K2 INC
Form 10-Q
May 07, 2004

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Quarterly Report pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2004

Commission File No. 1-4290

K2 INC.

(Exact name of registrant as specified in its charter)

DELAWARE (State of Incorporation)	**95-2077125** (I.R.S. Employer Identification No.)
2051 Palomar Airport Road	**92009**
Carlsbad, California (Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code (760) 494-1000

Former name, former address and former fiscal year, if changed since last report:

Not applicable

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes x No ¨

Indicate the number of shares outstanding of each of the registrant s classes of common stock as of April 30, 2004.

Common Stock, par value $1	35,576,612 Shares

PART 1 FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

CONSOLIDATED CONDENSED STATEMENTS OF INCOME (Unaudited)

(Thousands, except per share figures)

	Three months ended March 31	
	2004	2003
	(unaudited)	
Net sales	$ 277,364	$ 157,120
Cost of products sold	190,731	109,976
Gross profit	86,633	47,144
Selling expenses	42,047	23,170
General and administrative expenses	25,064	15,220
Operating income	19,522	8,754
Interest expense	3,302	1,794
Debt extinguishment costs		6,745
Other (income) expense, net	(53)	4
Income before income taxes	16,273	211
Provision for income taxes	5,533	74
Net income	$ 10,740	$ 137
Basic earnings per share:		
Net income	$ 0.31	$ 0.01
Diluted earnings per share:		
Net income	$ 0.27	$ 0.01
Basic shares outstanding	34,353	18,262
Diluted shares outstanding	43,099	18,471

See notes to consolidated condensed financial statements.

CONSOLIDATED CONDENSED BALANCE SHEETS

(Thousands, except number of shares)

	March 31 2004	December 31 2003
	(Unaudited)	
Assets		
Current Assets		
Cash and cash equivalents	$ 19,786	$ 21,256
Accounts receivable, net	244,103	224,818
Inventories, net	215,774	237,152
Deferred taxes and income taxes receivable	36,971	40,023
Prepaid expenses and other current assets	16,393	13,083
Total current assets	533,027	536,332
Property, plant and equipment	212,533	204,738
Less allowance for depreciation and amortization	118,056	113,716
	94,477	91,022
Intangible assets, net	239,965	228,847
Other	15,158	15,670
Total Assets	$ 882,627	$ 871,871
Liabilities and Shareholders Equity		
Current Liabilities		
Bank loans	$ 5,554	$ 10,751
Accounts payable	56,784	77,304
Accrued payroll and related	29,708	33,040
Other accruals	71,357	61,540
Current portion of long-term debt	62,629	72,126
Total current liabilities	226,032	254,761
Long-term pension liabilities	11,173	11,173
Long-term debt	42,842	35,194
Deferred taxes	38,636	38,636
Convertible subordinated debentures	98,184	98,067
Commitments and Contingencies		
Shareholders Equity		
Preferred Stock, $1 par value, authorized 12,500,000 shares, none issued		
Common Stock, $1 par value, authorized 60,000,000 shares, issued shares 35,672,902 in 2004 and 34,146,798 in 2003	35,673	34,147
Additional paid-in capital	332,511	313,142
Retained earnings	118,357	107,617
Employee Stock Ownership Plan and stock option loans	(1,160)	(1,214)
Treasury shares at cost, 747,234 shares in 2004 and 2003	(9,107)	(9,107)
Accumulated other comprehensive loss	(10,514)	(10,545)
Total Shareholders Equity	465,760	434,040

Total Liabilities and Shareholders Equity	$ 882,627	$ 871,871

See notes to consolidated condensed financial statements.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

(Thousands)

	Three months ended March 31	
	2004	**2003**
Operating Activities	**(unaudited)**	
Net Income	$ 10,740	$ 137
Adjustments to reconcile net income from operations to net cash provided by operating activities:		
Depreciation and amortization	6,073	5,634
Deferred taxes	4,489	(2,008)
Changes in current assets and current liabilities	(14,825)	271
Net cash provided by operating activities	6,477	4,034
Investing Activities		
Property, plant & equipment expenditures	(6,782)	(2,135)
Disposals of property, plant & equipment	273	(11)
Purchase of business, net of cash acquired	1,780	(365)
Other items, net	(162)	1,264
Net cash used in investing activities	(4,891)	(1,247)
Financing Activities		
Issuance of convertible subordinated debentures		25,000
Borrowings under long-term debt	172,000	201,842
Payments of long-term debt	(173,732)	(219,161)
Net decrease in short-term bank loans	(5,197)	(839)
Debt issuance costs		(4,247)
Exercise of stock options	3,873	107
Net cash provided by (used in) financing activities	(3,056)	2,702
Net increase (decrease) in cash and cash equivalents	(1,470)	5,489
Cash and cash equivalents at beginning of year	21,256	11,228
Cash and cash equivalents at end of period	$ 19,786	$ 16,717

See notes to consolidated condensed financial statements.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

March 31, 2004

NOTE 1 Basis of Presentation

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

The consolidated condensed balance sheet at December 31, 2003 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

The interim financial statements should be read in connection with the financial statements in K2 Inc. s (K2 s) Annual Report on Form 10-K for the year ended December 31, 2003.

NOTE 2 Summary of Significant Accounting Policies

Accounts Receivable and Allowances

Accounts receivable are net of allowances for doubtful accounts of $7,677,000 at March 31, 2004 and $7,558,000 at December 31, 2003.

Inventories

The components of inventories consisted of the following:

	March 31 2004	December 31 2003
	(Thousands)	
Finished goods	$ 153,917	$ 180,379
Work in process	11,496	10,843
Raw materials	50,361	45,930

	$ 215,774	$ 237,152

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2004

NOTE 2 Summary of Significant Accounting Policies (Continued)

Newly Adopted Accounting Standards

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities and issued FIN 46(R) in December 2003, which amended FIN 46. FIN 46 requires certain variable interest entities to be consolidated in certain circumstances by the primary beneficiary even if it lacks a controlling financial interest. Adopting FIN 46 and FIN 46(R) did not have an impact on K2 s operational results or financial position since K2 does not have any variable interest entities.

During 2003, the FASB revised SFAS 132, Employers Disclosures about Pensions and Other Postretirement Benefits : This statement revises employers disclosures about pension plans and other postretirement benefit plans. It requires disclosures beyond those in the original SFAS 132 about the assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined postretirement plans.

In addition, the revised statement requires interim-period disclosures regarding the amount of net periodic benefit cost recognized and the total amount of the employers contributions paid and expected to be paid during the current fiscal year. It does not change the measurement or recognition of those plans.

The following table provides the components of benefit costs for the quarters ended March 31:

	For the quarter ended March 31	
(Thousands)	**2004**	**2003**
Service cost	$ 450	$ 420
Interest cost	1,030	1,030
Expected return on assets	(910)	(890)
Amortization of:		
Prior service cost	15	20
Actuarial loss	135	260
Curtailment/settlement loss recognized		10
Total net periodic benefit cost	$ 720	$ 850

K2   s expected contribution to its pension plans in 2004 is $4,000,000. No contributions were made by K2 to the plans for the quarter ended March 31, 2004.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2004

NOTE 3 Stock Based Compensation

K2 applies the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation,* which allows entities to continue to apply the provisions of Accounting Principles Board (*APB*) Opinion No. 25 *Accounting for Stock Issued to Employees,* and related interpretations and provide pro forma net income and pro forma net income per share disclosures for employee stock option grants made as if the fair-value-based method defined in SFAS No. 123 had been applied. K2 has elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure provisions of SFAS No. 123. As such, compensation expense for stock options issued to employees is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Had compensation cost been determined based upon the fair value at the grant date for K2 s stock options under SFAS No. 123 using the Black Scholes option pricing model, pro forma net income (loss) and pro forma net income (loss) per share, including the following weighted average assumptions used in these calculations, would have been as follows:

	Quarter ended March 31	
	2004	2003
	(Thousands, except per share data, percentages and years)	
Net income, as reported	$ 10,740	$ 137
Less: Total stock-based compensation expense determined under fair value based method for all awards, net of taxes	85	95
Net income, adjusted	$ 10,655	$ 42
Earnings per share:		
Basic as reported	$ 0.31	$ 0.01
Basic pro forma	$ 0.31	$ 0.00
Diluted as reported	$ 0.27	$ 0.01
Diluted pro forma	$ 0.27	$ 0.00
Risk free interest rate	2.63%	2.63%
Expected life of options	5 years	5 years
Expected volatility	50.4%	50.4%
Expected dividend yield		

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2004

Note 4 Acquisitions

On January 23, 2004, K2 completed the acquisition of Fotoball USA, Inc., (Fotoball), a marketer and manufacturer of souvenir and promotional products, principally for team sports, in a stock-for-stock exchange offer/merger transaction. Under the terms of the merger, each outstanding share of Fotoball common stock was converted into 0.2757 shares of common stock of K2 for a total of approximately 1.0 million shares of K2 s common stock. Based on a $15.36 per share K2 common stock price, the transaction was valued at approximately $16.9 million plus estimated merger costs of approximately $1.2 million. The purchase price included fully vested K2 stock options issued in exchange for Fotoball stock options outstanding at the time of the acquisition with a value of approximately $1.5 million. The value of the K2 stock options issued in exchange for the Fotoball stock options outstanding was based on a Black-Scholes estimate using the following assumptions: risk free interest rate of 3.00%, volatility of K2 stock of 0.478 and expected life of 4.00 years. The results of the operations of Fotoball were included in the consolidated financial statements of K2 beginning with the date of the merger. Subsequent to the completion of the merger, K2 changed the name of Fotoball to K2 Licensing & Promotions, Inc.

This transaction is accounted for under the purchase method of accounting, and accordingly the purchased assets and liabilities are recorded at their estimated fair values at the date of the merger. The preliminary purchase price allocation resulted in an excess of the purchase price over net tangible assets acquired of $11.2 million. This preliminary allocation assumes the excess purchase price will be allocated to goodwill, and is thus not amortized, however the final allocation could include identifiable intangible assets with finite and indefinite lives separate from goodwill. Should there be assets with finite lives, those assets would be subject to amortization resulting in additional amortization expense. The final allocation of the purchase price will be completed during the 2004 second quarter based on K2 s final evaluation of such assets and liabilities.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2004

Note 4 Acquisitions (Continued)

During 2003, K2 completed seven acquisitions, including the acquisition of Rawlings Sporting Goods Company, Inc. (Rawlings), on March 26, 2003, Worth, Inc. (Worth), on September 16, 2003 and Brass Eagle, Inc. (Brass Eagle), on December 8, 2003 and four smaller acquisitions. The consolidated condensed statement of operations for the quarter ended March 31, 2004 includes the operating results of each of the acquired businesses in 2003 and of Fotoball since the date of acquisition, however the consolidated condensed statement of operations for the quarter ended March 31, 2003 does not include the operating results of the businesses acquired since the acquisitions of each of these businesses (except for Rawlings) were completed subsequent to March 31, 2003, and Rawlings was completed on March 26, 2003. The purchase price of one of the smaller acquisitions made during 2003 is subject to earn out provisions which may result in an additional payment of up to $7.5 million in the form of K2 common stock or cash in the second quarter of 2004.

The following summarized unaudited pro forma results of operations of K2 present the acquisitions of Rawlings, Worth, and Brass Eagle as if they had occurred as of the beginning of the respective periods presented. The 2003 first quarter pro forma results exclude the debt extinguishment costs incurred by K2 during the 2003 first quarter, and the results of operations of K2 s composite utility and decorative light poles and related products lines which K2 sold during the 2003 second quarter. Pro forma results of the four smaller acquisitions in 2003 and Fotoball in 2004 have not been presented because the effects of these additional acquisitions were not material on either an individual basis or aggregate basis to K2 s consolidated results of operations. This pro forma information does not purport to be indicative of what would have occurred had the acquisition been made as of those dates, or of results which may occur in the future:

Pro Forma Information (Unaudited)