NEIMAN MARCUS GROUP INC
Form 424B3
September 28, 2006

PROSPECTUS SUPPLEMENT **Filed Pursuant to Rule 424(b)(3)**
(To Prospectus dated June 5, 2006) **Registration No. 333-133186**

The Neiman Marcus Group, Inc.

Offer to Exchange

\$700,000,000 principal amount of our 9%/9¾% Senior Notes due 2015
\$500,000,000 principal amount of our 10 3/8% Senior Subordinated Notes due 2015

Recent Developments

We have attached to this prospectus supplement the Annual Report on Form 10-K of Neiman Marcus, Inc. for the fiscal year ended July 29, 2006. The attached information updates and supplements The Neiman Marcus Group, Inc. s Prospectus dated June 5, 2006.

You should carefully consider the risk factors beginning on page 23 of the Prospectus before investing.

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

September 27, 2006

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 July 29, 2006

OR

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

For the transition period from to

Commission file no. 333-133184-12

Neiman Marcus, Inc.
(Exact name of registrant as specified in its charter)

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

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

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o 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 Exchange Act. Yes o 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 o

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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

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

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

The aggregate market value of the registrant s voting and non-voting common equity held by non-affiliates of the registrant is zero. The registrant is a privately held corporation.

As of September 25, 2006, the registrant had outstanding 1,012,264 shares of its common stock, par value $0.01 per share.

NEIMAN MARCUS, INC.
ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED JULY 29, 2006
TABLE OF CONTENTS

PART I

ITEM 1. BUSINESS

Business Overview

We are one of the nation s leading luxury retailers, offering distinctive merchandise and excellent customer service that cater to the needs of the affluent consumer. Since our founding in the early 1900s, we have established ourselves as a leading fashion authority among luxury consumers and have become a premier U.S. retail channel for many of the world s most exclusive designers. Currently, we operate 37 Neiman Marcus full-line stores at prime retail locations in major U.S. markets and two Bergdorf Goodman stores on Fifth Avenue in New York City. We also operate catalogs and e-commerce websites under the brands Neiman Marcus®, Bergdorf Goodman® and Horchow® and own a majority interest in Kate Spade LLC, which designs and markets high-end accessories. During fiscal years 2006, 2005 and 2004, we generated revenues of $4,105.6 million, $3,774.8 million and $3,484.0 million, respectively, and operating earnings of $328.1 million, $409.0 million and $343.2 million, respectively.

We operate an integrated, multi-channel retailing model as described below:

Specialty Retail. Our specialty retail store operations (Specialty Retail) consist primarily of our 37 Neiman Marcus stores and two Bergdorf Goodman stores. We also operate 18 clearance centers to provide an outlet for the sale of end-of-season clearance merchandise. Over our past five fiscal years, Specialty Retail has achieved a compounded annual growth rate, or CAGR, in revenues of 6.4%. During fiscal years 2006, 2005 and 2004, Specialty Retail accounted for 82.2%, 82.2% and 81.8%, respectively, of our total revenues.

- Neiman Marcus Stores. Neiman Marcus stores offer distinctive luxury merchandise, including women s couture and designer apparel, contemporary sportswear, handbags, fashion accessories, shoes, cosmetics, men s clothing and furnishings, precious and designer jewelry, decorative home accessories, fine china, crystal and silver, children s apparel and gift items. We locate our Neiman Marcus stores at carefully selected venues that cater to our target customers in major metropolitan markets across the United States, and design our stores to provide a feeling of residential luxury by blending art and architectural details from the communities in which they are located. During fiscal years 2006, 2005 and 2004 our full-line Neiman Marcus stores and clearance centers accounted for 70.9%, 71.3% and 71.4%, respectively, of our total revenues and 86.3%, 86.8% and 87.2%, respectively, of Specialty Retail revenues.

- Bergdorf Goodman Stores. Bergdorf Goodman is a premier luxury retailer in New York City well known for its couture merchandise, opulent shopping environment and landmark Fifth Avenue locations. Bergdorf Goodman features high-end apparel, fashion accessories, shoes, decorative home accessories, precious and designer jewelry, cosmetics and gift items. During fiscal years 2006, 2005 and 2004, our Bergdorf Goodman stores accounted for 11.3%, 10.9% and 10.4%, respectively, of our total revenues and 13.7%, 13.2% and 12.8%, respectively, of Specialty Retail revenues.

Direct Marketing. Our upscale direct-to-consumer operation (Direct Marketing) conducts online and catalog sales of fashion apparel, accessories and home furnishings through the Neiman Marcus brand, online and catalog sales of home furnishings and accessories through the Horchow brand, and online sales of fashion apparel and accessories through the Bergdorf Goodman brand. In addition, Direct Marketing currently operates 9 designer websites (3 of which were launched at the beginning of fiscal year 2007). In connection with the designer websites, Direct Marketing creates and maintains separate e-commerce sites bearing the designers brand names. Direct Marketing procures inventory from each designer to be showcased on that designer s website and bears all the responsibilities related to the fulfillment of goods purchased on the designer website.

Direct Marketing generated revenues of $655.3 million, or 16.0% of our total revenues, in fiscal year 2006, $592.1 million, or 15.7% of our total revenues, in fiscal year 2005 and $570.6 million, or 16.4% of our total revenues in 2004. Over one million customers made a purchase through one of our catalogs or websites in fiscal year 2006. Our catalog business circulated over 100 million catalogs in fiscal year 2006. We regularly send e-mails to over 2.3 million e-mail addresses, alerting our customers to our newest merchandise and the latest fashion trends. Over the last five fiscal years, Direct Marketing has achieved a CAGR in revenues (excluding revenues of our Chef s Catalog brand sold in November 2004) of 12.9%.

For more information about our reportable segments, see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 16 of the Notes to Consolidated Financial Statements in Item 15.

2

Our fiscal year ends on the Saturday closest to July 31. All references to fiscal year 2006 relate to the combined 52 weeks ended July 29, 2006 (calculated as described in The Transactions); all references to fiscal year 2005 relate to the 52 weeks ended July 30, 2005; and all references to fiscal year 2004 relate to the 52 weeks ended July 31, 2004. References to fiscal years 2007 and years thereafter relate to our fiscal years for such periods.

We make our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and related amendments, available free of charge through our website at www.neimanmarcusgroup.com as soon as reasonably practicable after we electronically file such material with (or furnish such material to) the Securities and Exchange Commission. The information contained on our website is not incorporated by reference into this Form 10-K and should not be considered to be part of this Form 10-K.

The Transactions

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

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

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

The Sponsors financed the purchase of NMG and the concurrent redemption of the 6.65% senior notes due 2008 (2008 Notes) through:

- application of the proceeds from the offering of senior notes and senior subordinated notes;
- initial borrowings under a senior secured asset-based revolving credit facility and a senior secured term loan facility;
- equity investments funded by direct and indirect equity investments from the Sponsors and other investors; and
- cash on hand at NMG.

The Acquisition was completed on October 6, 2005 and occurred simultaneously with:

- the closing of the offering of our senior notes (Senior Notes) and our senior subordinated notes (Senior Subordinated Notes);
- the closing of our new senior secured asset-based revolving credit facility (Asset-Based Revolving Credit Facility);
- the closing of our new senior secured term loan facility (Senior Secured Term Loan Facility);
- the call for redemption of, the deposit into a segregated account of the estimated amount of the redemption payment related to, and the ratable provision of security pursuant to the terms thereof for, the 2008 Notes;

- the ratable provision of security for the 2028 debentures (2028 Debentures) pursuant to the terms thereof;
- the termination of our existing $350 million unsecured revolving credit facility; and
- the equity investments described above.

We refer to these transactions, including the merger and our payment of any costs related to these transactions and certain related transactions as the Transactions. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources for a description of our senior secured credit facilities and senior and senior subordinated notes.

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

We have prepared our discussion of the results of operations for the fiscal year ended July 29, 2006 by comparing the results of operations of the Predecessor for the fiscal year ended July 30, 2005 to the combined amounts obtained by adding the earnings and cash flows for the Predecessor nine-week period ended October 1, 2005 and the Successor forty-three week period ended July 29, 2006. Although this combined presentation does not comply with generally accepted accounting principles (GAAP), we believe that it provides a meaningful method of comparison. The combined operating results have not been prepared on a pro forma basis under applicable regulations and may not reflect the actual results we would have achieved absent the Transactions and may not be predictive of future results of operations.

In connection with the Transactions, we incurred significant indebtedness and became highly leveraged. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources. In addition, the purchase price paid in connection with the Acquisition has been allocated to state the acquired assets and liabilities at fair value. The purchase accounting adjustments increased the carrying value of our property and equipment and inventory, established intangible assets for our tradenames, customer lists and favorable lease commitments and revalued our long-term benefit plan obligations, among other things. Subsequent to the Transactions, interest expense and non-cash depreciation and amortization charges have significantly increased. As a result, our successor financial statements subsequent to the Transactions are not comparable to our predecessor financial statements.

Disposition of Gurwitch Products, L.L.C.

On July 27, 2006, we sold our former majority interest in Gurwitch Products, L.L.C. to Alticor Inc., for pretax net cash proceeds of approximately $40.8 million (Gurwitch Disposition). Gurwitch Products, L.L.C. designs and markets the Laura Mercier® cosmetics line and had annual revenues of approximately $71.6 million in fiscal year 2006. The net assets of Gurwitch Products, L.L.C. were sold for their net carrying value (after purchase accounting adjustments made in connection with the Transactions to state such assets at fair value). In addition, we recorded tax expense of $13.3 million, payable by the Company on the excess of the tax over book gain realized in connection with the Gurwitch Disposition.

The Company s financial statements, accompanying notes and other information provided in this Annual Report on Form 10-K reflect Gurwitch Products, L.L.C. as a discontinued operation for all periods presented.

Recent Developments

On August 31, 2006, we announced preliminary total revenues and comparable revenues of approximately $270 million and $262 million, respectively, for the four-week August period of fiscal year 2007, representing increases of 7.4% and 4.4%, respectively, compared to the four-week August period of fiscal year 2006. For the four-week August period of fiscal year 2007, comparable revenues increased 2.1% in the Specialty Retail stores segment and 19.3% in the Direct Marketing Segment.

All the financial data set forth above for the four-week August period of fiscal year 2007 are preliminary and unaudited and subject to revision based upon our review and a review by our independent registered public accounting firm of our financial condition and results of operations for the quarter ending October 28, 2006. Once we and our independent registered public accounting firm have completed our respective reviews of our financial information for the quarter ending October 28, 2006, we may report financial results that are materially different from those set forth above.

Industry Overview

We operate in the luxury apparel and accessories segment of the U.S. retail industry and have arrangements with luxury-branded fashion vendors, including Chanel, Prada, St. John, Gucci, David Yurman, Theory, Ermenegildo Zegna, Manolo Blahnik and Giorgio Armani, to market and sell their merchandise. Luxury-branded fashion vendors typically manage the distribution and marketing of their merchandise to maximize the perception of brand exclusivity and to facilitate the sale of their goods at premium prices, including limitations on the number of retail locations through which they distribute their merchandise. These retail locations typically consist of a limited number of specialty stores, high-end department stores and, in some instances, vendor-owned proprietary boutiques. Retailers that compete with us for the distribution of luxury fashion brands include Saks Fifth Avenue, Nordstrom, Barney s New York and other national, regional and local retailers.

We believe that the following factors benefit well-positioned luxury retailers:

- attractive demographic trends, including increasing wealth concentration and an aging baby boomer population;
- growing consumer demand for prestige brands and exclusive products;
- retail consumption patterns of affluent consumers that are generally less influenced by economic cycles than middle or lower income consumers;
- higher price points and limited distribution of luxury merchandise, which have generally protected high-end specialty retailing from the growth of discounters and mass merchandisers;
- aggressive marketing by luxury brands; and
- consumer trends towards aspirational lifestyles.

Customer Service and Marketing

We are committed to providing our customers with a premier shopping experience through our relationship-based customer service model, with superior merchandise selection and elegant store settings of our stores. Critical elements to our customer service approach are:

- knowledgeable, professional and well-trained sales associates;
- marketing programs designed to promote customer awareness of our offerings of the latest fashion trends;
- loyalty programs designed to cultivate long-term relationships with our customers; and
- facilitating the extension of credit to our customers through our proprietary credit card program.

Sales Associates. We seek to maintain a sales force of knowledgeable, professional and well-trained sales associates to deliver personal attention and service to our customers through our relationship-based customer service model. We compensate our sales associates primarily on a commission basis and provide them with training in the areas of customer service, selling skills and product knowledge. Our sales associates participate in active clienteling programs designed to maintain contact with our customers between store visits and to ensure that our customers are aware of the latest merchandise offerings and fashion trends that we present in our stores. We empower our sales associates to act as personal shoppers and in many cases, as the personal style advisor to our customers.

Marketing Programs. We conduct a wide variety of marketing programs to support our sales associates in the communication of fashion trends to our customers in order to create fashion excitement and enhance our customer relationships. The programs include both in-store events and targeted, brand-consistent print media communications.

5

We maintain an active calendar of in-store events to promote our sales efforts. The activities include in-store visits and trunk shows by leading designers featuring the newest fashions from the designer, in-store promotions of the merchandise of selected designers or merchandise categories, often through events conducted in connection with our loyalty programs, and participation in charitable functions in each of our markets. Past trunk shows and in-store promotions at our Neiman Marcus and Bergdorf Goodman stores have featured designers such as Chanel, Giorgio Armani and Oscar de la Renta.

Through our print media programs, we mail various publications to our customers communicating upcoming in-store events, new merchandise offerings and fashion trends. In connection with these programs, Neiman Marcus produces The Book® approximately eight to nine times each year. The Book is a high-quality publication featuring the latest fashion trends that is mailed on a targeted basis to our customers and has a yearly printing in excess of 3.4 million. Our other print publications include The Book for Men, the Bergdorf Goodman Magazine and specific designer mailers. Recently, we added The Addition®, which identifies for our younger, aspirational customers, as well as our core customers, must have items for the current season.

We also believe that the online and print catalog operations of Direct Marketing promote brand awareness, which benefits the operations of our retail stores.

Loyalty Programs. We maintain a loyalty program under the InCircle® brand name designed to cultivate long-term relationships with our customers. Our loyalty program focuses on our most active customers. This program includes marketing features, including private in-store events, special magazine issues, as well as the ability to accumulate points for qualifying purchases. Increased points are periodically offered in connection with in-store promotional and other events. Upon attaining specified point levels, customers may redeem their points for a wide variety of gifts ranging from gift cards to designer merchandise and trips to exotic locations. Approximately 46% of revenues at Neiman Marcus stores in calendar years 2005 and 2004 were generated by our InCircle members. Beginning in calendar 2006, we transitioned customers in our previous Bergdorf Goodman loyalty program to our InCircle loyalty program.

Proprietary Credit Card Program. We maintain a proprietary credit card program through which we facilitate the extension of credit to customers under the Neiman Marcus and Bergdorf Goodman names.

On July 7, 2005, HSBC purchased our approximately three million private label Neiman Marcus and Bergdorf Goodman credit card accounts and related assets, as well as the outstanding balances associated with such accounts. The total purchase price was approximately $647 million, consisting of approximately $534 million in net cash proceeds and the assumption of approximately $113 million of outstanding debt under our Credit Card Facility.

As a part of the Credit Card Sale, we entered into a long-term marketing and servicing alliance with HSBC. Under the terms of this alliance, HSBC offers credit cards and non-card payment plans bearing our brands and we receive from HSBC ongoing payments related to credit card sales and compensation for marketing and servicing activities (HSBC Program Income). During fiscal year 2006, we outsourced various administrative elements of the proprietary credit card program, including the processing of data with respect to our proprietary credit card program to HSBC as provided for in the program agreement with HSBC. We continue to handle key customer service functions, primarily customer inquiries.

Subsequent to the Credit Card Sale, we have changed and may continue to change, the terms of credit offered to our customers. In addition, HSBC will have discretion over certain policies and arrangements with credit card customers and may change these policies and arrangements in ways that affect our relationship with these customers. Any such changes in our credit card arrangements may adversely affect our credit card program and ultimately, our business.

Historically, our customers holding a proprietary credit card have tended to shop more frequently and have a higher level of spending than customers paying with cash or third-party credit cards. In fiscal years 2006 and 2005, approximately 54% of our revenues were transacted through our proprietary credit cards.

We utilize data captured through our proprietary credit card program in connection with promotional events and customer relationship programs targeting specific customers based upon their past spending patterns for certain brands, merchandise categories and store locations.

Integrated Multi-Channel Model. We offer products through our complementary Direct Marketing and Specialty Retail businesses, which enables us to maximize our brand recognition and strengthen our customer relationships across all channels. Our well-established catalog and online operation expands our reach beyond the trading area of our retail stores, as approximately 46% and 50%, respectively, of our Direct Marketing customers in fiscal years 2006 and 2005 were located outside of the trade areas of our existing retail locations. We also use our catalogs and e-commerce websites as selling and marketing tools to increase the visibility and exposure of our brand and generate customer traffic within our retail stores. We believe the combination of our retail stores and direct selling efforts is the main reason that our multi-channel customers spend more on average than our single-channel customers (approximately 3.6 times more in fiscal year 2006 and 3.5 times more in fiscal year 2005).

Merchandise

Our percentages of revenues (exclusive of revenues generated by leased departments) by major merchandise category are as follows:

	Years Ended					
	July 29, 2006		July 30, 2005		July 31, 2004	
Women s Apparel	35	%	35	%	35	%
Women s Shoes, Handbags and Accessories	19	%	19	%	19	%
Cosmetics and Fragrances	11	%	11	%	10	%
Men s Apparel and Shoes	12	%	12	%	11	%
Designer and Precious Jewelry	10	%	10	%	10	%
Home Furnishings and Décor	8	%	9	%	10	%
Other	5	%	4	%	5	%
	100	%	100	%	100	%

Substantially all of our merchandise is delivered to us by our vendors as finished goods and is manufactured in numerous locations, including Europe and the United States and, to a lesser extent, China, Mexico and South America.

We lease certain departments in our stores to independent companies. Our management regularly evaluates the performance of the leased departments and requires compliance with established guidelines. The companies to which we lease store space are generally responsible for paying their own employees. We receive commissions from these leased departments on a percent of sales basis.

Our merchandise consists primarily of apparel and accessories from luxury-branded designers. Our major merchandise categories are as follows:

Women s Apparel: Women s apparel consists of dresses, eveningwear, suits, coats, and sportswear separates skirts, pants, blouses, jackets, and sweaters. Women s apparel occupies the largest amount of square footage within our stores. We work with women s apparel vendors to present the merchandise and highlight the best of the vendor s product. Our primary women s apparel vendors include Chanel, Prada, St. John, Gucci, Theory, Giorgio Armani, Escada and Ellen Tracy.

Women s Shoes, Handbags and Accessories: Women s accessories include belts, gloves, scarves, hats and sunglasses. Our primary vendors in this category include Manolo Blahnik, Prada, Gucci, Chanel, Dior and Ferragamo in ladies shoes, and handbags from Chanel, Prada, Gucci, Marc Jacobs and Judith Leiber.

Cosmetics and Fragrances: Cosmetics and fragrances include facial and skin cosmetics, skin therapy and lotions, soaps, fragrance, candles and beauty accessories. Our primary vendors of cosmetics and beauty products include La Mer, Bobbie Brown, Sisley, La Prairie, Chanel and Laura Mercier.

Men s Apparel and Shoes: Men s apparel and shoes include suits, dress shirts and ties, sport coats, jackets, trousers, casual wear and eveningwear as well as business and casual footwear. In recent years, this category has been an area of increased focus. Bergdorf Goodman has a fully dedicated men s store in New York. Our primary vendors in this category include Ermenegildo Zegna, Brioni, Giorgio Armani, and Prada in men s clothing and sportswear; and Ermenegildo Zegna, Prada, Ferragamo and Gucci in men s furnishings and shoes.

Designer and Precious Jewelry: Our designer and precious jewelry offering includes women s accessories, necklaces, bracelets, rings, brooches and watches that are selected to complement our apparel merchandise offering. Our primary vendors in this category include David Yurman, Stephen Dweck and John Hardy in Designer Jewelry, and Henry Dunay and Roberto Coin in Precious Jewelry. We often sell precious jewelry on a consignment basis.

Home Furnishings and Décor: Home furnishings and décor include linens, tabletop, kitchen accessories, furniture, rugs, decoratives (frames, candlesticks, vases and sculptures) as well as collectables. Merchandise for the home complements our apparel offering in terms of quality and design. Our primary vendors in this category include Jay Strongwater, Daum, Waterford, Steuben and Baccarat.

Vendor Relationships

Our merchandise assortment consists of a wide selection of luxury goods purchased from both well-known luxury-branded fashion vendors as well as new and emerging designers. We communicate with our vendors frequently, providing feedback on current demand for their products, suggesting, at times, changes to specific product categories or items and gaining insight into their future fashion direction. Certain designers sell their merchandise, or certain of their design collections, exclusively to us and other designers sell to us pursuant to their limited distribution policies. We compete for quality merchandise and assortment principally based on relationships and purchasing power with designer resources. Our women s and men s apparel and fashion accessories businesses are especially dependent upon our relationships with these designer resources. We monitor and evaluate the sales and profitability performance of each vendor and adjust our future purchasing decisions from time to time based upon the results of this analysis. We have no guaranteed supply arrangements with our principal merchandising sources and, accordingly, there can be no assurance that such sources will continue to meet our needs for quality, style and volume. In addition, our vendor base is diverse, with no single vendor representing more than 5% of the cost of our total purchases in fiscal years 2006 or 2005. The breadth of our sourcing helps mitigate risks associated with a single brand or designer.

Consistent with industry business practice, we receive allowances from certain of our vendors in support of the merchandise we purchase for resale. We receive certain allowances to reimburse us for markdowns taken or to support the gross margins that we earn in connection with the sales of the vendor s merchandise. Other allowances we receive represent reductions to the amounts we pay to acquire the merchandise. We also receive advertising allowances from certain of our merchandise vendors, substantially all of which represent reimbursements of direct, specified and incremental costs we incurred to promote the vendors merchandise. These allowances are recorded as a reduction of our advertising costs when incurred. We also receive allowances from certain merchandise vendors in conjunction with compensation allowances for employees who sell the vendors merchandise, which allowances are netted against the related compensation expenses that we incur. For more information related to allowances received from vendors, see Note 1 to our audited consolidated financial statements included herein.

We offer certain merchandise, primarily precious jewelry, on a consignment basis in order to expand our product assortment. As of July 29, 2006 and July 30, 2005, we held consigned inventories with a cost basis of approximately $251.3 million and $226.8 million, respectively, (consigned inventories are not reflected in our consolidated balance sheet as we do not take title to consigned merchandise). From time to time, we make advances to certain of our vendors. These advances are typically deducted from amounts paid to vendors at the time we receive the merchandise or, in the case of advances made for consigned goods, at the time we sell the goods. We had net outstanding advances to vendors of approximately $25.0 million at July 29, 2006 and $24.6 million at July 30, 2005.

Inventory Management

Our merchandising function is decentralized with separate merchandising functions for Neiman Marcus stores, Bergdorf Goodman and Direct Marketing. Each merchandising function is responsible for the determination of the merchandise assortment and quantities to be purchased and, in the case of Neiman Marcus stores, for the allocation of merchandise to each store. We currently have over 300 merchandise buyers and merchandise planners.

The majority of the merchandise we purchase is initially received at one of our centralized distribution facilities. To support our Specialty Retail stores, we utilize a primary distribution facility in Longview, Texas, a regional distribution facility in Totowa, New Jersey and five regional service centers. We also operate two distribution facilities in the Dallas-Fort Worth area to support our Direct Marketing operation.

Our distribution facilities are linked electronically to our various merchandising staffs to facilitate the distribution of goods to our stores. We utilize electronic data interchange (EDI) technology with certain of our vendors, which is designed to move merchandise onto the selling floor quickly and cost-effectively by allowing vendors to deliver floor-ready merchandise to the distribution facilities. In addition, we utilize high-speed automated conveyor systems capable of scanning the bar coded labels on incoming cartons of merchandise and directing the cartons to the proper processing areas. Many types of merchandise are processed in the receiving area and immediately cross docked to the shipping dock for delivery to the stores. Certain processing areas are staffed with personnel equipped with hand-held radio frequency terminals that can scan a vendor s bar code and transmit the necessary information to a computer to record merchandise on hand. We utilize third-party carriers to distribute our merchandise to individual stores.

With respect to the Specialty Retail stores, the majority of the merchandise is held in our retail stores. We primarily operate on a pre-distribution model through which we allocate merchandise on our initial purchase orders to each store. This merchandise is shipped from our vendors to our distribution facilities for delivery to designated stores. We closely monitor the inventory levels and assortments in our retail stores to facilitate reorder and replenishment decisions, satisfy customer demand and maximize sales. Transfers of goods between stores are made primarily at the direction of merchandising personnel and, to a lesser extent, by store management primarily to fulfill customer requests.

We also maintain certain inventories at the Longview distribution facility. The goods held at the Longview distribution facility consist primarily of goods held in limited assortment or quantity by our stores and replenishment goods available to stores achieving high initial sales levels. During fiscal year 2004, we expanded our distribution center in Longview, Texas by 25% to over 600,000 square feet. As part of this expansion, we realigned the warehouse space, enabling us to strengthen our locker stock inventory management program. With this program, we maintain a portion of our most in-demand and high fashion merchandise at our distribution facilities. For products stored in locker stock, we can ship replenishment merchandise to the stores that demonstrate the highest customer demand. In addition, our sales associates can use the program to ship items directly to our customers, thereby improving customer service and increasing productivity. This program also helps us to restock inventory at individual stores more efficiently, to maximize the opportunity for full-price selling and to minimize the potential risks related to excess inventories. We plan to continue to expand this program to deliver goods to our customers more quickly and to enhance the allocation of goods to our stores.

Capital Investments

We make capital investments annually to support our long-term business goals and objectives. We invest capital in new and existing stores, distribution and support facilities as well as information technology. We have gradually increased the number of our stores over the past ten years, growing our full-line Neiman Marcus and Bergdorf Goodman store base from 27 stores at the beginning of fiscal year 1996 to our current 39 stores.

We invest capital in the development and construction of new stores in both existing and new markets. We conduct extensive demographic, marketing and lifestyle research to identify attractive retail markets with a high concentration of our target customers prior to our decision to construct a new store. We compete with other retailers for real estate opportunities principally on the basis of our ability to attract customers. In addition to the construction of new stores, we also invest in the on-going maintenance of our stores to ensure an elegant shopping experience for our customers. Capital expenditures for existing stores range from minor renovations of certain areas within the store to major remodels and renovations and store expansions. We are focused on operating only in attractive markets that can profitably support our stores and are focused on maintaining the quality of our stores and, consequently, our brand. With respect to our major remodels, we only expand after extensive analysis of our projected returns on capital. We generally experience an increase in both total sales and sales per square foot at stores that undergo a remodel or expansion.

We also believe capital investments for information technology in our stores, distribution facilities and support functions are necessary to support our business strategies. As a result, we are continually upgrading our information systems to improve efficiency and productivity.

In the past three fiscal years, we have made capital expenditures aggregating $486 million related primarily to:

- the construction of new stores in San Antonio, Boca Raton and Charlotte, as well as a store in Austin to be opened in fiscal year 2007;
- the renovation and expansion of our main Bergdorf Goodman store in New York City and Neiman Marcus stores in San Francisco, Newport Beach, Las Vegas, Houston, and Beverly Hills;
- the expansion of our distribution facilities;
- the development and installation of a new point-of-sale system in our retail stores;
- the installation of new warehousing and distribution systems for both Direct Marketing and Specialty Retail stores; and
- a new human capital management system (including the outsourcing of payroll and benefits administration).

In fiscal year 2007, we anticipate capital expenditures for planned new stores in Charlotte, Austin, suburban Boston, Long Island, the greater Los Angeles area and suburban Seattle and for renovations of our Atlanta store and San Diego stores, as well as the main Bergdorf Goodman store. We also expect to make technology related expenditures to enhance existing systems and reporting capabilities in a number of areas, including our warehousing systems at Direct Marketing.

We receive allowances from developers related to the construction of our stores thereby reducing our cash investment in these stores. We record these allowances as deferred real estate credits which are recognized as a reduction of rent expense on a straight-line basis over the lease term. We received construction allowances aggregating $32.0 million in fiscal year 2006 and $25.6 million in fiscal year 2005.

Competition

The specialty retail industry is highly competitive and fragmented. We compete for customers with specialty retailers, traditional and high-end department stores, national apparel chains, vendor-owned proprietary boutiques, individual specialty apparel stores and direct marketing firms. We compete for customers principally on the basis of quality and fashion, customer service, value, assortment and presentation of merchandise, marketing and customer loyalty programs and, in the case of Neiman Marcus and Bergdorf Goodman, store ambiance. Retailers that compete with us for distribution of luxury fashion brands include Saks Fifth Avenue, Nordstrom, Barney s New York and other national, regional and local retailers. Many of these competitors have greater resources than we do. In addition, following consummation of the Transactions many of those competitors are significantly less leveraged than we are, and therefore may have greater flexibility to respond to changes in our industry.

We believe we are differentiated from other national retailers by our distinctive merchandise assortment, which we believe is more upscale than other high-end department stores, excellent customer service, prime real estate locations and elegant shopping environment. We believe we differentiate ourselves from regional and local high-end luxury retailers through our diverse product selection, strong national brand, loyalty programs, customer service, prime shopping locations and strong vendor relationships that allow us to offer the top merchandise from each vendor. Vendor-owned proprietary boutiques and specialty stores carry a much smaller selection of brands and merchandise, lack the overall shopping experience we provide and have a limited number of retail locations.

Employees

As of September 1, 2006, we had approximately 17,200 employees. Neiman Marcus stores had approximately 14,200 employees, Bergdorf Goodman stores had approximately 1,200 employees, Direct Marketing had approximately 1,700 employees and Neiman Marcus Group had approximately 90 employees. Our staffing requirements fluctuate during the year as a result of the seasonality of the retail industry. We hire additional temporary associates and increase the hours of part-time employees during seasonal peak selling periods. None of our employees is subject to a collective bargaining agreement, except for approximately 14% of the Bergdorf Goodman employees. We believe that our relations with our employees are good.

Seasonality

Our business, like that of most retailers, is affected by seasonal fluctuations in customer demand, product offerings and working capital expenditures. For additional information on seasonality, see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Executive Overview Seasonality.

Regulation

Our operations are affected by numerous federal and state laws that impose disclosure and other requirements upon the origination, servicing and enforcement of credit accounts and limitations on the maximum amount of finance charges that may be charged by a credit provider. In addition to our proprietary credit cards, credit to our customers is also provided primarily through third parties such as American Express, Visa and MasterCard. Any change in the regulation of credit that would materially limit the availability of credit to our customer base could adversely affect our results of operations or financial condition.

Our practices, as well as our competitors, are subject to review in the ordinary course of business by the Federal Trade Commission and are subject to numerous federal and state laws. Additionally, we are subject to certain customs, truth-in-advertising and other laws, including consumer protection regulations that regulate retailers generally and/or govern the importation, promotion and sale of merchandise. We undertake to monitor changes in these laws and believe that we are in material compliance with all applicable state and federal regulations with respect to such practices.

Investment in Kate Spade LLC

We currently own a 56% interest in Kate Spade LLC, which designs and markets high-end designer handbags and accessories. A minority investor owns the remaining 44% interest. Our investment in and relationship with Kate Spade LLC is governed by an operating agreement that provides for an orderly transition process in the event either investor wishes to sell its interest, or purchase the other investor s interest. Among other things, this operating agreement contains currently exercisable put option provisions entitling the minority investor to put its interest to us, and currently exercisable call option provisions entitling us to purchase the minority investor s interest, at a purchase price mutually agreed to by the parties. The purchase price will be determined by the parties or, in the event the parties are unable to agree on a mutually acceptable price, by a mutually acceptable nationally recognized investment banking firm, subject to certain conditions. We may elect to defer the consummation of a put option for a period of six months by cooperating with the minority investor in seeking either a sale of Kate Spade LLC to a third party or a public offering of Kate Spade LLC s securities. If a sale to a third party or public offering of Kate Spade LLC s securities is not consummated within six months after the exercise of the put option (which period may be automatically extended for an additional two months if a registration statement for Kate Spade LLC is filed with the Securities and Exchange Commission), we are obligated to consummate the put option. Under the terms of the Kate Spade LLC operating agreement, consummation of the put option shall occur within thirty days after the determination of the valuation with respect to the exercise of the put option, unless we have elected to defer the consummation of the put option for the six-month period referred to above, and should a third party sale or public offering of Kate Spade LLC occur within such six-month period, we are required to pay the minority investor the excess, if any, of the put option valuation price for its interest over the amount it realizes through the third party sale or public offering.

In April 2005, the minority investor in Kate Spade LLC exercised the put option described above with respect to the full amount of its stake in such company. We subsequently entered into a standstill agreement to postpone the put process while we engaged in discussions with the minority investor in Kate Spade LLC regarding certain strategic alternatives, including the possible sale of such company. The standstill agreement, as extended, expired on March 21, 2006, but the parties are continuing to pursue discussions regarding a possible sale of such company while the put valuation process proceeds. Although such discussions are ongoing, no assurance can be given that they will ultimately lead to any transaction. It is possible that we may be required to purchase the shares of the minority investor in Kate Spade LLC pursuant to the option as early as the second quarter of fiscal year 2007.

ITEM 1A. RISK FACTORS

Risks Related to Our Structure and NMG s Indebtedness

Because our ownership of NMG accounts for substantially all of our assets and operations, we are subject to all risks applicable to NMG.

We are a holding company. NMG and its subsidiaries conduct substantially all of our consolidated operations and own substantially all of our consolidated assets. As a result, we are subject to all risks applicable to NMG. In addition, NMG s Asset-Based Revolving Credit Facility, NMG s Senior Secured Term Loan Facility and the indentures governing NMG s senior notes and senior subordinated notes contain provisions limiting NMG s ability to distribute earnings to us, in the form of dividends or otherwise.

NMG has a substantial amount of indebtedness, which may adversely affect NMG s cash flow and its ability to operate the business, to comply with debt covenants and make payments on its indebtedness.

As a result of the Transactions, we are highly leveraged. As of July 29, 2006, the principal amount of NMG s total indebtedness was approximately $3,210.2 million and the unused borrowing availability under the $600 million Asset-Based Revolving Credit Facility was approximately $570.9 million after giving effect to $29.1 million of letters of credit outstanding thereunder. NMG s substantial indebtedness, combined with its lease and other financial obligations and contractual commitments, could have other important consequences. For example, it could:

- make it more difficult for NMG to satisfy its obligations with respect to its indebtedness and any failure to comply with the obligations of any of its debt instruments, including restrictive covenants and borrowing conditions, could result in an event of default under the agreements governing NMG s indebtedness;

- make NMG more vulnerable to adverse changes in general economic, industry and competitive conditions and adverse changes in government regulation;

- require NMG to dedicate a substantial portion of its cash flow from operations to payments on its indebtedness, thereby reducing the availability of cash flows to fund working capital, capital expenditures, acquisitions and other general corporate purposes;

- limit NMG s flexibility in planning for, or reacting to, changes in NMG s business and the industry in which it operates;

- place NMG at a competitive disadvantage compared to its competitors that are less highly leveraged and therefore may be able to take advantage of opportunities that its leverage prevents it from exploiting; and

- limit NMG s ability to borrow additional amounts for working capital, capital expenditures, acquisitions, debt service requirements, execution of its business strategy or other purposes.

Any of the above listed factors could materially adversely affect NMG s business, financial condition and results of operations.

In addition, NMG s interest expense could increase if interest rates increase because the entire amount of the indebtedness under the senior secured credit facilities bears interest at floating rates. As of July 29, 2006, NMG had approximately $1,875.0 million principal amount of floating rate debt, consisting of outstanding borrowings under Senior Secured Term Loan Facility. NMG also had at that date approximately $570.9 million of unused floating rate debt borrowing capacity available under the Asset-Based Revolving Credit Facility based on a borrowing base of over $600.0 million at that date and after giving effect to $29.1 million used for letters of credit. Effective December 6, 2005, NMG entered into floating to fixed interest rate swap agreements for an aggregate notional amount of $1,000.0 million to limit its exposure to interest rate increases related to a portion of its floating rate indebtedness.

To service NMG s indebtedness, it will require a significant amount of cash. NMG s ability to generate cash depends on many factors beyond its control, and any failure to meet the its debt service obligations could harm its business, financial condition and results of

operations.

NMG s ability to pay interest on and principal of the debt obligations will primarily depend upon NMG s future

12

operating performance. As a result, prevailing economic conditions and financial, business and other factors, many of which are beyond our control, will affect its ability to make these payments.

If NMG does not generate sufficient cash flow from operations to satisfy the debt service obligations, NMG may have to undertake alternative financing plans, such as refinancing or restructuring its indebtedness, selling assets, reducing or delaying capital investments or seeking to raise additional capital. Our ability to restructure or refinance its debt will depend on the condition of the capital markets and our financial condition at such time. Any refinancing of NMG s debt could be at higher interest rates and may require it to comply with more onerous covenants, which could further restrict its business operations. The terms of existing or future debt instruments may restrict NMG from adopting some of these alternatives. In addition, any failure to make payments of interest and principal on NMG s outstanding indebtedness on a timely basis would likely result in a reduction of NMG s credit rating, which could harm its ability to incur additional indebtedness on acceptable terms.

Contractual limitations on NMG s ability to execute any necessary alternative financing plans could exacerbate the effects of any failure to generate sufficient cash flow to satisfy its debt service obligations. The Asset-Based Revolving Credit Facility permits NMG to borrow up to $600.0 million; however, NMG s ability to borrow thereunder is limited by a borrowing base, which at any time will equal the lesser of 80% of eligible inventory valued at the lower of cost or market value and 85% of the net orderly liquidation value of the eligible inventory, less certain reserves. In addition, our ability to borrow under this facility is limited by a minimum liquidity condition, providing that, if less than $60.0 million is available at any time, NMG is not permitted to borrow any additional amounts under the Asset-Based Revolving Credit Facility unless NMG s pro forma ratio of consolidated EBITDA to consolidated Fixed Charges (as such terms are defined in the credit agreement for the senior secured asset-based revolving credit facility) is at least 1.1 to 1.0. Our ability to meet this financial ratio may be affected by events beyond our control, and we cannot assure you that we will meet this ratio.

NMG s inability to generate sufficient cash flow to satisfy its debt service obligations, or to refinance its obligations at all or on commercially reasonable terms, would have an adverse effect, which could be material, on NMG s business, financial condition and results of operations.

The terms of NMG s Asset-Based Revolving Credit Facility and Senior Secured Term Loan Facility and the indentures governing the Senior Notes, the Senior Subordinated Notes and the 2028 Debentures may restrict NMG s current and future operations, particularly its ability to respond to changes in its business or to take certain actions.

The credit agreements governing NMG s Asset-Based Revolving Credit Facility and Senior Secured Term Loan Facility credit facilities and the indentures governing the Senior Notes, the Senior Subordinated Notes and the 2028 Debentures contain, and any future indebtedness of NMG would likely contain, a number of restrictive covenants that impose significant operating and financial restrictions, including restrictions on NMG s ability to engage in acts that may be in its best long-term interests. The indentures governing the Senior Notes, the Senior Subordinated Notes and the 2028 Debentures and the credit agreements governing the senior secured credit facilities include covenants that, among other things, restrict NMG s ability to:

- incur additional indebtedness;
- pay dividends on NMG s capital stock or redeem, repurchase or retire its capital stock or indebtedness;
- make investments;
- create restrictions on the payment of dividends or other amounts to NMG from NMG s restricted subsidiaries;
- engage in transactions with its affiliates;
- sell assets, including capital stock of NMG s subsidiaries;
- consolidate or merge;
- create liens; and
- enter into sale and lease back transactions.

In addition, NMG s ability to borrow under the Asset-Based Revolving Credit Facility is limited by a borrowing base and a minimum liquidity condition, as described above.

Moreover, NMG s Asset-Based Revolving Credit Facility provides discretion to the agent bank acting on behalf of the

13

lenders to impose additional availability and other reserves, which could materially impair the amount of borrowings that would otherwise be available to us. There can be no assurance that the agent bank will not impose such reserves or, were it to do so, that the resulting impact of this action would not materially and adversely impair NMG s liquidity.

A breach of any of the restrictive covenants would result in a default under the Asset-Based Revolving Credit Facility and Senior Secured Term Loan Facility. If any such default occurs, the lenders under the Asset-Based Revolving Credit Facility and Senior Secured Term Loan Facility may elect to declare all outstanding borrowings under such facilities, together with accrued interest and other fees, to be immediately due and payable, or enforce their security interest, any of which would result in an event of default under NMG s Senior Notes and Senior Subordinated Notes and 2028 Debentures. The lenders would also have the right in these circumstances to terminate any commitments they have to provide further borrowings.

The operating and financial restrictions and covenants in these debt agreements and any future financing agreements may adversely affect NMG s ability to finance future operations or capital needs or to engage in other business activities.

Risks Related to Our Business and Industry

The specialty retail industry is highly competitive.

The specialty retail industry is highly competitive and fragmented. Competition is strong both to attract and sell to customers and to establish relationships with, and obtain merchandise from, key vendors.

We compete for customers with specialty retailers, traditional and high-end department stores, national apparel chains, vendor-owned proprietary boutiques, individual specialty apparel stores and direct marketing firms. We compete for customers principally on the basis of quality and fashion, customer service, value, assortment and presentation of merchandise, marketing and customer loyalty programs and, in the case of Neiman Marcus and Bergdorf Goodman, store ambiance. In our Specialty Retail business, merchandise assortment is a critical competitive factor, and retail stores compete for exclusive, preferred and limited distribution arrangements with key designers. Many of our competitors are larger than we are and have greater financial resources than we do. In addition, certain designers from whom we source merchandise have established competing free-standing retail stores in the same vicinity as our stores. If we fail to successfully compete for customers or merchandise, our business will suffer.

We are dependent on our relationships with certain designers, vendors and other sources of merchandise.

Our relationships with established and emerging designers are a key factor in our position as a retailer of high-fashion merchandise, and a substantial portion of our revenues is attributable to our sales of designer merchandise. Many of our key vendors limit the number of retail channels they use to sell their merchandise and competition among luxury retailers to obtain and sell these goods is intense. Our relationships with our designers have been a significant contributor to our past success. We have no guaranteed supply arrangements with our principal merchandising sources. Accordingly, there can be no assurance that such sources will continue to meet our quality, style and volume requirements. Moreover, nearly all of the brands of our top designers are sold by competing retailers, and many of our top designers also have their own dedicated retail stores. If one or more of our top designers were to cease providing us with adequate supplies of merchandise or, conversely, were to increase sales of merchandise through its own stores or to the stores of our competitors, our business could be adversely affected. In addition, any decline in the popularity or quality of any of our designer brands could adversely affect our business.

If we significantly overestimate our sales, our profitability may be adversely affected.

We make decisions regarding the purchase of our merchandise well in advance of the season in which it will be sold. For example, women s apparel, men s apparel and shoes are typically ordered six to nine months in advance of the products being offered for sale while handbags, jewelry and other categories are typically ordered three to six months in advance. If our sales during any season, particularly a peak season, are significantly lower than we expect for any reason, we may not be able to adjust our expenditures for inventory and other expenses in a timely fashion and may be left with a substantial amount of unsold inventory. If that occurs, we may be forced to rely on markdowns or promotional sales to dispose of excess inventory. This could have an adverse effect on our margins and operating income. At the same time, if we fail to purchase a sufficient quantity of merchandise, we may not have an adequate supply of products to meet consumer demand. This may cause us to lose sales or harm our customer relationships.

Our failure to identify changes in consumer preferences or fashion trends may adversely affect our performance.

Our success depends in large part on our ability to identify fashion trends as well as to anticipate, gauge and react to

14

changing consumer demands in a timely manner. If we fail to adequately match our product mix to prevailing customer tastes, we may be required to sell our merchandise at higher average markdown levels and lower average margins. Furthermore, the products we sell often require long lead times to order and must appeal to consumers whose preferences cannot be predicted with certainty and often change rapidly. Consequently, we must stay abreast of emerging lifestyle and consumer trends and anticipate trends and fashions that will appeal to our consumer base. Any failure on our part to anticipate, identify and respond effectively to changing consumer demands and fashion trends could adversely affect our business.

Our business and performance may be affected by our ability to implement our store expansion and remodeling strategies.

Based upon our expansion strategy, we expect that planned new stores will add over 660,000 square feet of new store space over approximately the next four fiscal years, representing an increase of over 12% above the current aggregate square footage of our full-line Neiman Marcus and Bergdorf Goodman stores, and that our store remodeling program will add additional new store space from remodels that are already underway. New store openings involve certain risks, including constructing, furnishing and supplying a store in a timely and cost effective manner, accurately assessing the demographic or retail environment at a given location, hiring and training quality staff, obtaining necessary permits and zoning approvals, obtaining commitments from a core group of vendors to supply the new store, integrating the new store into our distribution network and building customer awareness and loyalty. In undertaking store remodels, we must complete the remodel in a timely, cost effective manner, minimize disruptions to our existing operations, and succeed in creating an improved shopping environment. If we fail to execute on these or other aspects of our store expansion and remodeling strategy, we could suffer harm to our sales, an increase in costs and expenses and an adverse effect on our business.

Acts of terrorism could adversely affect our business.

The economic downturn that followed the terrorist attacks of September 11, 2001 had a material adverse effect on our business. Any further acts of terrorism or other future conflicts may disrupt commerce and undermine consumer confidence, cause a downturn in the economy generally, cause consumer spending or shopping center traffic to decline or reduce the desire of our customers to make discretionary purchases. Any of the foregoing factors could negatively impact our sales revenue, particularly in the case of any terrorist attack targeting retail space, such as a shopping center. Furthermore, an act of terrorism or war, or the threat thereof, could negatively impact our business by interfering with our ability to obtain merchandise from foreign manufacturers. Any future inability to obtain merchandise from our foreign manufacturers or to substitute other manufacturers, at similar costs and in a timely manner, could adversely affect our business.

Deterioration in economic conditions could adversely affect our business.

The merchandise we sell consists in large part of luxury retail goods. The purchase of these goods by customers is discretionary, and therefore highly dependent upon the level of consumer spending, particularly among affluent customers. Accordingly, sales of these products may be adversely affected by an economic downturn, increases in consumer debt levels, uncertainties regarding future economic prospects or a decline in consumer confidence. An economic downturn in the United States generally or in any of the geographic areas in which we have stores, particularly in Texas, California, Florida and the New York City metropolitan area, from which we derive a significant portion of our revenues, could have a material adverse effect on our business and results of operations.

The loss of any of our senior management team or attrition among our buyers or key sales associates could adversely affect our business.

Our success in the specialty retail industry will continue to depend to a significant extent on our senior management team, buyers and key sales associates. We rely on the experience of our senior management, who have specific knowledge relating to us and our industry that would be difficult to replace. If we were to lose a portion of our buyers or key sales associates, our ability to benefit from long-standing relationships with key vendors or to provide relationship-based customer service may suffer. We cannot assure you that we will be able to retain our current senior management team, buyers or key sales associates. The loss of any of these individuals could adversely affect our business.

Inflation may adversely affect our business operations in the future.

In recent years, we have experienced certain inflationary conditions in our cost base due primarily to (1) changes in foreign currency exchange rates that have reduced the purchasing power of the U.S. dollar and (2) increases in selling, general and administrative expenses, particularly with regard to employee benefits. Inflation can harm our margins and profitability if we are unable to increase prices or cut costs enough to offset the effects of inflation in our cost base. If inflation in these or other

costs worsens, we cannot assure you that our attempts to offset the effects of inflation and cost increases through control of expenses, passing cost increases on to customers or any other method will be successful. Any future inflation could adversely affect our profitability and our business.

Failure to maintain competitive terms under our loyalty programs could adversely affect our business.

We maintain loyalty programs that are designed to cultivate long-term relationships with our customers and enhance the quality of service we provide to our customers. We must constantly monitor and update the terms of our loyalty programs so that they continue to meet the demands and needs of our customers and remain competitive with loyalty programs offered by other high-end specialty retailers. Given that approximately 46% of our revenues at Neiman Marcus stores in calendar year 2005 were generated by our InCircle loyalty program members, our failure to continue to provide quality service and competitive loyalty programs to our customers through the InCircle loyalty program could adversely affect our business.

Changes in our credit card arrangements, applicable regulations and consumer credit patterns could adversely impact our ability to facilitate the provision of consumer credit to our customers and adversely affect our business.

We maintain a proprietary credit card program through which credit is extended to customers under the Neiman Marcus and Bergdorf Goodman names. Because a majority of our revenues were transacted through our proprietary credit cards, changes in our proprietary credit card arrangement that adversely impact our ability to facilitate the provision of consumer credit may adversely affect our performance. In July 2005, we sold our approximately three million private label credit card accounts and related assets, as well as the outstanding balances associated with such accounts. Initially, we continue to handle key customer service functions, including new account processing, most transaction authorization, billing adjustments, collection services and customer inquiries. As part of this transaction, we have changed, and will continue to change, the terms of credit offered to our customers following the Credit Card Sale. In addition, the purchaser of our credit card business will have discretion over certain policies and arrangements with credit card customers and may change these policies and arrangements in ways that affect our relationship with these customers. Any such changes in our credit card arrangements may adversely affect our credit card program and ultimately, our business.

Credit card operations are subject to numerous federal and state laws that impose disclosure and other requirements upon the origination, servicing and enforcement of credit accounts and limitations on the maximum amount of finance charges that may be charged by a credit provider. The purchaser of our credit card business is subject to regulations to which we were not subject prior to the Credit Card Sale. Any effect of these regulations or change in the regulation of credit arrangements that would materially limit the availability of credit to our customer base could adversely affect our business. In addition, changes in credit card use, payment patterns, and default rates may result from a variety of economic, legal, social, and other factors that we cannot control or predict with certainty.

Our business can be affected by extreme or unseasonable weather conditions.

Extreme weather conditions in the areas in which our stores are located could adversely affect our business. For example, heavy snowfall, rainfall or other extreme weather conditions over a prolonged period might make it difficult for our customers to travel to our stores and thereby reduce our sales and profitability. Our business is also susceptible to unseasonable weather conditions. For example, extended periods of unseasonably warm temperatures during the winter season or cool weather during the summer season could render a portion of our inventory incompatible with those unseasonable conditions. Reduced sales from extreme or prolonged unseasonable weather conditions would adversely affect our business.

We are subject to numerous regulations that could affect our operations.

We are subject to customs, truth-in-advertising and other laws, including consumer protection regulations and zoning and occupancy ordinances that regulate retailers generally and/or govern the importation, promotion and sale of merchandise and the operation of retail stores and warehouse facilities. Although we undertake to monitor changes in these laws, if these laws change without our knowledge, or are violated by importers, designers, manufacturers or distributors, we could experience delays in shipments and receipt of goods or be subject to fines or other penalties under the controlling regulations, any of which could adversely affect our business.

Our revenues and cash requirements are affected by the seasonal nature of our business.

The specialty retail industry is seasonal in nature, with a higher level of sales typically generated in the fall and holiday selling seasons. We have in the past experienced significant fluctuation in our revenues from quarter to quarter with a disproportionate amount of our revenues falling in our second fiscal quarter, which coincides with the holiday season. In

16

addition, we incur significant additional expenses in the period leading up to the months of November and December in anticipation of higher sales volume in those periods, including for additional inventory, advertising and employees.

Our business is affected by foreign currency fluctuations.

We purchase a substantial portion of our inventory from foreign suppliers whose cost to us is affected by the fluctuation of their local currency against the dollar or who price their merchandise in currencies other than the dollar. Accordingly, changes in the value of the dollar relative to foreign currencies may increase our cost of goods sold and, if we are unable to pass such cost increases on to our customers, decrease our gross margins and ultimately our earnings. Fluctuations in the Euro-dollar exchange rate affect us most significantly; however, we source goods from numerous countries and thus are affected by changes in numerous currencies and, generally, by fluctuations in the U.S. dollar relative to such currencies. Although we hedge some exposures to changes in foreign currency exchange rates arising in the ordinary course of business, foreign currency fluctuations may have a material adverse effect on our business, financial condition and results of operations.

Conditions in, and the United States relationship with, the countries where we source our merchandise could affect our sales.

A substantial majority of our merchandise is manufactured overseas, mostly in Europe. As a result, political instability or other events resulting in the disruption of trade from other countries or the imposition of additional regulations relating to or duties upon imports could cause significant delays or interruptions in the supply of our merchandise or increase our costs, either of which could have a material adverse effect on our business. If we are forced to source merchandise from other countries, those goods may be more expensive or of a different or inferior quality from the ones we now sell. The importance to us of our existing designer relationships could present additional difficulties, as it may not be possible to source merchandise from a given designer from alternative jurisdictions. If we were unable to adequately replace the merchandise we currently source with merchandise produced elsewhere, our business could be adversely affected.

Significant increases in costs associated with the production of catalogs and other promotional material may adversely affect our operating income.

We advertise and promote in-store events, new merchandise and fashion trends through print catalogs and other promotional materials mailed on a targeted basis to our customers. Significant increases in paper, printing and postage costs could affect the cost of producing these materials and as a result, may adversely affect our operating income.

We are indirectly owned and controlled by the Sponsors, and their interests as equity holders may conflict with those of our creditors.

We are indirectly owned and controlled by the Sponsors and certain other equity investors, and the Sponsors have the ability to control our policies and operations. The interests of the Sponsors may not in all cases be aligned with those of our creditors. For example, if we encounter financial difficulties or are unable to pay our debts as they mature, the interests of our equity holders might conflict with our creditors interests. In addition, our equity holders may have an interest in pursuing acquisitions, divestitures, financings or other transactions that, in their judgment, could enhance their equity investments, even though such transactions might involve risks to holders of our indebtedness. Furthermore, the Sponsors may in the future own businesses that directly or indirectly compete with us. One or more of the Sponsors also may pursue acquisition opportunities that may be complementary to our business, and as a result, those acquisition opportunities may not be available to us.

If we are unable to enforce our intellectual property rights, or if we are accused of infringing on a third party s intellectual property rights, our net income may decline.

We and our subsidiaries currently own our trademarks and service marks, including the Neiman Marcus, Bergdorf Goodman and Kate Spade marks. Our trademarks and service marks are registered in the United States and in various foreign countries, primarily in Europe. The laws of some foreign countries do not protect proprietary rights to the same extent as do the laws of the United States. Moreover, we are unable to predict the effect that any future foreign or domestic intellectual property legislation or regulation may have on our existing or future business. The loss or reduction of any of our significant proprietary rights could have an adverse effect on our business.

Additionally, third parties may assert claims against us alleging infringement, misappropriation or other violations of their trademark or other proprietary rights, whether or not the claims have merit. Claims like these may be time consuming and expensive to defend and could result in our being required to cease using the trademark or other rights and selling the allegedly infringing products. This might have an adverse affect on our sales and cause us to incur significant litigation costs and expenses.

Failure to successfully maintain and update information technology systems and enhance existing systems may adversely affect our business.

To keep pace with changing technology, we must continuously provide for the design and implementation of new information technology systems as well as enhancements of our existing systems. Any failure to adequately maintain and update the information technology systems supporting our online operations, sales operations or inventory control could prevent our customers from purchasing merchandise on our websites or prevent us from processing and delivering merchandise, which could adversely affect our business.

Delays in receipt of merchandise in connection with either the manufacturing or shipment of such merchandise can affect our performance.

Substantially all of our merchandise is delivered to us by our vendors as finished goods and is manufactured in numerous locations, including Europe and the United States and, to a lesser extent, China, Mexico and South America. Our vendors rely on third party carriers to deliver merchandise to our distribution facilities. In addition, our success depends on our ability efficiently to source and distribute merchandise to our Specialty Retail stores and Direct Marketing customers. Events such as U.S. or foreign labor strikes, natural disasters, work stoppages or boycotts affecting the manufacturing or transportation sectors could increase the cost or reduce the supply of merchandise available to us and could adversely affect our results of operations.

ITEM 2. PROPERTIES

Our corporate headquarters are located at the Downtown Neiman Marcus store location in Dallas, Texas. The operating headquarters for Neiman Marcus, Bergdorf Goodman and Direct Marketing are located in Dallas, Texas; New York, New York; and Irving, Texas, respectively.

Properties that we use in our operations include Neiman Marcus stores, Bergdorf Goodman stores, clearance centers and distribution support and office facilities. As of September 20, 2006, the approximate aggregate square footage of the properties used in our operations was as follows:

	Owned	Owned Subject to Ground Lease	Leased	Total
Neiman Marcus Stores	752,000	2,075,000	2,261,000	5,088,000
Bergdorf Goodman Stores			316,000	316,000
Clearance Centers and Other			510,000	510,000
Distribution, Support and Office Facilities	1,317,000	150,000	987,000	2,454,000

Neiman Marcus Stores. As of September 20, 2006, we operated 37 Neiman Marcus stores, with an aggregate total property size of approximately 5,088,000 square feet. The following table sets forth certain details regarding each Neiman Marcus store:

Neiman Marcus Stores

Locations	Fiscal Year Operations Began	Gross Store Sq. Feet
Dallas, Texas (Downtown)(1)	1908	129,000
Dallas, Texas (NorthPark)(2)*	1965	218,000
Houston, Texas (Galleria)(3)*	1969	224,000
Bal Harbour, Florida(2)	1971	97,000
Atlanta, Georgia(2)*	1973	154,000
St. Louis, Missouri(2)	1975	145,000
Northbrook, Illinois(3)	1976	144,000
Fort Worth, Texas(2)	1977	119,000
Washington, D.C.(2)*	1978	130,000
Newport Beach, California(3)*	1978	154,000
Beverly Hills, California(1)*	1979	185,000
Westchester, New York(2)*	1981	138,000
Las Vegas, Nevada(2)	1981	174,000
Oak Brook, Illinois(2)	1982	119,000
San Diego, California(2)	1982	106,000
Fort Lauderdale, Florida(3)*	1983	94,000
San Francisco, California(4)*	1983	251,000
Chicago, Illinois (Michigan Ave.)(2)	1984	188,000
Boston, Massachusetts(2)	1984	111,000
Palo Alto, California(3)*	1986	120,000
McLean, Virginia(4)*	1990	130,000
Denver, Colorado(3)*	1991	90,000
Minneapolis, Minnesota(2)	1992	119,000
Scottsdale, Arizona(2)*	1992	118,000
Troy, Michigan(3)**	1993	157,000
Short Hills, New Jersey(3)*	1996	138,000
King of Prussia, Pennsylvania(3)*	1996	142,000
Paramus, New Jersey(3)*	1997	141,000
Honolulu, Hawaii(3)	1999	181,000
Palm Beach, Florida(2)	2001	53,000
Plano, Texas (Willow Bend)(4)*	2002	156,000

Tampa, Florida(3)*	2002	96,000
Coral Gables, Florida(2)*	2003	136,000
Orlando, Florida(4)*	2003	95,000
San Antonio, Texas(4)*	2006	120,000
Boca Raton, Florida(2)**	2006	136,000
Charlotte, North Carolina(3)	2007	80,000

(1) Owned subject to partial ground lease.

(2) Leased.

(3) Owned subject to ground lease.

(4) Owned.

* Mortgaged to secure our senior secured credit facilities and the 2028 Debentures.

** Expected to be mortgaged to secure our senior secured credit facilities and the 2028 Debentures.

We recently opened new stores in San Antonio (120,000 square feet) in September 2005, Boca Raton (136,000 square feet) in November 2005 and Charlotte (80,000 square feet) in September 2006 and currently plan to open new stores in:

- Austin in Spring 2007 (80,000 square feet planned),
- suburban Boston in Fall 2007 (100,000 square feet planned),
- Long Island in Fall 2008 (150,000 square feet planned),
- the greater Los Angeles area in Fall 2008 (120,000 square feet planned),
- suburban Seattle in Spring 2009 (120,000 square feet planned), and
- Princeton in Spring 2010 (90,000 square feet planned).

Bergdorf Goodman Stores. We operate two Bergdorf Goodman stores, both of which are located in Manhattan at 58th Street and Fifth Avenue. The following table sets forth certain details regarding these stores:

Bergdorf Goodman Stores

Locations	**Fiscal Year Operations Began**	**Gross Store Sq. Feet**
New York City (Main)(1)	1901	250,000
New York City (Men s)(1)*	1991	66,000

(1) Leased.

* Mortgaged to secure our senior secured credit facilities and the 2028 Debentures.

Clearance Centers. As of September 1, 2006, we operated 18 clearance centers (16 Last Call and 2 Horchow) that average approximately 27,000 square feet each in size.

Distribution, support and office facilities. We own approximately 34 acres of land in Longview, Texas, where our primary distribution facility is located. The Longview facility is the principal merchandise processing and distribution facility for Neiman Marcus stores. We currently utilize a regional distribution facility in Totowa, New Jersey and five regional service centers in New York, Florida, Illinois, Texas and California. We also own approximately 50 acres of land in Irving, Texas, where our Direct Marketing operating headquarters and distribution facility is located. In addition, we currently utilize another regional distribution facility in Dallas, Texas to support our Direct Marketing operation.

Lease Terms. The terms of the leases for substantially all of our stores, assuming all outstanding renewal options are exercised, range from 15 to 99 years. The lease on the Bergdorf Goodman Main Store expires in 2050 and the lease on the Bergdorf Goodman Men s Store expires in 2010, with two 10-year renewal options. Most leases provide for monthly fixed rentals or contingent rentals based upon sales in excess of stated amounts and normally require us to pay real estate taxes, insurance, common area maintenance costs and other occupancy costs.

For further information on our properties and lease obligations, see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 14 of the Notes to Consolidated Financial Statements in Item 15.

20

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our security holders during the quarter ended July 29, 2006.

PART II

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data is qualified in entirety by our consolidated financial statements (and the related Notes thereto) contained in Item 15 and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7. We derived the selected financial data as of July 29, 2006 and July 30, 2005 and for the forty-three weeks ended July 29, 2006, nine weeks ended October 1, 2005, fiscal years ended July 30, 2005 and July 31, 2004 from our audited consolidated financial statements and related notes. The selected financial data as of July 31, 2004, August 2, 2003 and August 3, 2002 and for the fiscal years ended August 2, 2003 and August 3, 2002 reflect adjustments to the Predecessor s audited consolidated financial statements to reclassify the operations of Gurwitch Products, L.L.C. as a discontinued operation. The selected financial data as of fiscal year ended August 3, 2002 also reflect adjustments to the Predecessor s audited consolidated financial statements to reclassify certain amounts related to the presentation of 1) construction allowances, 2) depreciation expense and 3) income from credit card operations in order to conform such amounts to our current basis of presentation. Additionally, 2002 included 53 weeks of operations while the other years presented consist of 52 weeks of operations.

(in thousands)	(Successor) Forty-three weeks ended July 29, 2006		(Predecessor) Nine weeks ended October 1, 2005		Fiscal year ended July 30, 2005		Fiscal year ended July 31, 2004		Fiscal year ended August 2, 2003		Fiscal year ended August 3, 2002	
OPERATING RESULTS												
Revenues	$ 3,462.2		$ 643.4		$ 3,774.8		$ 3,484.0		$ 3,045.8		$ 2,905.1	
Cost of goods sold including buying and occupancy costs (excluding depreciation)	2,259.1		378.2		2,390.3		2,231.2		1,997.8		1,928.4	
Selling, general and administrative expenses (excluding depreciation)	822.1		160.7		931.6		863.4		799.2		771.4	
Income from credit card operations	(49.4	)	(7.8	)	(71.6	)	(55.8	)	(53.3	)	(49.5	)
Depreciation and amortization	171.3		19.7		106.3		98.1		82.1		82.4	
Operating earnings	259.1		69.0	(2)	409.0	(3)	343.2	(5)	219.9		175.7	(8)
Earnings from continuing operations before income taxes, minority interest and change in accounting principle	41.2		69.9		396.7		327.3		203.7		160.3	
Net earnings	$ 12.5	(1)	$ 44.2		$ 248.8	(4)	$ 204.8	(6)	$ 109.3	(7)	$ 99.6	

	(Successor) July 29, 2006	(Predecessor)	July 30, 2005	July 31, 2004	August 2, 2003	August 3, 2002
FINANCIAL POSITION						
Cash and cash equivalents	$ 224.8		$ 853.4	$ 368.4	$ 207.0	$ 177.7
Merchandise inventories	804.2		742.9	713.8	682.2	652.4
Total current assets	1,135.9		1,708.5	1,706.2	1,246.1	1,127.6
Property and equipment, net	1,043.8		851.4	748.4	732.1	685.8
Total assets	6,608.0		2,660.7	2,617.6	2,104.5	1,941.5
Current liabilities	699.1		617.3	727.7	530.4	518.5
Long-term liabilities	$ 4,474.9		$ 457.3	$ 509.1	$ 428.0	$ 361.1

	(Successor) Forty-three weeks ended July 29, 2006	(Predecessor) Nine weeks ended October 1, 2005	Fiscal year ended July 30, 2005	Fiscal year ended July 31, 2004	Fiscal year ended August 2, 2003	Fiscal year ended August 3, 2002
OTHER OPERATING DATA:						
Capital expenditures	$ 141.0	$ 26.2	$ 199.7	$ 119.1	$ 128.4	$ 171.1
Depreciation expense	$ 111.1	$ 19.7	$ 106.3	$ 98.1	$ 82.1	$ 77.3
Rent expense	$ 59.6	$ 11.5	$ 65.9	$ 57.7	$ 53.6	$ 53.3
Change in comparable revenues(9)	6.4 %	9.2 %	9.8 %	14.4 %	3.8 %	(4.8)%
Number of stores open at period end	38	37	36	37	37	35

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(1) For the forty-three weeks ended July 29, 2006, net earnings include a loss from discontinued operation of $13.9 million, which includes $13.3 million of income tax expense related to the excess of the tax over book gain realized in connection with the Gurwitch Disposition.

(2) For the nine weeks ended October 1, 2005, operating earnings includes $23.5 million of transaction and other costs incurred in connection with the Transactions. These costs consist primarily of $4.5 million of accounting, investment banking, legal and other costs associated with the Transactions and a $19.0 million non-cash charge for stock compensation resulting from the accelerated vesting of Predecessor stock options and restricted stock in connection with the Acquisition.

(3) For fiscal year 2005, operating earnings include a $15.3 million pretax loss related to the disposition of Chef s Catalog and a $6.2 million pretax gain related to the sale of our credit card portfolio.

(4) For fiscal year 2005, net earnings reflect tax benefits aggregating $7.6 million resulting from favorable settlements associated with previous state tax filings and reductions in previously recorded deferred tax liabilities.

(5) For fiscal year 2004, operating earnings include a $3.9 million pretax impairment charge related to the writedown to fair value in the net carrying value of the Chef s Catalog tradename intangible asset.

(6) For fiscal year 2004, net income reflects a $7.5 million tax benefit related to favorable settlements associated with previous state tax filings.

(7) For fiscal year 2003, net earnings reflect an after-tax charge of $14.8 million for the writedown of certain intangible assets related to prior purchase business combinations as a result of the implementation of a new accounting principle.

(8) For fiscal year 2002, operating earnings reflect 1) a $16.6 million gain from the change in vacation policy made by the Company and 2) $13.2 million of impairment and other charges, related primarily to the impairment of certain long-lived assets.

(9) Comparable revenues include 1) revenues derived from our retail stores open for more than 52 weeks, including stores that have been relocated or expanded, 2) revenues from our Direct Marketing operation and 3) revenues from Kate Spade LLC. Comparable revenues exclude 1) revenues of closed stores, 2) revenues of Gurwitch Products, L.L.C. (sold in July 2006) and 3) revenues of our previous Chef s Catalog operations (sold in November 2004). The calculation of the change in comparable revenues for 2003 is based on revenues for the 52 weeks ended August 2, 2003 compared to revenues for the 52 weeks ended July 27, 2002.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

EXECUTIVE OVERVIEW

The following discussion and analysis of our financial condition and results of operations should be read together with our audited consolidated financial statements and related notes. Unless otherwise specified, the meanings of all defined terms in Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) are consistent with the meanings of such terms as defined in the Notes to Consolidated Financial Statements. This discussion contains forward-looking statements. Please see Forward-Looking Statements for a discussion of the risks, uncertainties and assumptions relating to these statements.

Overview

Neiman Marcus, Inc., (the Company) together with our operating segments and subsidiaries, is a high-end specialty retailer. Our operations include the Specialty Retail stores segment and the Direct Marketing segment. The Specialty Retail stores segment consists primarily of Neiman Marcus and Bergdorf Goodman stores. The Direct Marketing segment conducts both online operations and print catalog under the brand names of Neiman Marcus, Bergdorf Goodman, Horchow and Chef s Catalog (prior to its disposition in November 2004). We also own a 56% interest in Kate Spade LLC, which designs and markets high-end designer handbags and accessories.

Neiman Marcus, Inc. (formerly Newton Acquisition, Inc.) acquired The Neiman Marcus Group, Inc. (NMG) on October 6, 2005 through a merger transaction with Newton Acquisition Merger Sub, Inc., a wholly-owned subsidiary of Neiman Marcus, Inc. The acquisition was accomplished through the merger of the Newton Acquisition Merger Sub, Inc. with and into NMG, with NMG being the surviving entity (the Acquisition). Subsequent to the Acquisition, NMG is a subsidiary of the Company, which is controlled by Newton Holding, LLC (Holding). Both the Company and Holding were formed by investment funds affiliated with Texas Pacific Group and Warburg Pincus LLC (the Sponsors).

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

We have prepared our discussion of the results of operations for the fiscal year ended July 29, 2006 by comparing the results of operations of the Predecessor for the fiscal year ended July 30, 2005 to the combined amounts obtained by adding the earnings and cash flows for the Predecessor nine-week period ended October 1, 2005 and the Successor forty-three week period ended July 29, 2006. Although this combined presentation does not comply with generally accepted accounting principles (GAAP), we believe that it provides a meaningful method of comparison. The combined operating results have not been prepared on a pro forma basis under applicable regulations and may not reflect the actual results we would have achieved absent the Transactions and may not be predictive of future results of operations.

In connection with the Transactions, we incurred significant indebtedness and became highly leveraged. See Liquidity and Capital Resources. In addition, the purchase price paid in connection with the Acquisition has been allocated to state the acquired assets and liabilities at fair value. The purchase accounting adjustments increased the carrying value of our property and equipment and inventory, established intangible assets for our tradenames, customer lists and favorable lease commitments and revalued our long-term benefit plan obligations, among other things. Subsequent to the Transactions, interest expense and non-cash depreciation and amortization charges have significantly increased. As a result, our successor financial statements subsequent to the Transactions are not comparable to our predecessor financial statements.

Our fiscal year ends on the Saturday closest to July 31. All references to fiscal year 2006 relate to the combined 52 weeks ended July 29, 2006 (calculated as described above); all references to fiscal year 2005 relate to the 52 weeks ended July 30, 2005 and all references to fiscal year 2004 relate to the 52 weeks ended July 31, 2004.

On July 27, 2006, we sold our former majority interest in Gurwitch Products, L.L.C. to Alticor Inc., for pretax net cash proceeds of approximately $40.8 million (Gurwitch Disposition). Gurwitch Products, L.L.C. designs and markets the Laura Mercier cosmetics line and had annual revenues of approximately $71.6 million in fiscal year 2006. The net assets of Gurwitch Products, L.L.C. were sold for their net carrying value (after purchase accounting adjustments made in connection with the Transactions to state such assets at fair value). In addition, we recorded tax expense of $13.3 million, payable by the Company, on the excess of the tax over book gain realized in connection with the Gurwitch Disposition. The Company s financial statements, accompanying notes and other information provided in this Annual Report on Form 10-K reflect Gurwitch Products, L.L.C. as a discontinued operation for all periods presented.

Recent Developments

On August 31, 2006, we announced preliminary total revenues and comparable revenues of approximately $270 million and $262 million, respectively, for the four-week August period of fiscal year 2007, representing increases of 7.4% and 4.4%, respectively, compared to the four-week August period of fiscal year 2006. For the four-week August period of fiscal year 2007, comparable revenues increased 2.1% in the Specialty Retail stores segment and 19.3% in the Direct Marketing Segment.

All the financial data for the four-week August period of fiscal year 2007 set forth above are preliminary and unaudited and subject to revision based upon our review and the review by our independent registered public accounting firm of our financial condition and results of operations for the quarter ending October 28, 2006. Once we and our independent registered public accounting firm have completed our respective reviews of our financial information for the quarter ending October 28, 2006, we may report financial results that are materially different from those set forth above.

Factors Affecting Our Results

Revenues. We generate our revenues primarily from the sale of high-end merchandise through our Specialty Retail stores and Direct Marketing operation. Components of our revenues include:

- Sales of merchandise Revenues from our Specialty Retail stores are recognized at the later of the point of sale or the delivery of goods to the customer. Revenues from our Direct Marketing operation are recognized when the merchandise is delivered to the customer. We maintain reserves for anticipated sales returns primarily based on our historical trends related to returns by both our retail and direct marketing customers.

- Commissions from leased departments A small portion of the sales of our Specialty Retail stores consist of commissions from certain departments in our stores that we lease to independent companies.

- Delivery and processing We generate revenues from delivery and processing charges related to merchandise delivered to our customers from our retail and direct marketing operations.

Our revenues can be affected by the following factors:

- changes in the level of consumer spending generally and, specifically, on luxury goods;
- changes in the level of full-price sales;
- changes in the level of promotional events conducted by our Specialty Retail stores;
- our ability to successfully implement our store expansion and remodeling strategies;
- the rate of growth in internet sales by our Direct Marketing operation; and
- general economic conditions.

In addition, our revenues are seasonal. For a description of the seasonality of our business, see Seasonality.

25

Cost of goods sold including buying and occupancy costs (excluding depreciation) (COGS). COGS consists of the following components:

- Inventory costs We utilize the retail method of accounting, which is widely used in the retail industry due to its practicality, for substantially all of our merchandise inventories. Merchandise inventories are stated at the lower of cost or market. Under the retail inventory method, the valuation of inventories at cost and the resulting gross margins are determined by applying a calculated cost-to-retail ratio, for various groupings of similar items, to the retail value of inventories. The cost of the inventory reflected on the consolidated balance sheet is decreased by charges to cost of goods sold at the time the retail value of the inventory is lowered through the use of markdowns. Hence, earnings are negatively impacted when merchandise is marked down.

- Buying costs Buying costs consist primarily of salaries and expenses incurred by our merchandising and buying operations.

- Occupancy costs Occupancy costs consist primarily of rent, property taxes and operating costs of our retail, distribution and support facilities. A significant portion of our buying and occupancy costs are fixed.

- Delivery and processing costs Delivery and processing costs consist primarily of delivery charges we pay to third-party carriers and other costs related to the fulfillment of customer orders not delivered at the point-of-sale.

With the introduction of new fashions in the first and third fiscal quarters and our emphasis on full-price selling in these quarters, a lower level of markdowns and higher margins are characteristic of these quarters.

Consistent with industry business practice, we receive allowances from certain of our vendors in support of the merchandise we purchase for resale. Certain allowances are received to reimburse us for markdowns taken or to support the gross margins that we earn in connection with the sales of the vendor s merchandise. These allowances result in an increase to gross margin when we earn the allowances and they are approved by the vendor. Other allowances we receive represent reductions to the amounts we pay to acquire the merchandise. These allowances reduce the cost of the acquired merchandise and are recognized at the time the goods are sold.

Changes in our COGS as a percentage of revenues are affected primarily by the following factors:

- customer acceptance of and demand for the merchandise we offer in a given season and the related impact of such factors on the level of full-price sales;

- our ability to order an appropriate amount of merchandise to match customer demand and the related impact on the level of net markdowns incurred;

- factors affecting revenues generally;

- changes in occupancy costs primarily associated with the opening of new stores or distribution facilities; and

- the amount of vendor reimbursements we receive during the fiscal year.

Selling, general and administrative expenses (excluding depreciation) (SG&A). SG&A principally consists of costs related to employee compensation and benefits in the selling and administrative support areas, advertising and catalog costs and insurance expense. A significant portion of our selling, general and administrative expenses are variable in nature and are dependent on the sales we generate.

Advertising costs incurred by our Specialty Retail segment consist primarily of print media costs related to promotional materials mailed to our customers, while advertising costs incurred by our Direct Marketing operation relate to the production, printing and distribution of our print catalogs and the production of the photographic content on our websites, as well as online marketing costs. We receive advertising allowances from certain of our merchandise vendors. Substantially all the advertising allowances we receive represent reimbursements of direct, specific and incremental costs that we incur to promote the vendor s merchandise in connection with our various advertising programs, primarily catalogs and other print media. As a result, these allowances are recorded as a reduction of our advertising costs when earned. Vendor allowances earned and recorded as a reduction to selling, general and administrative expenses aggregated approximately $61.7 million in fiscal year 2006 (including $18.6 million for the Predecessor prior to the Acquisition), $57.5 million in fiscal year 2005 and $55.3 million in fiscal year 2004.

We also receive allowances from certain merchandise vendors in conjunction with compensation programs for employees who sell the vendor s merchandise. These allowances are netted against the related compensation expense that we incur. Amounts received from vendors related to compensation programs were $59.5 million in fiscal year 2006 (including $10.1 million for the Predecessor prior to the Acquisition), $53.2 million in fiscal year 2005 and $46.3 million in fiscal year 2004.

Changes in our selling, general and administrative expenses are affected primarily by the following factors:

- changes in the number of sales associates primarily due to expansion of existing stores and new store openings, including increased health care and related benefits expenses;

- changes in expenses incurred in connection with our advertising and marketing programs; and

- changes in expenses related to insurance and long-term benefits due to general economic conditions such as rising health care costs.

Income from credit card operations. Prior to the Credit Card Sale on July 7, 2005, our credit card operations generated finance charge income, net of credit losses, which we recognized as income when earned. As a part of the Credit Card Sale, we entered into a long-term marketing and servicing alliance with HSBC. Under the terms of this alliance, HSBC offers credit card and non-card payment plans bearing our brands and we receive ongoing payments from HSBC based on net credit card sales and compensation for marketing and servicing activities (HSBC Program Income). We recognize HSBC Program Income when earned. Prior to fiscal year 2006, we presented income from credit card operations as a reduction of selling, general and administrative expenses. We now present this income as a separate line item on our statements of earnings and have reclassified prior periods to conform to this presentation.

As a percentage of revenues, the HSBC Program Income is lower than the net finance charge income we earned prior to the Credit Card Sale. However, the resulting decrease in income from credit card operations is mitigated, in part, by 1) decreases in SG&A expenses we incur due to the transfer of certain servicing functions to HSBC after the sale, 2) decreases in our capital investments related to the servicing of the credit card portfolio and 3) decreases in carrying costs related to our previous funding of the seasonal working capital requirements of the credit card portfolio. In tandem with HSBC, we have initiated various changes in our credit card program to alter the credit terms available to our cardholders and to enhance the earnings of the portfolio. These changes have increased the level of HSBC Program Income earned by the Company.

In the future, the HSBC Program Income may be:

- decreased based upon the level of future services we provide to HSBC; and

- increased based upon other changes to our historical credit card program related to, among other things, the interest rates applied to unpaid balances and the assessment of late fees.

Fiscal Year 2006 Highlights

We believe that our product assortment of luxury, designer and fashion merchandise, coupled with our sales promotion activities and our commitment to superior customer service, have been critical to our success in the past. In addition, we believe these factors are critical to our future growth and success. Highlights from fiscal year 2006 include:

- Revenues Our revenues for fiscal year 2006 were $4,105.6 million, the highest in our history. Revenues increased 8.8% in fiscal year 2006 as compared to fiscal year 2005, with increases in comparable store sales in all four fiscal quarters compared to the same periods in fiscal year 2005. Comparable revenues percentage increases by fiscal quarter for fiscal year 2006 as compared to the same periods in fiscal year 2005 were:

First fiscal quarter	8.3 %
Second fiscal quarter	6.3 %
Third fiscal quarter	6.3 %
Fourth fiscal quarter	6.6 %

For Specialty Retail stores, our sales per square foot increased by 5.9% to $611 in fiscal year 2006 compared to $577 in fiscal year 2005.

- Cost of goods sold including buying and occupancy costs (excluding depreciation) COGS represented 64.2% of our revenues in fiscal year 2006 as compared to 63.3% for fiscal year 2005. This increase was primarily due to purchase accounting adjustments in fiscal year 2006 of $43.8 million, or 1.1% of revenues.

- Selling, general and administrative expenses (excluding depreciation) Selling, general and administrative expenses were 23.9% of our revenues in fiscal year 2006 and 24.7% of our revenues in fiscal year 2005.

- Operating earnings For fiscal year 2006, our operating earnings were $328.1 million, or 8.0% of revenues, compared to $409.0 million, or 10.8% of revenues for fiscal year 2005. Fiscal year 2006 operating earnings include charges aggregating $121.9 million, or 3.0% of revenues, consisting of 1) $60.2 million of amortization expense related to intangible assets recorded in connection with the Transactions, 2) $38.2 million of non-cash charges related to other valuation adjustments recorded in connection with the Transactions and 3) $23.5 million of costs incurred in connection with the Transactions. In addition, fiscal year 2006 operating earnings were negatively impacted by 1) lower income from credit card operations of $14.5 million, or 0.5% of revenues, as a result of the Credit Card Sale and 2) higher depreciation charges of 0.4% of revenues as a result of higher levels of capital expenditures for new stores and remodels in recent years.

Seasonality

We conduct our selling activities in two primary selling seasons Fall and Spring. The Fall season is comprised of our first and second fiscal quarters and the Spring season is comprised of our third and fourth fiscal quarters.

Our first fiscal quarter is generally characterized by a higher level of full-price selling with a focus on the initial introduction of Fall season fashions. Aggressive in-store marketing activities designed to stimulate customer buying, a lower level of markdowns and higher margins are characteristic of this quarter. The second fiscal quarter is more focused on promotional activities related to the December holiday season, the early introduction of resort season collections from certain designers and the sale of Fall season goods on a marked down basis. As a result, margins are typically lower in the second fiscal quarter. However, due to the seasonal increase in sales that occurs during the holiday season, the second fiscal quarter is typically the quarter in which our revenues are the highest and in which expenses as a percentage of revenues are the lowest. Our working capital requirements are also the greatest in the first and second fiscal quarters as a result of higher seasonal requirements.

Similarly, the third fiscal quarter is generally characterized by a higher level of full-price selling with a focus on the initial introduction of Spring season fashions. Aggressive in-store marketing activities designed to stimulate customer buying, a lower level of markdowns and higher margins are again characteristic of this quarter. Revenues are generally the lowest in the fourth fiscal quarter with a focus on promotional activities offering Spring season goods to the customer on a marked down basis, resulting in lower margins during the quarter. Our working capital requirements are typically lower in the third and fourth fiscal quarters than in the other quarters.

A large percentage of our merchandise assortment, particularly in the apparel, fashion accessories and shoe categories, is ordered months in advance of the introduction of such goods. For example, women s apparel, men s apparel and shoes are typically ordered six to nine months in advance of the products being offered for sale while handbags, jewelry and other categories are typically ordered three to six months in advance. As a result, inherent in the successful execution of our business plans is our ability both to predict the fashion trends that will be of interest to our customers and to anticipate future spending patterns of our customer base.

We monitor the sales performance of our inventories throughout each season. We seek to order additional goods to supplement our original purchasing decisions when the level of customer demand is higher than originally anticipated. However, in certain merchandise categories, particularly fashion apparel, our ability to purchase additional goods can be limited. This can result in lost sales in the event of higher than anticipated demand of the fashion goods we offer or a higher than anticipated level of consumer spending. Conversely, in the event we buy fashion goods that are not accepted by the customer or the level of consumer spending is less than we anticipated, we typically incur a higher than anticipated level of markdowns, net of vendor allowances, to sell the goods that remain at the end of the season, resulting in lower operating profits. We believe that the experience of our merchandising and selling organizations helps to minimize the inherent risk in predicting fashion trends.

OPERATING RESULTS

Performance Summary

The following table sets forth certain items expressed as percentages of net revenues for the periods indicated.

	Forty-three weeks ended July 29, 2006 (Successor)	Nine weeks ended October 1, 2005 (Predecessor)	Fiscal year ended July 29, 2006 (Combined)	Fiscal year ended July 30, 2005 (Predecessor)	Fiscal year ended July 31, 2004 (Predecessor)
Revenues	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %
Cost of goods sold including buying and occupancy costs (excluding depreciation)	65.3	58.8	64.2	63.3	64.0
Selling, general and administrative expenses (excluding depreciation)	23.7	25.0	23.9	24.7	24.8
Income from credit card operations	(1.4)	(1.2)	(1.4)	(1.9)	(1.6)
Depreciation expense	3.2	3.1	3.2	2.8	2.8
Amortization of customer lists	1.3		1.1		
Amortization of favorable lease commitments	0.4		0.4		
Transaction and other costs		3.7	0.6		0.1
Loss on disposition of Chef s Catalog				0.4	
Gain on credit card sale				(0.2)	
Operating earnings	7.5	10.7	8.0	10.8	9.9
Interest expense (income), net	6.3	(0.1)	5.3	0.3	0.5
Earnings from continuing operations before income taxes and minority interest	1.2	10.9	2.7	10.5	9.4
Income taxes	0.4	4.0	1.0	3.9	3.4
Earnings from continuing operations before minority interest	0.8	6.9	1.7	6.7	5.9
Minority interest in net (earnings) loss of subsidiaries	(0.0)	0.1	0.0	(0.1)	(0.1)
Earnings from continuing operations	0.8	6.9	1.7	6.6	5.9
(Loss) earnings from discontinued operation	(0.4)	0.0	(0.3)	0.0	0.0
Net earnings	0.4 %	6.9 %	1.4 %	6.6 %	5.9 %

In connection with the Transactions, the Company incurred significant indebtedness and became highly leveraged. See Liquidity and Capital Resources. In addition, the purchase price paid in connection with the Acquisition has been allocated to state the acquired assets and liabilities at fair value. The purchase accounting adjustments increased the carrying value of our property and equipment and inventory, established intangible assets for our tradenames, customer lists and favorable lease commitments and revalued our long-term benefit plan obligations, among other things. Subsequent to the Transactions, interest expense and non-cash depreciation and amortization charges have significantly increased. As a result, our Successor financial statements subsequent to the Transactions are not comparable to our Predecessor financial statements.

Set forth in the following table is certain summary information with respect to our operations for the periods indicated.

(dollars in millions)	Forty-three weeks ended July 29, 2006 (Successor)	Nine weeks ended October 1, 2005 (Predecessor)	Fiscal year ended July 29, 2006 (Combined)	Fiscal year ended July 30, 2005 (Predecessor)	Fiscal year ended July 31, 2004 (Predecessor)
REVENUES					
Specialty Retail stores	$ 2,829.9	$ 544.9	$ 3,374.8	$ 3,103.0	$ 2,850.1
Direct Marketing	567.8	87.5	655.3	592.1	570.6
Other(1)	64.5	11.0	75.5	79.7	63.3
Total	$ 3,462.2	$ 643.4	$ 4,105.6	$ 3,774.8	$ 3,484.0
OPERATING EARNINGS					
Specialty Retail stores	$ 312.3	$ 91.4	$ 403.7	$ 377.8	$ 310.6
Direct Marketing	90.0	8.2	98.2	75.2	61.3
Other(1)	1.0	(1.3)	(0.2)	11.5	11.0
Subtotal	403.3	98.3	501.7	464.5	382.9
Corporate expenses	(45.8)	(5.8)	(51.7)	(46.4)	(35.8)
Amortization of customer lists and favorable lease commitments	(60.2)		(60.2)		
Non-cash charges related to other valuation adjustments made in connection with the Acquisition	(38.2)		(38.2)		
Transaction and other costs		(23.5)	(23.5)		
Loss on disposition of Chef s Catalog				(15.3)	
Gain on Credit Card Sale				6.2	
Impairment and other charges					(3.9)
Total	$ 259.1	$ 69.0	$ 328.1	$ 409.0	$ 343.2
OPERATING PROFIT MARGIN					
Specialty Retail stores	11.0%	16.8%	12.0%	12.2%	10.9%
Direct Marketing	15.8%	9.4%	15.0%	12.7%	10.7%
Total	7.5%	10.7%	8.0%	10.8%	9.9%
CHANGE IN COMPARABLE REVENUES(2)					
Specialty Retail stores	5.4%	9.8%	6.1%	8.7%	13.1%
Direct Marketing	13.9%	9.6%	13.3%	16.3%	19.2%
Total	6.4%	9.2%	6.8%	9.8%	14.4%
SALES PER SQUARE FOOT					
Specialty Retail stores	$ 508	$ 103	$ 611	$ 577	$ 528
STORE COUNT					
Neiman Marcus and Bergdorf Goodman stores:					
Open at beginning of period	37	36	36	37	37
Opened during the period	1	1	2	(1)	
Open at end of period	38	37	38	36	37
Clearance centers:					
Open at beginning of period	17	16	16	14	14
Opened during the period	1	1	2	2	
Open at end of period	18	17	18	16	14

30

(1) Other includes the operations of Kate Spade, LLC.

(2) Comparable revenues include 1) revenues derived from our retail stores open for more than 52 weeks, including stores that have been relocated or expanded, 2) revenues from our Direct Marketing operation and 3) revenues from Kate Spade LLC. Comparable revenues exclude 1) revenues of closed stores, 2) revenues of Gurwitch Products, L.L.C. (sold in July 2006) and 3) revenues of our previous Chef s Catalog operations (sold in November 2004).

Fiscal Year Ended July 29, 2006 Compared to Fiscal Year Ended July 30, 2005

Revenues. Revenues for fiscal year 2006 of $4,105.6 million increased $330.8 million, or 8.8%, from $3,774.8 million in fiscal year 2005, reflecting increases in comparable revenues, revenues from new stores and higher internet sales. Revenues increased in fiscal year 2006 compared to fiscal year 2005 at all our operating companies, except for Kate Spade.

Comparable revenues for fiscal year 2006 were $3,992.2 million compared to $3,740.6 million in fiscal year 2005, representing an increase of 6.8%. Comparable revenues increased in fiscal year 2006 by 6.1% for Specialty Retail stores, 13.3% for Direct Marketing and decreased 13.1% for Kate Spade compared to fiscal year 2005.

Comparable revenues in fiscal year 2005 increased by 9.8% as compared to fiscal year 2004. Changes in comparable revenues by fiscal quarter are as follows:

	Fiscal Year 2006				**Fiscal Year 2005**			
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Fourth Quarter**	**Third Quarter**	**Second Quarter**	**First Quarter**
Specialty Retail stores	5.8 %	5.7 %	4.5 %	8.8 %	7.4 %	6.5 %	9.6 %	11.1 %
Direct Marketing	13.2 %	16.5 %	13.2 %	10.4 %	19.5 %	16.8 %	15.8 %	13.1 %
Total	6.6 %	6.3 %	6.3 %	8.3 %	9.4 %	7.9 %	10.4 %	11.4 %

In fiscal year 2006, internet sales by Direct Marketing were $405.7 million, an increase of 33.0% from fiscal year 2005, excluding Chef s Catalog. Total revenues of Chef s Catalog (prior to its sale in November 2004) of $13.9 million are included in consolidated revenues for fiscal year 2005.

Cost of goods sold including buying and occupancy costs (excluding depreciation). COGS for fiscal year 2006 and fiscal year 2005 were:

(in millions, except percentages)	**Fiscal year ended July 29, 2006 (Combined) $**	**% of revenues**	**Fiscal year ended July 30, 2005 (Predecessor) $**	**% of revenues**
COGS, before purchase accounting adjustments	$ 2,593.6	63.1 %	$ 2,390.3	63.3 %
Purchase accounting adjustments, primarily non-cash charges related to step-up in carrying value of acquired inventories	43.8	1.1		
COGS, as reported	$ 2,637.4	64.2 %	$ 2,390.3	63.3 %

We present the non-GAAP financial measure COGS, before purchase accounting adjustments because we use this measure to monitor and evaluate the performance of our business and believe the presentation of this measure will enhance investors ability to analyze trends in our business and evaluate our performance relative to other companies in our industry.

The increase in COGS as reported under GAAP to 64.2% of revenues from 63.3% of revenues in the prior fiscal year primarily reflects $43.8 million of purchase accounting adjustments to increase the carrying value of the acquired inventories recorded in connection with the Transactions. COGS before purchase accounting adjustments was 63.1% of revenues compared to 63.3% of revenues in the prior year reflecting:

- a decrease in product costs by approximately 0.1% of revenues primarily due to lower net markdowns; and

- a decrease in buying and occupancy costs of approximately 0.1% of revenues primarily due to leveraging payroll and rent expense on a higher level of revenues in fiscal year 2006.

We incurred a lower level of net markdowns in our Specialty Retail stores in fiscal year 2006 primarily due to:

- higher levels of full-price selling; and
- markdown savings, primarily in the Spring season, related to lower markdown percentages taken in connection with the end-of-season clearance activities in our full-line stores.

Consistent with industry business practice, we receive allowances from certain of our vendors in support of the merchandise we purchase for resale. We receive certain allowances to reimburse us for markdowns taken and/or to support the gross margins realized in connection with the sales of the vendor s merchandise. We recognize these allowances as a decrease in COGS when the allowances are earned and approved by the vendor. Other allowances we receive represent reductions to the amounts initially paid to acquire the merchandise. We recognize these allowances as a reduction in the cost of the acquired merchandise resulting in a decrease in COGS at the time the goods are sold. We received vendor allowances of $88.9 million, or 2.2% of revenues, in fiscal year 2006 and $82.8 million, or 2.2% of revenues, in fiscal year 2005.

Selling, general and administrative expenses (excluding depreciation). SG&A expenses were 23.9% of revenues in fiscal year 2006 compared to 24.7% of revenues in the prior fiscal year period.

The net decrease in SG&A expenses as a percentage of revenues in fiscal year 2006 was primarily due to:

- a decrease in marketing and advertising costs of approximately 0.3% of revenues primarily due to higher internet sales by our Direct Marketing segment, which have a lower expense to revenue ratio than catalog sales;
- a decrease of approximately 0.3% of revenues in our payroll and employee benefit costs primarily due to the leveraging of these expenses on a higher level of revenues in fiscal year 2006 period and favorable insurance claims experience;
- lower annual incentive compensation costs of approximately 0.1% of revenues;
- a decrease in costs incurred to support our credit card operations subsequent to the Credit Card Sale of approximately 0.1% of revenues; and
- a decrease of approximately 0.1% of revenues in professional and legal fees incurred primarily due to a higher level of costs incurred in the fourth quarter of fiscal year 2005 related to the Transactions.

These decreases in SG&A expenses, as a percentage of revenues, were partially offset by:

- management services fees of $8.7 million, or 0.2% of revenues, payable to the Sponsors as a result of the Acquisition; and
- an increase in preopening expenses and store remodeling expenses primarily incurred in connection with the opening of our San Antonio store in September 2005 and our Boca Raton store in November 2005 by approximately 0.1% of revenues.

Income from credit card operations. We received HSBC Program Income of $57.2 million, or 1.4% of revenues, in fiscal year 2006 compared to net finance charge income of $71.6 million, or 1.9% of revenues, in fiscal year 2005.

Depreciation expense. Depreciation expense was $130.8 million, or 3.2% of revenues, in fiscal year 2006 compared to $106.3 million, or 2.8% of revenues, in the prior fiscal year. The increase in depreciation was primarily due to 1) a higher level of capital spending in recent years and 2) additional depreciation expense resulting from the revaluation of our property and equipment at fair value in connection with the Acquisition.

Amortization expense. Amortization of acquisition related intangibles (customer lists and favorable lease commitments) recorded as a result of the application of purchase accounting in connection with the Acquisition aggregated $60.2 million, or 1.5% of revenues, for fiscal year 2006. We had no amortization expense in the prior year period.

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

Segment operating earnings. Segment operating earnings for our Specialty Retail stores and Direct Marketing segments do not reflect the impact of adjustments to revalue our assets and liabilities to estimated fair value at the Acquisition date. See Note 16 to our consolidated financial statements.

Operating earnings for our Specialty Retail stores segment were $403.7 million, or 12.0% of Specialty Retail stores revenues, for fiscal year 2006 compared to $377.8 million, or 12.2% of Specialty Retail stores revenues, for the prior year period. Operating margin for Specialty Retail stores was positively impacted by 1) higher product margins, 2) lower SG&A expenses for compensation and related benefits, as a percentage of revenues, as a result of leveraging these expenses on a higher level of revenues in fiscal year 2006 and 3) the leveraging of buying and occupancy costs on a higher level of revenues. These effects were offset, in part, by 1) a lower level of income from our credit card operations due to the sale of our credit card operations to HSBC in July 2005, 2) higher preopening costs and 3) higher depreciation charges as a result of higher levels of capital expenditures for new stores and store remodels in recent years.

Operating earnings for Direct Marketing increased to $98.2 million, or 15.0% of Direct Marketing revenues, in fiscal year 2006 from $75.2 million, or 12.7% of Direct Marketing revenues, for the prior year period. The increase in operating earnings and operating margin for Direct Marketing was primarily the result of 1) higher product margins and 2) the decrease in advertising and marketing costs, as a percentage of revenues, incurred to support internet sales.

Interest expense, net. Net interest expense was $217.0 million in fiscal year 2006 and $12.3 million for the prior year period. The significant components of interest expense are as follows:

(in thousands)	**Forty-three weeks ended July 29, 2006 (Successor)**	**Nine weeks Ended October 1, 2005 (Predecessor)**	**Fiscal year ended July 29, 2006 (Combined)**	**Fiscal year ended July 30, 2005 (Predecessor)**
Asset-Based Revolving Credit Facility	$ 1,332	$	$ 1,332	$
Senior Secured Term Loan Facility	111,662		111,662	
2028 Debentures	7,266	1,542	8,808	8,904
Senior Notes	51,421		51,421	
Senior Subordinated Notes	42,339		42,339	
Credit Agreement				5,803
2008 Notes	638	1,439	2,077	8,308
Amortization of debt issue costs and other	12,275	322	12,597	1,193
Total interest expense	226,933	3,303	230,236	24,208
Less:				
Interest income	5,557	3,046	8,603	6,556
Capitalized interest	3,446	1,146	4,592	5,350
Interest expense, net	$ 217,930	$ (889)	$ 217,041	$ 12,302

The increase in interest expense is due to the $3.3 billion increase in debt incurred in connection with the Transactions. The increase in interest income was due primarily to interest earned on higher average invested balances after the Credit Card Sale in July 2005 and prior to the Transactions.

Income taxes. Our effective income tax rate was 35.6% for the forty-three weeks ended July 29, 2006 and 36.8% for the nine weeks ended October 1, 2005, resulting in an effective tax rate of 36.4% for the combined fiscal year 2006 period. Our combined effective tax rate for fiscal year 2006 was favorably impacted by a higher level of tax-exempt interest income earned. Our effective income tax rate was 36.7% for the fiscal year ended July 30, 2005 and was favorably impacted by tax-exempt interest income, offset by non-deductible transaction costs. In the fourth fiscal quarter of fiscal year 2005, we recognized tax benefits aggregating $7.6 million related to a favorable settlement associated with previous state tax filings and reductions in previously recorded deferred tax liabilities. Excluding these benefits, our effective tax rate was 38.6% for fiscal year 2005.

The Company s federal tax returns for fiscal years 2004 and 2003 are currently under examination by the Internal Revenue Service (IRS). We believe our recorded tax liabilities as of July 29, 2006 are sufficient to cover any potential assessments to be made by the IRS upon the completion of their examinations. We will continue to monitor the progress of the IRS examinations and review our recorded tax liabilities for potential audit assessments. Adjustments to increase or decrease the recorded tax liabilities may be required in the future as additional facts become known.

Fiscal Year Ended July 30, 2005 Compared to Fiscal Year Ended July 31, 2004

Revenues. Revenues for fiscal year 2005 of $3,774.8 million increased $290.8 million, or 8.3%, from $3,484.0 million in fiscal year 2004.

Comparable revenues for fiscal year 2005 were $3,740.6 million compared to $3,390.5 million in fiscal year 2004, representing an increase of 9.8%. Comparable revenues increased in fiscal year 2005 by 8.7% for Specialty Retail stores, 16.3% for Direct Marketing and 8.6% for Kate Spade LLC compared to fiscal year 2004. Comparable revenues in fiscal year 2004 increased by 14.4% as compared to fiscal year 2003. Changes in comparable revenues by fiscal quarter are as follows:

	Fiscal Year 2005				**Fiscal Year 2004**			
	Fourth Quarter	**Third Quarter**	**Second Quarter**	**First Quarter**	**Fourth Quarter**	**Third Quarter**	**Second Quarter**	**First Quarter**
Specialty Retail stores	7.4 %	6.5 %	9.6 %	11.1 %	11.3 %	22.2 %	10.2 %	9.6 %
Direct Marketing	19.5 %	16.8 %	15.8 %	13.1 %	21.7 %	14.4 %	25.7 %	13.2 %
Total	9.4 %	7.9 %	10.4 %	11.4 %	12.8 %	22.0 %	12.6 %	10.7 %

We believe the increases in our comparable revenues in fiscal year 2005 were primarily the result of a higher level of consumer spending, in general, with a higher increase coming from the affluent luxury customers we serve. In addition, we believe the increases in our comparable revenues were driven by sales events conducted by our Specialty Retail stores and by the growth of internet sales for Direct Marketing. In fiscal year 2005, internet sales by Direct Marketing, excluding Chef s Catalog, were $305.9 million, representing 51.7% of Direct Marketing revenues and an increase of 46.0% from fiscal year 2004.

Costs of goods sold including buying and occupancy costs (excluding depreciation). COGS was 63.3% of revenues in fiscal year 2005 compared to 64.0% of revenues in fiscal year 2004. The decrease in COGS as percentage of revenues was primarily due to:

- the decrease in product costs by approximately 0.6% as a percentage of revenues; and
- a decrease in buying and occupancy costs by approximately 0.1% as a percentage of revenues.

We had lower product costs as a percentage of revenues at both our Specialty Retail stores and our Direct Marketing operations during fiscal year 2005. We believe the decrease in product costs as a percentage of revenues at our Specialty Retail stores was due primarily to the higher portion of full-price sales generated in fiscal year 2005 and our continued emphasis on inventory management. Net markdowns for Specialty Retail stores were consistent, as a percentage of revenues, in fiscal year 2005 and fiscal year 2004. We also had lower product costs as a percentage of revenues at our Direct Marketing operation in fiscal year 2005 subsequent to our disposition of Chef s Catalog in November 2004. Chef s Catalog had higher product costs as a percentage of revenues than our other Direct Marketing brands. However, we incurred a higher level of net markdowns in fiscal year 2005 for Direct Marketing as compared to fiscal year 2004 primarily due to lower than anticipated sales in our catalog operations during the December holiday season. We received vendor allowances to reimburse us for markdowns taken or to support the gross margins we earned in connection with the sales of the vendors merchandise of $82.8 million, or 2.2% of revenues, in fiscal year 2005 and $79.3 million, or 2.3% of revenues, in fiscal year 2004.

Buying and occupancy costs decreased by approximately 0.1% as a percentage of revenues during fiscal year 2005 compared to fiscal year 2004 primarily due to the leveraging of fixed expenses over the higher level of revenues we generated during fiscal year 2005.

Selling, general and administrative expenses (excluding depreciation). SG&A expenses were 24.7% of revenues in fiscal year 2005 compared to 24.8% of revenues in fiscal year 2004.

The net decrease in selling, general and administrative expenses as a percentage of revenues in fiscal year 2005 as compared to fiscal year 2004 was primarily due to:

- a decrease in marketing and advertising costs by approximately 0.3% as a percentage of revenues, primarily due to the elimination of expenditures for Chef s Catalog which were higher as a percentage of revenues than the marketing and advertising costs for our other Direct Marketing brands; and

- a decrease in incentive compensation by approximately 0.1% as a percentage of revenues.

These decreases in selling, general and administrative expenses as a percentage of revenues were partially offset by:

- costs, consisting primarily of legal and consulting fees, aggregating $6.7 million, or approximately 0.2% as a percentage of revenues, incurred in connection with the Transactions;

- an increase in costs, primarily payroll, by approximately 0.1% as a percentage of revenues incurred by Direct Marketing and Kate Spade LLC in support of new business initiatives and the expansion of Kate Spade operations; and

- an increase in employee benefit expenses, including medical and pension expenses, by approximately 0.1% as a percentage of revenues.

In addition, selling, general and administrative expenses increased as a percentage of revenues in fiscal year 2005 due to a $3.7 million reduction in selling, general and administrative expenses recorded in the second fiscal quarter of fiscal year 2004 for the favorable impact of conclusions of certain sales tax and unclaimed property examinations for which the agreed-on settlements were less than the amounts we previously estimated. We recorded no corresponding reduction in selling, general and administrative expenses in fiscal year 2005.

Income from credit card operations. Income from credit card operations, net was $71.6 million, or 1.9% of revenues, in fiscal year 2005 compared to $55.7 million, or 1.6% of revenues, in fiscal year 2004. An increase in net income generated by our credit card portfolio by approximately 0.1% as a percentage of revenues is consistent with the increase in sales made pursuant to our proprietary credit card program. In addition, income from credit card operations, net was higher in fiscal year 2005 as compared to fiscal year 2004 by approximately 0.2% due to a $7.6 million reduction in the income generated by our credit card portfolio in fiscal year 2004 related to the required amortization of the premium associated with the carrying value of the Retained Interests and Sold Interests during the transition from Off-Balance Sheet Accounting to financing accounting in fiscal year 2004, as more fully described in Note 6 of the notes to our audited consolidated financial statements. We recorded no corresponding decrease in fiscal year 2005.

Depreciation expense. Depreciation expense was $106.3 million, or 2.8% of revenues, in fiscal year 2005 compared to $98.1 million, or 2.8% of revenues, in fiscal year 2004. Included in depreciation expense in fiscal year 2005 are unfavorable net adjustments to depreciation aggregating approximately $5.8 million, or 0.2% of revenues, made primarily in the second and third fiscal quarters of fiscal year 2005 in connection with our review of the amortization periods assigned to our leased property and equipment and deferred real estate credits.

Loss on disposition of Chef s Catalog. In November 2004, we completed the Chef s Catalog Disposition. Chef s Catalog is a multi-channel retailer of professional-quality kitchenware with revenues of approximately $73 million in fiscal year 2004. At October 30, 2004, Chef s Catalog had net tangible assets, primarily inventory, of $12.5 million and net intangible assets of $17.2 million. We received proceeds, net of selling costs, of $14.4 million from the sale. As the carrying value of the Chef s Catalog assets exceeded the net proceeds from the sale, we incurred a pretax loss of $15.3 million in the first fiscal quarter of fiscal year 2005 related to the Chef s Catalog Disposition.

Gain on Credit Card Sale. On July 7, 2005, HSBC purchased our approximately three million private label Neiman Marcus and Bergdorf Goodman credit card accounts and related assets, as well as the outstanding balances associated with such accounts in connection with the Credit Card Sale. The total purchase price was approximately $647 million, consisting of approximately $534 million in net cash proceeds and the assumption of approximately $113 million of outstanding debt under our Credit Card Facility. We recognized a gain of $6.2 million in connection with the Credit Card Sale. Our proprietary credit card portfolio generated income, representing primarily the excess of finance charge income, net of credit losses, of approximately $75.4 million in fiscal year 2005. If the Credit Card Sale had been consummated as of the first day of fiscal year 2005, we believe the HSBC Program Income for fiscal year 2005 would have been at least $42 million. HSBC and the Company are currently in the process of implementing changes to the proprietary credit card program that we expect will be fully implemented during the fourth quarter of fiscal year 2006. Had such changes been fully implemented on the first day of fiscal year 2005, we believe the HSBC Program Income for fiscal year 2005 would have been approximately $56 million.

Segment operating earnings. Operating earnings for our Specialty Retail stores segment were $377.8 million for fiscal year 2005 compared to $310.6 million for fiscal year 2004. This 21.6% increase was primarily the result of increased revenues and margins and net decreases in both buying and occupancy expenses and selling, general and administrative expenses as a percentage of revenues.

Operating earnings for Direct Marketing increased to $75.2 million in fiscal year 2005 from $61.3 million for fiscal year 2004. This 22.6% increase was primarily the result of increased revenues and margins and net decreases in both buying and occupancy expenses and selling, general and administrative expenses as a percentage of revenues, partly offset by a higher level of net markdowns.

Interest expense, net. Net interest expense was $12.3 million in fiscal year 2005 and $15.9 million in fiscal year 2004.

The net decrease in net interest expense was due to:

- increases in interest income of $4.4 million generated by higher cash balances; and
- increases in capitalized interest charges of $2.3 million associated with store construction and remodeling activities.

The net decrease in interest expense was offset by a $3.5 million increase in the interest expense attributable to the monthly distributions to the holders of certain interests issued by a trust in connection with our revolving credit securitization program (the obligations under which have been transferred as part of the Credit Card Sale). We began charging those distributions to interest expense in December 2003 as a result of the discontinuance of Off-Balance Sheet Accounting (as defined below under Critical Accounting Policies Accounts Receivable Prior to the Credit Card Sale).

Income taxes. Our effective income tax rate was 36.7% for fiscal year 2005 and 36.7% for fiscal year 2004. The income tax rate for fiscal year 2005 was favorably impacted by tax-exempt interest income, offset by non-deductible transaction costs. In the fourth fiscal quarter of fiscal year 2005, we recognized tax benefits aggregating $7.6 million related to a favorable settlement associated with previous state tax filings and reductions in previously recorded deferred tax liabilities. Excluding these benefits, our effective tax rate was 38.6% for fiscal year 2005. In the second fiscal quarter of fiscal year 2004, we also recognized a tax benefit of $7.5 million related to favorable settlements associated with previous state tax filings. Excluding this benefit, our effective tax rate was 39.0% for fiscal year 2004.

Inflation and Deflation

We believe changes in revenues and net earnings that have resulted from inflation or deflation have not been material during the periods presented. In recent years, we have experienced certain inflationary conditions related to 1) increases in product costs due primarily to changes in foreign currency exchange rates that have reduced the purchasing power of the U.S. dollar and 2) increases in SG&A. We purchase a substantial portion of our inventory from foreign suppliers whose costs are affected by the fluctuation of their local currency against the dollar or who price their merchandise in currencies other than the dollar. Accordingly, changes in the value of the dollar relative to foreign currencies may increase our cost of goods sold and if we are unable to pass such cost increases to our customers, our gross margins, and ultimately our earnings, would decrease. Fluctuations in the euro-U.S. dollar exchange rate affect us most significantly; however, we source goods from numerous countries and thus are affected by changes in numerous currencies and, generally, by fluctuations in the U.S. dollar relative to such currencies. Although we hedge some exposures to changes in foreign currency exchange rates arising in the ordinary course of business, foreign currency fluctuations could have a material adverse effect on our business, financial condition and results of operations in the future. We attempt to offset the effects of inflation through price increases and control of expenses, although our ability to increase prices may be limited by competitive factors. We attempt to offset the effects of merchandise deflation, which has occurred on a limited basis in recent years, through control of expenses. There is no assurance, however, that inflation or deflation will not materially affect our operations in the future.

LIQUIDITY AND CAPITAL RESOURCES

Our cash requirements consist principally of:

- the funding of our merchandise purchases;
- capital expenditures for new store construction, store renovations and upgrades of our management information systems;
- debt service requirements;
- income tax payments; and
- obligations related to our Pension Plan.

Our primary sources of short-term liquidity are comprised of cash on hand and availability under our Asset-Based Revolving Credit Facility. The amounts of cash on hand and borrowings under the Asset-Based Revolving Credit Facility are influenced by a number of factors, including revenues, working capital levels, vendor terms, the level of capital expenditures, cash requirements related to financing instruments and debt service obligations following the Transactions, Pension Plan funding obligations and our tax payment obligations, among others.

Our working capital requirements fluctuate during the fiscal year, increasing substantially during the first and second quarters of each fiscal year as a result of higher seasonal levels of inventories. We have typically financed the increases in working capital needs during the first and second fiscal quarters with cash flows from operations and, to a lesser extent, with cash provided from borrowings under our credit facilities. During fiscal year 2006, we financed our seasonal increases in working capital with cash flows from operations and borrowings under our Asset-Based Revolving Credit Facility. During the first quarter of fiscal year 2006, we borrowed $150 million under our Asset-Based Revolving Credit Facility. We repaid these borrowings in the second quarter of fiscal year 2006.

We believe that operating cash flows, available vendor financing and amounts available pursuant to our senior secured Asset-Based Revolving Credit Facility will be sufficient to fund our operations, anticipated capital expenditure requirements, debt service obligations, contractual obligations and commitments and Pension Plan funding requirements through the end of fiscal year 2007.

At July 29, 2006, cash and equivalents were $224.8 million compared to $853.4 million at July 30, 2005. This $628.6 million decrease in cash is primarily due to:

- higher cash balance at July 30, 2005 as a result of the net cash proceeds of $533.7 million received from the Credit Card Sale in July 2005;
- the use of available cash of approximately $666.1 million in connection with the consummation of the Transactions in October 2005;
- higher debt and interest requirements in fiscal year 2006, including a $100 million voluntary principal repayment on the Senior Secured Term Loan Facility made in the second quarter; offset, in part by,
- pretax net cash proceeds of $40.8 million received for the Gurwitch Disposition in July 2006.

Net cash provided by operating activities was $400.2 million in fiscal year 2006 compared to $845.4 million in fiscal year 2005. Cash flows related to operating activities in fiscal year 2005 were favorably impacted by 1) the $533.7 million net cash proceeds received by the Predecessor in connection with the Credit Card Sale, partially offset by 2) the funding of a $68.8 million increase in accounts receivable prior to the Credit Card Sale.

Net cash used for investing activities was $5,286.1 million fiscal year 2006 which consisted of cash outflows of $5,156.4 million paid to effect the Acquisition and $167.2 million of capital expenditures, partially offset by $40.8 million pretax net cash proceeds received in connection with the Gurwitch Disposition. Net cash used in investing activities was $228.8 million in fiscal year 2005 primarily for $199.7 million of capital expenditures and $40.7 million cash restricted for the repayment of the outstanding indebtedness on our Credit Card Facility, offset by $14.4 million in cash proceeds from the sale of

Chef s Catalog. We incurred capital expenditures in fiscal year 2006 related to the construction of new stores in San Antonio, Boca Raton, Charlotte and Austin and the remodels of our San Francisco, Houston, Beverly Hills and Bergdorf Goodman stores. We opened our San Antonio store in September 2005, our Boca Raton store in November 2005 and our Charlotte store in September 2006. We plan to open the Austin store in March 2007. We currently project capital expenditures for fiscal year 2007 to be approximately $160 to $170 million.

Net cash provided by financing activities was $4,257.6 million in fiscal year 2006 as compared to net cash used for financing activities of $131.5 million in fiscal year 2005. Proceeds from debt incurred in connection with the Transactions, net of issuance costs, aggregated $3,222.1 million and cash equity contributions received in connection with the Transactions aggregated $1,427.7 million. In fiscal year 2006, we also repaid our $150.0 million of seasonal borrowings under our Asset-Based Revolving Credit Facility, paid $134.7 million for the redemption of our 2008 Notes pursuant to our call of such notes for redemption in connection with the Transactions and repaid $100.0 million principal amount of borrowings on the Senior Term Loan Facility. In fiscal year 2005, we repaid $112.5 million of borrowings under our revolving credit securitization program and paid dividends of $27.4 million.

Financing Structure at July 29, 2006

Our major sources of funds are comprised of vendor financing, a $600.0 million Asset-Based Revolving Credit Facility, $1,875.0 million Senior Secured Term Loan Facility, $700.0 million Senior Notes, $500.0 million Senior Subordinated Notes, $125.0 million 2028 Debentures and operating leases.

Senior Secured Asset-Based Revolving Credit Facility. On October 6, 2005, in connection with the Transactions, NMG entered into a credit agreement and related security and other agreements for a senior secured Asset-Based Revolving Credit Facility with Deutsche Bank Trust Company Americas as administrative agent and collateral agent. The Asset-Based Revolving Credit Facility provides financing of up to $600.0 million, subject to a borrowing base equal to at any time the lesser of 80% of eligible inventory (valued at the lower of cost or market value) and 85% of net orderly liquidation value of the eligible inventory, less certain reserves. The Asset-Based Revolving Credit Facility includes borrowing capacity available for letters of credit and for borrowings on same-day notice. At the closing of the Transactions, NMG utilized $150.0 million of the Asset-Based Revolving Credit Facility for loans and approximately $16.5 million for letters of credit. In the second quarter of fiscal year 2006, NMG repaid all loans under the Asset-Based Revolving Credit Facility. As of July 29, 2006, NMG had $570.9 million of unused borrowing availability under the Asset-Based Revolving Credit Facility based on a borrowing base of over $600.0 million and after giving effect to $29.1 million used for letters of credit.

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

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

If at any time the aggregate amount of outstanding loans, unreimbursed letter of credit drawings and undrawn letters of credit under the Asset-Based Revolving Credit Facility exceeds the lesser of (i) the commitment amount and (ii) the borrowing base, NMG will be required to repay outstanding loans or cash collateralize letters of credit in an aggregate amount equal to such excess, with no reduction of the commitment amount. If the amount available under the Asset-Based Revolving Credit Facility is less than $60 million or an event of default has occurred, NMG will be required to repay outstanding loans and cash collateralize letters of credit with the cash NMG would then be required to deposit daily in a collection account maintained with the agent under the Asset-Based Revolving Credit Facility. NMG may voluntarily reduce the unutilized portion of the commitment amount and repay outstanding loans at any time without premium or penalty other than customary breakage costs with respect

to LIBOR loans. There is no scheduled amortization under the Asset-Based Revolving Credit Facility; the principal amount of the loans outstanding is due and payable in full on October 6, 2010.

All obligations under the Asset-Based Revolving Credit Facility are guaranteed by the Company and certain of NMG s existing and future domestic subsidiaries (excluding, among others, Kate Spade LLC). As of July 29, 2006, the liabilities of NMG s non-guarantor subsidiaries totaled approximately $21.0 million, or 0.4% of consolidated liabilities, and the assets of NMG s non-guarantor subsidiaries aggregated approximately $143.3 million, or 2.2% of consolidated total assets. All obligations under NMG s Asset-Based Revolving Credit Facility, and the guarantees of those obligations, are secured, subject to certain significant exceptions, by substantially all of the assets of the Company and NMG and NMG s subsidiaries that have guaranteed the Asset-Based Revolving Credit Facility (subsidiary guarantors), including:

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

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

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

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

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

- incur additional indebtedness;

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

- make investments, loans, advances and acquisitions;

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

- engage in transactions with NMG s affiliates;

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

- consolidate or merge;

- create liens; and

- enter into sale and lease back transactions.

The covenants limiting dividends and other restricted payments; investments, loans, advances and acquisitions; and prepayments or redemptions of other indebtedness, each permit the restricted actions in an unlimited amount, subject to the

39

satisfaction of certain payment conditions, principally that NMG must have at least $75.0 million of pro forma excess availability under the Asset-Based Revolving Credit Facility and that NMG must be in pro forma compliance with the fixed charge coverage ratio described below.

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

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

Borrowings under the Senior Secured Term Loan Facility bear interest at a rate per annum equal to, at NMG s option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Credit Suisse and (2) the federal funds effective rate plus 1/2 of 1% or (b) a LIBOR rate, subject to certain adjustments, in each case plus an applicable margin. The applicable margin is 1.5% with respect to base rate borrowings and 2.5% with respect to LIBOR borrowings. The interest rate on the outstanding borrowings pursuant to the Senior Secured Term Loan Facility was 7.77% at July 29, 2006.

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

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

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

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

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

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

Capital stock and other securities of a subsidiary of NMG that are owned by NMG or any subsidiary guarantor will not constitute collateral under NMG s Senior Secured Term Loan Facility to the extent that such securities cannot secure the 2028

40

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

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

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

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

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

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

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

Except as described below, the Senior Notes are not redeemable at NMG s option prior to October 15, 2010. From and after October 15, 2010, NMG may redeem the Senior Notes, in whole or in part, at a redemption price equal to 104.5% of

41

principal amount, declining annually to 100% of the principal amount on October 15, 2013, plus accrued and unpaid interest, and Additional Interest (as defined in the Senior Indenture), if any, thereon to the applicable redemption date.

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

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

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

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

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

Senior Subordinated Notes. On October 6, 2005, Newton Acquisition Merger Sub, Inc. issued $500.0 million aggregate principal amount of 10.375% Senior Subordinated Notes under a senior subordinated indenture (Senior Subordinated Indenture) with Wells Fargo Bank, National Association, as trustee. At the closing of the Transactions, as the surviving corporation in the Acquisition, NMG assumed all the obligations of Newton Acquisition Merger Sub, Inc. under the Senior Subordinated Indenture. The Senior Subordinated Notes mature on October 15, 2015. Interest on the Senior Subordinated Notes is payable in cash semi-annually in arrears on each April 15 and October 15, commencing April 15, 2006.

The Senior Subordinated Notes are fully and unconditionally guaranteed, on a joint and several unsecured, senior subordinated basis, by each of NMG s wholly-owned domestic subsidiaries that guarantee NMG s obligations under its Senior Secured Credit Facilities and by the Company. The Senior Subordinated Notes and the guarantees thereof are NMG s and the guarantors unsecured, senior subordinated obligations and rank (i) junior to all of NMG s and the guarantors existing and future senior indebtedness, including the Senior Notes and any borrowings under

NMG s Senior Secured Credit Facilities, and the guarantees thereof and NMG s 2028 Debentures; (ii) equally with any of NMG s and the guarantors future senior subordinated indebtedness; and (iii) senior to any of NMG s and the guarantors future subordinated indebtedness. In addition, the Senior Subordinated Notes are structurally subordinated to all existing and future liabilities, including trade payables, of NMG s subsidiaries that are not providing guarantees.

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

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

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

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

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

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

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

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

At July 29, 2006, the fair value of NMG s interest rate swap agreements was a gain of approximately $20.2 million, which amount is included in other assets. As a result of the swap agreements, NMG s effective fixed interest rates as to the $1,000.0 million in floating rate indebtedness will range from 6.931% to 7.499% per quarter and result in an average fixed rate of 7.285%.

Contractual Obligations and Commitments

The following table summarizes our estimated significant contractual cash obligations at July 29, 2006:

	Payments Due By Period				
(in thousands)	**Total**	**Fiscal Year 2007**	**Fiscal Years 2008-2009**	**Fiscal Years 2010-2011**	**Fiscal Year 2012 and Beyond**
Contractual obligations:					
Senior Secured Term Loan Facility (1)	$ 1,875,000	$	$	$	$ 1,875,000
Senior Notes	700,000				700,000
Senior Subordinated Notes	500,000				500,000
2028 Debentures	125,000				125,000
Interest requirements (2)	2,124,000	267,000	534,000	540,000	783,000
Operating lease obligations	808,900	47,800	99,400	93,500	568,200
Minimum pension funding obligation (3)					
Other long-term liabilities (4)	68,500	8,100	13,500	11,400	35,500
Construction commitments	235,000	97,800	137,200		
Inventory purchase commitments (5)	953,900	953,900			
	$ 7,390,300	$ 1,374,600	$ 784,100		