at Citigroup Asset Management; Joined Citigroup or its predecessor firms in 1989. 30 years of industry experience.
Pablo Cisilino	Executive Vice President	Since 2010	Co-portfolio manager of Fund; Since July 2006, Portfolio Manager of Stone Harbor; From June 1, 2004 to July 2006, Executive Director for Sales and Trading in Emerging Markets at Morgan Stanley Inc; Prior to June 1, 2004, Vice President for local markets and FX sales and trading, Goldman Sachs; Joined Goldman Sachs in 1994. 21 years of industry experience.
James E. Craige	Executive Vice President	Since 2010	Co-portfolio manager of Fund; Since April 2006, Portfolio Manager of Stone Harbor; Prior to April 2006, Managing Director and Senior Portfolio Manager for emerging markets debt portfolios at Salomon Brothers Asset Management

Inc.; Joined Salomon Brothers Asset Management Inc. in 1992. 21 years of industry experience.

Thomas K. Flanagan	Executive Vice President	Since 2010	Co-portfolio manager of Fund; Since April 2006, Portfolio Manager of Stone Harbor; Prior to April 2006, Managing Director and Senior Portfolio Manager for emerging markets debt portfolios at Salomon Brothers Asset Management Inc.; Joined Salomon Brothers Asset Management Inc. in 1991. 32 years of industry experience.
David A. Oliver	Executive Vice President	Since 2010	Co-portfolio manager of Fund; Since June 2008, Portfolio Manager of Stone Harbor; Prior to June 2008, Managing Director in emerging market sales and trading at Citigroup; Joined Citigroup in 1986. 23 years of industry experience.
Christopher M. Wilder	Executive Vice President	Since 2010	Co-portfolio manager of Fund; Since June 2010, Portfolio Manager of Stone Harbor; From May 2008 to May 2010, served as manager of an emerging market corporate debt and private equity fund at Autonomy Capital Group; Prior to May 2008, head of the Emerging Markets Corporate Credit Trading and Special Situations Group at Deutsche Bank; Joined Deutsche Bank in 1997. 15 years of industry experience.
David Scott	Executive Vice President	Since 2010	Co-Portfolio manager of Fund; Since April 2006, Portfolio Manager of Stone Harbor; Prior to April 2006, Managing Director and Head of Traditional Investment Group responsible for the global bond portfolios at Salomon Brothers Asset Management Limited; Joined Salomon Brothers Asset Management Limited in 1994.

David Griffiths	Executive Vice President	Since 2010	Co-Portfolio manager of Fund; Since April 2006, Portfolio Manager of Stone Harbor; Prior to April 2006, Senior Portfolio Manager and economist responsible market opportunity analysis, hedging and alternative asset allocation strategies; Joined Salomon Brothers Asset Management Limited in 1993.

(a)(2) As of November 30, 2011, the Portfolio Managers listed above are also responsible for the day-to-day management of the following:

	Registered Investment Companies		Other Pooled Investment Vehicles		Other Accounts	
Portfolio Manager	**# of Accounts**	**Total Assets**	**# of Accounts**	**Total Assets**	**# of Accounts**	**Total Assets**
Peter J. Wilby, CFA	11	$ 4,201,184,202	19[1]	$ 9,516,040,411	84[3]	$ 23,062,154,476
James E. Craige, CFA	8	$ 3,329,621,348	13[2]	$ 8,523,532,521	63[4]	$ 17,873,275,588
Thomas K. Flanagan, CFA	8	$ 3,329,621,348	13[2]	$ 8,523,532,521	63[4]	$ 17,873,275,588
Pablo Cisilino	8	$ 3,329,621,348	13[2]	$ 8,523,532,521	63[4]	$ 17,873,275,588
David A. Oliver, CFA	8	$ 3,329,621,348	13[2]	$ 8,523,532,521	63[4]	$ 17,873,275,588
Christopher M. Wilder, CFA	8	$ 3,329,621,348	13[2]	$ 8,523,532,521	63[4]	$ 17,873,275,588
David Scott	8	$ 3,329,621,348	13[2]	$ 8,523,532,521	63[4]	$ 17,873,275,588
David Griffiths	8	$ 3,329,621,348	13[2]	$ 8,523,532,521	63[4]	$ 17,873,275,588

(1) One pooled investment vehicle contains an account (market value $209,456,975) that is subject to a performance-based advisory fee. Two accounts are also subject to a performance-based advisory fee with a total market value of $706,472,581.

(2) One pooled investment vehicle contains a portion of one account (market value $88,517,332) that is subject to a performance-based advisory fee. Two accounts are also subject to a performance-based advisory fee with a total market value of $706,472,581.

(3) Four accounts are subject to a performance-based advisory fee with a total market value of $1,343,838,986.

(4) Three accounts are subject to a performance-based advisory fee with a total market value of $1,067,064,399.

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Potential Conflicts of Interest

Potential Conflicts of Interest

Potential conflicts of interest may arise when one of the Fund s portfolio managers has day-to-day management responsibilities with respect to one or more other funds or other accounts, as is the case for the portfolio managers listed in the table above.

The Investment Manager and the Fund have adopted compliance policies and procedures that are designed to address various conflicts of interest that may arise for the Investment Manager and the individuals that it employs. For example, the Investment Manager seeks to minimize the effects of competing interests for the time and attention of portfolio managers by assigning portfolio managers to manage funds and accounts that share a similar investment style. The Investment Manager has also adopted trade allocation procedures that are designed to facilitate the fair allocation of limited investment opportunities among similarly-managed funds and accounts. There is no guarantee, however, that the policies and procedures adopted by the Investment Manager and the Fund will be able to detect and/or prevent every situation in which an actual or potential conflict may appear.

These potential conflicts include:

Allocation of Limited Time and Attention. A portfolio manager who is responsible for managing multiple funds and/or accounts may devote unequal time and attention to the management of those funds and/or accounts. As a result, the portfolio manager may not be able to formulate as complete a strategy or identify equally attractive investment opportunities for each of those accounts as might be the case if he or she were to devote substantially more attention to the management of a single fund. The effects of this potential conflict may be more pronounced where funds and/or accounts overseen by a particular portfolio manager have different investment strategies.

Allocation of Limited Investment Opportunities. If a portfolio manager identifies a limited investment opportunity that may be suitable for multiple funds and/or accounts, the opportunity may be allocated among these several funds or accounts, which may limit a fund s ability to take full advantage of the investment opportunity.

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Pursuit of Differing Strategies. At times, a portfolio manager may determine that an investment opportunity may be appropriate for only some of the funds and/or accounts for which he or she exercises investment responsibility, or may decide that certain of the funds and/or accounts should take differing positions with respect to a particular security. In these cases, the portfolio manager may place separate transactions for one or more funds or accounts which may affect the market price of the security or the execution of the transaction, or both, to the detriment or benefit of one or more other funds and/or accounts.

Selection of Brokers/Dealers. Portfolio managers may be able to select or influence the selection of the brokers and dealers that are used to execute securities transactions for the funds and/or account that they supervise. In addition to executing trades, some brokers and dealers provide portfolio managers with brokerage and research services (as those terms are defined in Section 28(e) of the Securities Exchange Act of 1934), which may result in the payment of higher brokerage fees than might have otherwise been available. These services may be more beneficial to certain funds or accounts than to others. Although the payment of brokerage commissions is subject to the requirement that the portfolio manager determine in good faith that the commissions are reasonable in relation to the value of the brokerage and research services provided to the fund, a portfolio manager s decision as to the selection of brokers and dealers could yield disproportionate costs and benefits among the funds and/or accounts that he or she manages.

Use of Leverage. During periods in which the Fund is using leverage, the fees paid to the Investment Manager, which may directly or indirectly affect the portfolio manager s compensation, for investment advisory services will be higher than if the Fund did not use leverage because the fees paid will be calculated on the basis of the Fund s Total Assets, including assets attributable to any Borrowings and/or to any Preferred Shares, which may create an incentive for the portfolio manager to leverage the Fund or to leverage using strategies that increase the Investment Manager s fee.

Variation in Compensation. A conflict of interest may arise where the financial or other benefits available to the portfolio manager differ among the funds and/or accounts that he or she manages. If the structure of the Investment Manager s management fee and/or the portfolio manager s compensation differs among funds and/or accounts (such as where certain funds or accounts pay higher management fees or performance-based management fees), the portfolio manager might be motivated to help certain funds and/or accounts over others. The portfolio manager might be motivated to favor funds and/or accounts in which he or she has an interest or in which the investment advisor and/or its affiliates have interests. Similarly, the desire to maintain or raise assets under management or to enhance the portfolio manager s performance record or to derive other rewards, financial or otherwise, could influence the portfolio manager to lend preferential treatment to those funds and/or accounts that could most significantly benefit the portfolio manager.

Related Business Opportunities. The Investment Manager or its affiliates may provide more services (such as distribution or recordkeeping) for some types of funds or accounts than for others. In such cases, a portfolio manager may benefit, either directly or indirectly, by devoting disproportionate attention to the management of fund and/or accounts that provide greater overall returns to the Investment Manager and its affiliates.

(a)(3) Portfolio Manager Compensation as of November 30, 2011.

The Investment Manager is 100% employee owned, which gives its personnel a direct stake in the success of the firm. In addition to a share in firm ownership, this compensation program includes a salary commensurate with experience and a performance-based bonus.

The overall compensation structure for the Fund s portfolio managers is based on three components: (a) base remuneration; (b) discretionary performance-based bonus; and (c) profit participation.

Portfolio managers are compensated on pre-tax investment performance versus both the applicable benchmark and peer group as measured on a one-, three- and five-year horizon equally weighted. For these purposes, the benchmark for the Fund is a blend of the J.P. Morgan GBI-EM Global Diversified Bond Index, the J.P. Morgan EMBI Global Diversified Bond Index and the J.P. Morgan Corporate Emerging Markets Bond Index. Analysts are compensated on credit performance versus the applicable benchmark for the same periods. All employees will also participate in firm profit-sharing.

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(a)(4) Dollar Range of Securities Owned as of November 30, 2011.

Portfolio Managers	Dollar Range of the Registrant s Securities Owned by the Portfolio Managers
Peter J. Wilby, CFA	Over $1,000,000
James E. Craige, CFA	$500,001 - $1,000,000
Thomas K. Flanagan, CFA	$100,001 - $500,000
Pablo Cisilino	$100,001 - $500,000
David A. Oliver, CFA	$100,001 - $500,000
Christopher M. Wilder, CFA	$0
David Scott	$0
David Griffiths	$0

Item 9. **Purchases of Equity Securities by Closed-End Management Investment Companies and Affiliated Purchasers.**

None

Item 10. **Submission of Matters to Vote of Security Holders.**

There have been no material changes to the procedures by which shareholders may recommend nominees to the Registrant s Board of Trustees, where those changes were implemented after the Registrant last provided disclosure in response to the requirements of Item 407(c)(2) of Regulation S-K, or this Item.

Item 11. **Controls and Procedures.**

(a) The registrant s principal executive officer and principal financial officer have concluded that the Registrant s disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940, as amended) are effective based on their evaluation of these controls and procedures as of a date within 90 days of the filing date of this document.

(b) There was no change in the Registrant's internal control over financial reporting (as defined in Rule 30a-3(d) under the Investment Company Act of 1940, as amended) during the second fiscal quarter of the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting.

Item 12. **Exhibits.**

(a)(1) The Code of Ethics that applies to the registrant s principal executive officer and principal financial officer is attached hereto as Exhibit 12.A.1.

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(a)(2) The certifications required by Rule 30a-2(a) of the Investment Company Act of 1940, as amended, and Section 302 of the Sarbanes-Oxley Act of 2002 are attached hereto as Ex-99.Cert.

(a)(3) Not applicable.

(b) A certification for the Registrant s Principal Executive Officer and Principal Financial Officer, as required by Rule 30a-2(b) of the Investment Company Act of 1940, as amended, and Section 906 of the Sarbanes-Oxley Act of 2002 are attached hereto as Ex-99.906Cert.

(c) The Proxy Voting Policies and Procedures are attached hereto as Ex99. Item 7.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Stone Harbor Emerging Markets Income Fund

By: /s/ Peter J. Wilby
Peter J. Wilby
President/Principal Executive Officer

Date: February 6, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Stone Harbor Emerging Markets Income Fund

By: /s/ Peter J. Wilby
Peter J. Wilby
President/Principal Executive Officer

Date: February 6, 2012

By: /s/ James J. Dooley
James J. Dooley
Treasurer, Chief Financial Officer/
Principal Financial Officer

Date: February 6, 2012