K2 INC
Form 10-Q
August 14, 2002

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

ý **QUARTERLY REPORT UNDER SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarter Ended June 30, 2002

Commission File No. 1-4290

K2 INC.

(exact name of registrant as specified in its charter)

Delaware	**95-2077125**
(State of Incorporation)	(I.R.S. Employer Identification No.)
4900 South Eastern Avenue **Los Angeles, California**	**90040**
(Address of principal executive offices)	(Zip Code)

(323) 724-2800
Registrant's telephone number, including area code

Not applicable
Former name, former address and former fiscal year, if changed since last report:

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, and (2) has been subject to such filing requirements for the past 90 days. Yes ý

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of July 31, 2002.

Common Stock, par value $1	17,939,076 Shares

FORM 10-Q QUARTERLY REPORT

PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

STATEMENTS OF CONSOLIDATED INCOME (condensed)
(Thousands, except per share figures)

	Three months ended June 30		Six months ended June 30	
	2002	**2001**	**2002**	**2001**
		(Unaudited)		
Net sales	$ 157,213	$ 143,074	$ 304,676	$ 314,617
Cost of products sold	111,945	97,879	217,289	220,409
Gross profit	45,268	45,195	87,387	94,208
Selling expenses	21,355	24,853	41,829	51,646
General and administrative expenses	15,688	13,338	28,853	27,892
Operating income	8,225	7,004	16,705	14,670
Interest expense	2,310	3,451	4,867	6,714
Other expense (income), net	4	200	13	33
Income before income taxes	5,911	3,353	11,825	7,923
Provision for income taxes	2,069	1,039	4,139	2,456
Net income	$ 3,842	$ 2,314	$ 7,686	$ 5,467
Basic earnings per share:				
Net income	$ 0.21	$ 0.13	$ 0.43	$ 0.30
Diluted earnings per share:				
Net income	$ 0.21	$ 0.13	$ 0.43	$ 0.30
Basic shares outstanding	17,941	17,938	17,940	17,941
Diluted shares outstanding	17,959	18,113	17,954	18,096

See notes to consolidated condensed financial statements.

CONSOLIDATED BALANCE SHEETS (condensed)
(Thousands, except share and per share figures)

	June 30 2002	December 31 2001
	(Unaudited)	

	June 30 2002	December 31 2001
Assets		
Current Assets		
Cash and cash equivalents	$ 13,723	$ 11,416
Accounts receivable, net	144,788	99,803
Inventories, net	144,572	169,969
Deferred taxes and income taxes receivable	13,081	15,019
Prepaid expenses and other current assets	9,779	8,606
Total current assets	325,943	304,813
Property, plant and equipment	168,318	170,175
Less allowance for depreciation and amortization	102,685	101,771
	65,633	68,404
Intangibles, principally goodwill, net	41,293	41,068
Other	7,897	6,753
Total Assets	$ 440,766	$ 421,038
Liabilities and Shareholders' Equity		
Current Liabilities		
Bank loans	$ 7,806	$ 5,016
Accounts payable	34,861	46,015
Accrued payroll and related	18,977	18,041
Other accruals	29,913	26,007
Current portion of long-term debt	8,074	5,886
Total current liabilities	99,631	100,965
Long-term debt	105,228	97,828
Deferred taxes	7,588	7,588
Commitments and Contingencies		
Shareholders' Equity		
Preferred Stock, $1 par value, authorized 12,500,000 shares, none issued Common Stock, $1 par value, authorized 40,000,000 shares, issued shares 18,679,146 in 2002 and 18,676,146 in 2001	18,679	18,676
Additional paid-in capital	143,395	143,346
Retained earnings	91,809	84,123
Employee Stock Ownership Plan and stock option loans	(1,439)	(1,582)
Treasury shares at cost, 747,234 shares in 2002 and 2001	(9,107)	(9,107)
Accumulated other comprehensive loss	(15,018)	(20,799)
Total Shareholders' Equity	228,319	214,657
Total Liabilities and Shareholders' Equity	$ 440,766	$ 421,038

See notes to consolidated condensed financial statements

STATEMENTS OF CONSOLIDATED CASH FLOWS (condensed)
(Thousands)

	Six months ended June 30	
	2002	2001
	(unaudited)	
Operating Activities		
Net Income	$ 7,686	$ 5,467
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,180	8,096
Deferred taxes	1,938	3,568
Repurchase of previously securitized receivables	(51,827)	(33,769)
Changes in noncash current assets and current liabilities	29,899	20,037
Net cash provided by (used in) operating activities	(5,124)	3,399
Investing Activities		
Property, plant & equipment expenditures	(5,140)	(7,044)
Disposals of property, plant & equipment	570	293
Purchase of business, net of cash acquired	0	(4,581)
Other items, net	(377)	1,315
Net cash used in investing activities	(4,947)	(10,017)
Financing Activities		
Borrowings under long-term debt	48,375	77,500
Borrowings under accounts receivable purchase facility	43,702	
Payments under long-term debt	(82,489)	(63,037)
Net increase (decrease) in short-term bank loans	2,790	(8,619)
Net cash provided by financing activities	12,378	5,844
Net increase (decrease) in cash and cash equivalents	2,307	(774)
Cash and cash equivalents at beginning of year	11,416	3,174
Cash and cash equivalents at end of period	$ 13,723	$ 2,400

See notes to consolidated condensed financial statements.

K2 INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
June 30, 2002

NOTE 1 Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles 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 generally accepted accounting principles 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 and six-month periods ended June 30, 2002 are not necessarily indicative of the results that may be expected for the year ended December 31, 2002.

The balance sheet at December 31, 2001 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the Consolidated Financial Statements and Notes to Financial Statements included in K2 Inc.'s ("K2's) Annual Report on Form 10-K for the year ended December 31, 2001.

NOTE 2 Summary of Significant Accounting Policies

Accounts Receivable and Allowances

Accounts receivable are net of allowances for doubtful accounts of $7,542,000 at June 30, 2002 and $5,316,000 at December 31, 2001.

Inventories

The components of inventory consisted of the following:

	June 30 2002	December 31 2001
	(thousands)	
Finished goods	$ 108,527	$ 135,623
Work in process	9,994	11,788
Raw materials	26,051	22,558
	$ 144,572	$ 169,969

Newly Adopted Accounting Standards

Effective January 1, 2002, K2 adopted new accounting standards on "Business Combinations," and "Goodwill and Other Intangible Assets." The Business Combination changes require the use of the purchase method of accounting for business combinations and eliminates the pooling-of interests method. The changes to goodwill require that goodwill and indefinite-lived intangible assets no longer be amortized to earnings, but instead reviewed annually for impairment. In addition, the standard includes provisions, upon adoption, for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the testing for impairment of existing goodwill and other intangibles. Had K2 adopted the new goodwill accounting on the first day of 2001, second quarter 2001 and first half 2001 amortization expense would have been lowered by approximately $330,000 and $830,000, respectively, and net income would have increased by the same amounts (or

$.02 and $.05 per diluted share, respectively) to $2.6 million and $6.3 million, respectively. The adoption of SFAS No. 142 resulted in an increase in operating income through a reduction of amortization expense of approximately $330,000 and $830,000 for the three and six months ended June 30, 2002, respectively.

Effective January 1, 2002, K2 adopted "Accounting for the Impairment or Disposal of Long-Lived Assets." The adoption of SFAS No. 144 did not have an impact on K2's financial statements.

In 2000 and 2001, the FASB Emerging Issues Task Force issued several changes to the accounting for incentives to customers resulting in K2 recording such items as deductions from sales rather than selling expense. The impact of K2's adoption of these changes on the financial statements was immaterial.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

Note 3-Charges Against Earnings

In ongoing cost reduction moves initiated in 1999, K2 completed the move of its remaining ski production to China in 2001, closing the Washington ski manufacturing facility during the 2001 third quarter. In addition, three other smaller manufacturing facilities were shut down in Minnesota and Alabama, which serviced the Stearns and Hilton operations, with most of the production also moving overseas.

The scooter market experienced explosive growth in 2000, however, orders for scooters abruptly stopped early in the 2001 first quarter. Orders for in-line skates began to decline in the 2001 second quarter in response to higher than expected retail inventory levels and remained soft throughout the remainder of 2001. K2 responded by downsizing its small-wheeled products operation and it additionally closed certain manufacturing facilities. The facility closures, coupled with the downsizing activities, resulted in the reduction of approximately 600 positions worldwide. As a result, K2 recorded a pre-tax charge to earnings in the 2001 third quarter of $18.0 million, primarily related to severance, the write down of facilities and equipment, and the reduction in the net carrying value of small-wheeled products inventory, of which approximately $5.0 million has or will result in a cash outlay. Approximately $15.6 million of the charge was included in cost of sales and approximately $2.4 million was included in general and administrative expenses in the third quarter of 2001.

The following table summarizes the activity in 2001 and 2002:

	Facilities & Equipment	Inventory	Severance and Related	Subtotal	Other Downsizing	Total
			(Thousands)			
2001 Charges	$ 3,179	$ 9,266	$ 4,389	$ 16,834	$ 1,166	$ 18,000
Utilized in 2001:						
Cash			3,104	3,104	537	3,641
Non-cash write down		9,266		9,266		9,266
Non-cash disposal	3,179			3,179	529	3,708
	3,179	9,266	3,104	15,549	1,066	16,615
Balance December 31, 2001			1,285	1,285	100	1,385
Utilized in 2002:						
Cash			1,004	1,004	100	1,104

	Facilities & Equipment	Inventory	Severance and Related	Subtotal	Other Downsizing	Total
			1,004	1,004	100	1,104
Balance June 30, 2002	$	$	$ 281	$ 281	$	$ 281

Of the remaining cash charges not utilized at June 30, 2002, K2 anticipates such amounts will be settled by the end of the 2002, resulting in a future cash outlay of $0.3 million.

NOTE 4 Intangible Assets

The components of intangible assets consisted of the following:

	June 30 2002	December 31 2001
	(Thousands)	
Intangibles subject to amortization:		
Net carrying amount:		
Patents and Trademarks	$ 1,695	$ 1,616
Goodwill not subject to amortization (by segment):		
Net carrying amount:		
Sporting goods	35,687	35,629
Other recreational	1,524	1,524
Industrial	2,387	2,299
	39,598	39,452
Total intangible assets, net	$ 41,293	$ 41,068

Amortization expense of intangible assets subject to amortization will be approximately $400,000 per year over the next five years.

NOTE 5 Borrowings and Other Financial Instruments

K2's principal long-term borrowing facility is a $75 million revolving Credit Line ("Credit Line"), secured by substantially all of the assets of K2, other than domestic accounts receivable which are sold pursuant to the Purchase Facility described below. The Credit Line is due on December 31, 2003. Additionally, K2 has a five year, $75 million accounts receivable purchase facility ("Purchase Facility").

At June 30, 2002, there were no borrowings under the Credit Line. At December 31, 2001, outstanding indebtedness under the Credit Line totaled $26.5 million, and the effective interest rate of

such borrowings was 4.68%. Pursuant to the terms of the Credit Line, $67.0 million was available for borrowing at June 30, 2002.

The Purchase Facility is a five-year domestic accounts receivable arrangement, under which K2 can sell with limited recourse, an undivided interest in designated pools of accounts receivable in an amount not to exceed $75 million. The originators of the receivables sell the receivables through a subsidiary of K2 to a conduit, which then issues commercial paper and charges K2 interest based on the commercial paper rate plus a spread. The interest rate at June 30, 2002 was 2.46%.

Unlike the asset securitization program which was in effect prior to March 2002, financing obtained pursuant to the Purchase Facility is treated in K2's financial statements as a borrowing. As of June 30, 2002, financings under the Purchase Facility totaled $43.7 million and are classified as long-term debt as K2 believes the amount outstanding at June 30, 2002 is equal to or less than the minimum amount expected to be outstanding during the next twelve months. As of December 31, 2001, accounts receivable of $51.8 million were sold under the prior asset securitization program, with the related assets and liabilities for the receivables securitized by the facility treated as off balance sheet.

The credit facilities currently prohibit the payment of cash dividends and stock repurchases by K2.

NOTE 6 Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss includes the cumulative foreign currency translation adjustments related to long-term investments in foreign subsidiaries and unrealized gains or losses on derivative instruments.

The components of other comprehensive loss are as follows:

	Currency Translation Adjustments	Derivative Financial Instruments Gains/(Losses)	Total
		(Thousands)	
Balance at December 31, 2001	$ (21,238)	$ 439	$ (20,799)
Currency Translation Adjustment	6,863		6,863
Reclassification adjustment for amounts recognized in cost of sales		(341)	(341)
Change in fair value of derivatives, net of ($399) taxes		(741)	(741)
Balance at June 30, 2002	$ (14,375)	$ (643)	$ (15,018)

Total comprehensive income was $10.0 million and $13.5 million for the three and six months ended June 30, 2002, respectively. Total comprehensive income was $3.0 million and $2.7 million for the three and six months ended June 30, 2001, respectively. Total comprehensive income includes the net change in accumulated other comprehensive loss for the period.

NOTE 7- Earnings Per Share Data

Basic earnings per share ("EPS") are determined by dividing net income by the weighted average number of shares outstanding during the period. Diluted EPS reflects the potential dilutive effects of stock options, using the treasury stock method. For the three and six month periods ended June 30, 2002, computation of diluted EPS included the dilutive effects of 417,000 and 395,000 stock options, respectively, and excluded 1,473,000 and 1,495,000 stock options outstanding, respectively, since their inclusion would have been antidilutive. For the three and six month periods ended June 30, 2001, computation of diluted EPS included the dilutive effects of 1,053,000 and 1,037,000 stock options, respectively, and excluded 912,000 and 927,000 stock options outstanding, respectively, since their inclusion would have been antidilutive.

NOTE 8 Segment Information

The segment information presented below is for the three months ended June 30:

	Net Sales to Unaffiliated Customers		Intersegment Sales		Operating Profit (Loss)	
	2002	2001	2002	2001	2002	2001

	Net Sales to Unaffiliated Customers		Intersegment Sales		Operating Profit (Loss)	
			(Millions)			
Sporting goods	$ 116.2	$ 103.8	$ 24.6	$ 15.4	$ 7.2	$ 4.7
Other recreational	9.9	9.0	0.6	0.6	(0.9)	(0.9)
Industrial	31.1	30.3	0.2	0.1	3.1	4.0
Total segment data	$ 157.2	$ 143.1	$ 25.4	$ 16.1	9.4	7.8
Corporate expenses, net					1.2	1.0
Interest expense					2.3	3.4
Income from operations before provision for income taxes					$ 5.9	$ 3.4

The segment information presented below is for the six months ended June 30:

	Net Sales to Unaffiliated Customers		Intersegment Sales		Operating Profit (Loss)	
	2002	2001	2002	2001	2002	2001
			(Millions)			
Sporting goods	$ 227.6	$ 234.4	$ 39.8	$ 26.5	$ 14.8	$ 11.1
Other recreational	18.4	19.5	0.9	1.0	(1.6)	(1.7)
Industrial	58.7	60.7	0.3	0.4	6.4	7.8
Total segment data	$ 304.7	$ 314.6	$ 41.0	$ 27.9	19.6	17.2
Corporate expenses, net					2.9	2.6
Interest expense					4.9	6.7
Income from operations before provision for income taxes					$ 11.8	$ 7.9

NOTE 9 Contingencies

K2 is subject to various legal actions and proceedings in the normal course of business. While the ultimate outcome of these matters cannot be predicted with certainty, management does not believe these matters will have a material adverse effect on K2's financial statements.

K2 is one of several named potentially responsible parties ("PRP") in three Environmental Protection Agency matters involving discharge of hazardous materials at old waste sites in South Carolina and Michigan. Although environmental laws technically impose joint and several liability upon each PRP at each site, the extent of K2's required financial contribution to the cleanup of these sites is expected to be limited based upon the number and financial strength of the other named PRPs and the volume and types of waste involved which might be attributable to K2.

Environmental and related remediation costs are difficult to quantify for a number of reasons including the number of parties involved, the difficulty in determining the extent of the contamination, the length of time remediation may require, the complexity of environmental regulation and the continuing advancement of remediation technology. K2 accrues for liabilities of this nature when it is probable a liability has been incurred and the amount can be reasonably estimated. At June 30, 2002 and December 31, 2001, K2 had recorded an estimated liability of approximately $867,000 and $745,000, respectively, for environmental liabilities and made no provision for expected insurance recovery.

The ultimate outcome of these matters cannot be predicted with certainty, however, management does not believe these matters will have a material adverse effect on K2's financial statements.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Comparative Second Quarter Results of Operations

Net sales for the three months ended June 30, 2002 increased $14.1 million or 9.9%, to $157.2 million from $143.1 million in the year-earlier period. Net income for the second quarter of 2002 improved $1.5 million or 65.2%, to $3.8 million, or $.21 per diluted share, from $2.3 million, or $.13 per diluted share, in the second quarter a year ago.

Net Sales. In the sporting goods segment, net sales for the 2002 second quarter improved $12.4 million or 11.9%, to $116.2 million from $103.8 million in the 2001 second quarter. The overall improvement