DELTA APPAREL, INC
Form 10-Q
May 07, 2014
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 29, 2014
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 Number 1-15583
DELTA APPAREL, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| GEORGIA | 58-2508794 |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| 322 South Main Street Greenville, SC | 29601 |
| (Address of principal executive offices) | (Zip Code) |

(864) 232-5200

(Registrant's telephone number, including area code)

(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 (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 þ No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of a "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer o | Accelerated filer þ | Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |

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

As of April 25, 2014, there were outstanding 7,936,230 shares of the registrant's common stock, par value of $0.01 per share, which is the only class of outstanding common or voting stock of the registrant.

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PART 1. FINANCIAL INFORMATION
Item 1. Financial Statements
Delta Apparel, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(Amounts in thousands, except share amounts and per share data)
(Unaudited)

| | March 29, 2014 | September 28, 2013 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $894 | $829 |
| Accounts receivable, less allowances of $3,229 and $2,958 respectively | 65,809 | 68,707 |
| Income tax receivable | 3,076 | 1,232 |
| Inventories, net | 170,785 | 165,190 |
| Prepaid expenses and other current assets | 5,163 | 3,786 |
| Deferred income taxes | 5,698 | 5,981 |
| Total current assets | 251,425 | 245,725 |
| | | |
| Property, plant and equipment, net of accumulated depreciation of $74,607 and $71,453 respectively | 42,242 | 40,600 |
| Goodwill | 36,729 | 36,729 |
| Intangibles, net | 24,165 | 24,837 |
| Other assets | 3,697 | 3,871 |
| Total assets | $358,258 | $351,762 |
| | | |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | $51,414 | $52,877 |
| Accrued expenses | 15,276 | 17,463 |
| Current portion of long-term debt | 14,504 | 3,704 |
| Total current liabilities | 81,194 | 74,044 |
| | | |
| Long-term debt, less current maturities | 129,307 | 131,030 |
| Deferred income taxes | 4,830 | 3,610 |
| Other liabilities | 1,540 | 806 |
| Contingent consideration | 3,525 | 3,400 |
| Total liabilities | $220,396 | $212,890 |
| | | |
| Shareholders' equity: | | |
| Preferred stock—$0.01 par value, 2,000,000 shares authorized, none issued and outstanding | — | — |
| Common stock —$0.01 par value, 15,000,000 shares authorized, 9,646,972 shares issued, and 7,936,230 and 7,873,848 shares outstanding as of March 29, 2014 and September 28, 2013, respectively | 96 | 96 |
| Additional paid-in capital | 59,927 | 59,428 |
| Retained earnings | 98,218 | 100,579 |
| Accumulated other comprehensive loss | (394) | (557) |
| Treasury stock —1,710,742 and 1,773,124 shares as of March 29, 2014 and September 28, 2013, respectively | (19,985) | (20,674) |

| | | |
|---|---|---|
| Total shareholders’ equity | 137,862 | 138,872 |
| Total liabilities and shareholders' equity | $358,258 | $351,762 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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Delta Apparel, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
(Amounts in thousands, except per share data)
(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | March 29, 2014 | March 30, 2013 | March 29, 2014 | March 30, 2013 |
| Net sales | $114,458 | $120,092 | $214,470 | $226,842 |
| Cost of goods sold | 92,179 | 93,677 | 173,149 | 177,672 |
| Gross profit | 22,279 | 26,415 | 41,321 | 49,170 |
| | | | | |
| Selling, general and administrative expenses | 21,292 | 23,706 | 41,136 | 45,581 |
| Change in fair value of contingent consideration | 125 | — | 125 | — |
| Other expense (income), net | 28 | 145 | (99) | 179 |
| Operating income | 834 | 2,564 | 159 | 3,410 |
| | | | | |
| Interest expense, net | 1,455 | 1,015 | 2,913 | 1,902 |
| (Loss) income before provision for (benefit from) income taxes | (621) | 1,549 | (2,754) | 1,508 |
| Provision for (benefit from) income taxes | 142 | (59) | (393) | (145) |
| Net (loss) earnings | $(763) | $1,608 | $(2,361) | $1,653 |
| | | | | |
| Basic (loss) earnings per share | $(0.10) | $0.20 | $(0.30) | $0.20 |
| Diluted (loss) earnings per share | $(0.10) | $0.19 | $(0.30) | $0.19 |
| | | | | |
| Weighted average number of shares outstanding | 7,939 | 8,165 | 7,911 | 8,233 |
| Dilutive effect of stock options and awards | — | 274 | — | 258 |
| Weighted average number of shares assuming dilution | 7,939 | 8,439 | 7,911 | 8,491 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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Delta Apparel, Inc. and Subsidiaries
Condensed Consolidated Statements of Comprehensive (Loss) Income
(Amounts in thousands)
(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | March 29, 2014 | March 30, 2013 | March 29, 2014 | March 30, 2013 |
| Net (loss) earnings | $(763) | $1,608 | $(2,361) | $1,653 |
| Net unrealized gain on cash flow hedges | 78 | 26 | 163 | 51 |
| Comprehensive (loss) income | $(685) | $1,634 | $(2,198) | $1,704 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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Delta Apparel, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Amounts in thousands)
(Unaudited)

| | Six Months Ended | |
|---|---|---|
| | March 29, 2014 | March 30, 2013 |
| Operating activities: | | |
| Net (loss) earnings from continuing operations | $(2,361) | $1,653 |
| Adjustments to reconcile earnings to net cash used in operating activities: | | |
| Depreciation and amortization | 4,626 | 4,038 |
| Amortization of deferred financing fees | 174 | 181 |
| Excess tax benefits from exercise of stock options | (33) | (37) |
| Provision for (benefit from) deferred income taxes | 1,503 | (1,104) |
| Non-cash stock compensation | 496 | 145 |
| Change in the fair value of contingent consideration | 125 | — |
| (Gain) loss on disposal or impairment of property and equipment | (47) | 64 |
| Release of cash held in escrow | 3,000 | — |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 2,898 | (1,512) |
| Inventories | (5,595) | (4,008) |
| Prepaid expenses and other assets | (1,377) | (375) |
| Accounts payable | (1,463) | 1,476 |
| Accrued expenses | (5,312) | (4,145) |
| Income tax receivable | (1,811) | (522) |
| Other liabilities | 1,022 | (73) |
| Net cash used in operating activities | (4,155) | (4,219) |
| | | |
| Investing activities: | | |
| Purchases of property and equipment, net | (5,574) | (3,778) |
| Proceeds from sale of equipment | 24 | 15 |
| Net cash used in investing activities | (5,550) | (3,763) |
| | | |
| Financing activities: | | |
| Proceeds from long-term debt | 250,869 | 239,840 |
| Repayment of long-term debt | (241,792) | (229,508) |
| Repurchase of common stock | (180) | (3,499) |
| Proceeds from exercise of stock options | 840 | — |
| Payment of withholding taxes on exercise of stock options | — | (239) |
| Excess tax benefits from exercise of stock options | 33 | 37 |
| Net cash provided by financing activities | 9,770 | 6,631 |
| Net increase (decrease) in cash and cash equivalents | 65 | (1,351) |
| Cash and cash equivalents at beginning of period | 829 | 1,840 |
| Cash and cash equivalents at end of period | $894 | $489 |
| | | |
| Supplemental cash flow information: | | |
| Cash paid during the period for interest | $2,217 | $1,622 |
| Cash paid during the period for income taxes, net of refunds received | $80 | $1,517 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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Delta Apparel, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)

Note A—Basis of Presentation and Description of Business
On August 26, 2013, our Board of Directors determined that the Company's fiscal year will begin on the Sunday closest to September 30th of each year and end on the Saturday closest to September 30th of each year. The change is intended to better align our planning, financial and reporting functions with the seasonality of our business.
We prepared the accompanying interim condensed consolidated financial statements in accordance with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles ("U.S. GAAP") for complete financial statements. We believe these Condensed Consolidated Financial Statements consist of normal recurring adjustments considered necessary for a fair presentation. Operating results for the six months ended March 29, 2014, are not necessarily indicative of the results that may be expected for our fiscal year ending September 27, 2014. Although our various product lines are sold on a year-round basis, the demand for specific products or styles reflects some seasonality, with sales in our June fiscal quarter generally being the highest and sales in our December quarter generally being the lowest. For more information regarding our results of operations and financial position, refer to the Consolidated Financial Statements and footnotes included in our Form 10-K for our fiscal year ended June 29, 2013, filed with the United States Securities and Exchange Commission (“SEC”).

“Delta Apparel”, the “Company”, and “we”, “us” and “our” are used interchangeably to refer to Delta Apparel, Inc. together w our domestic wholly-owned subsidiaries, including M.J. Soffe, LLC (“Soffe”), Junkfood Clothing Company (“Junkfood”), To The Game, LLC (“To The Game”), Art Gun, LLC (“Art Gun”), and other international subsidiaries, as appropriate to the context.
Delta Apparel, Inc. is an international apparel design, marketing, manufacturing and sourcing company that features a diverse portfolio of lifestyle basic and branded activewear apparel and headwear. We specialize in selling casual and athletic products through a variety of distribution channels and distribution tiers including specialty stores, boutiques, department stores, mid and mass channels, college bookstores and the U.S. military. Our products are made available direct-to-consumer on our websites at www.soffe.com, www.junkfoodclothing.com, www.saltlife.com and www.deltaapparel.com. We design and internally manufacture the majority of our products, which allows us to offer a high degree of consistency and quality control as well as leverage scale efficiencies. We have manufacturing operations located in the United States, El Salvador, Honduras and Mexico, and use domestic and foreign contractors as additional sources of production. Our distribution facilities are strategically located throughout the United States to better serve our customers with same-day shipping on our catalog products and weekly replenishments to retailers.
We were incorporated in Georgia in 1999 and our headquarters is located at 322 South Main Street, Greenville, South Carolina 29601 (telephone number: 864-232-5200). Our common stock trades on the NYSE MKT under the symbol “DLA”. We operate on a 52-53 week fiscal year ending on the Saturday closest to September 30.

Note B—Accounting Policies
Our accounting policies are consistent with those described in our Significant Accounting Policies in our Form 10-K for the fiscal year ended June 29, 2013, filed with the SEC.

Note C—New Accounting Standards
Recently Adopted Standards
In July 2012, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2012-02, Intangibles - Goodwill and Other (Topic 350), Testing Indefinite-Lived Intangible Assets for Impairment, ("ASU 2012-02"). This new guidance adds an optional qualitative assessment for determining whether an indefinite-lived intangible asset is impaired. Companies have the option to first perform a qualitative assessment to determine whether it is more likely than not (likelihood of more than 50%) that an indefinite-lived intangible is impaired. If a company determines that it is more likely than not that the fair value of such an asset exceeds its

carrying amount, it would not need to calculate whether the fair value of such an asset exceeds its carrying amount and it would not need to calculate the fair value of the asset in that year. The company must, however, make a positive assertion about the conclusion and the circumstances taken into account to reach that conclusion. However, if the company determines otherwise, it must calculate the fair value of the asset and compare that value with its carrying amount. If the carrying amount of the company's intangible asset exceeds its fair value, the company must record an impairment charge for the amount of that excess, if any. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. ASU 2012-02 was adopted on June 30, 2013, and the adoption had no impact on our financial statements.

In February 2013, the FASB issued ASU No. 2013-02, Comprehensive Income (Topic 220), Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ("ASU 2013-02"). This guidance requires companies to report information about reclassifications out of accumulated other comprehensive income in one place. These reclassifications must be presented by component.

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If these items are significant and are reclassified in their entirety in the period, companies must report the effect of the reclassifications on the respective line items in the statement where net income is presented. If the items are not reclassified in their entirety to net income in the period, companies must cross-reference in a note. ASU 2013-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. ASU 2013-02 was adopted on June 30, 2013, and the adoption had no impact on our financial statements.

In July 2013, the FASB issued ASU No. 2013-10, Derivatives and Hedging (Topic 815), Inclusion of the Fed Funds Effective Swap Rate as a Benchmark Interest Rate for Hedge Accounting Purposes ("ASU 2013-10"). This guidance allows an entity to now designate the Federal Funds Effective Swap Rate, (the Overnight Index Swap rate, or OIS rate, in the United States) as a benchmark interest rate for hedge accounting purposes in addition to the interest rate on direct Treasury obligations of the United States government and the London Interbank Offered Rate ("LIBOR"). The FASB also eliminated the restriction on designating different benchmark interest rate hedges for similar hedges. ASU 2013-10 is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 2013. ASU 2013-10 was adopted on June 30, 2013, and the adoption had no impact on our financial statements.

In March 2014, the FASB issued ASU No. 2014-06, Technical Corrections and Improvements Related to Glossary Terms ("ASU 2014-06"). This guidance clarifies the Master Glossary of the Codification, consolidates multiple instances of the same term into a single definition and makes minor improvements to the Master Glossary. ASU 2014-06 is effective immediately. ASU 2014-06 was adopted on March 29, 2014, and the adoption had no impact on our financial statements.

Standards Not Yet Adopted

In July 2013, the FASB issued ASU No. 2013-11, Income Taxes (Topic 740), Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, ("ASU 2013-11"). This new guidance requires entities to present unrecognized tax benefits as a decrease in a net operating loss, similar tax loss or tax credit carryforward if certain criteria are met. The determination of whether a deferred tax asset is available is based on the unrecognized tax benefit and the deferred tax asset that exists as of the reporting date and presumes disallowance of the tax position at the reporting date. This amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2013. ASU 2013-11 is therefore effective for our fiscal year beginning September 28, 2014.

Note D—Salt Life Acquisition

On August 27, 2013, To The Game purchased substantially all of the assets of Salt Life Holdings, LLC, including all of its domestic and international trademark rights in the Salt Life brand (the "Salt Life Acquisition"). The purchase price for the Salt Life Acquisition consisted of: (i) a cash payment at closing of $12,000,000, (ii) a deposit at closing of $3,000,000 into an escrow account to be held to secure indemnification obligations of the seller under the asset purchase agreement and to be held for a period of up to fifty-four months following the closing, and (iii) delivery of two promissory notes in the aggregate principal amount of $22,000,000. An additional amount may be payable in cash after the end of calendar year 2019 if financial performance targets involving the sale of Salt Life-branded products are met during the 2019 calendar year. At acquisition, we recorded an accrual of $3.4 million for the fair value of the contingent consideration associated with the Salt Life Acquisition. We financed the cash portion of the purchase price through our Fourth Amended and Restated Loan and Security Agreement, as amended on August 27, 2013. We expensed all acquisition related costs in the selling, general and administrative expense line item of our Condensed Consolidated Statements of Operations in the quarter ended September 28, 2013.

On December 6, 2013, we entered into an agreement (the "IMG Agreement") with IMG Worldwide, Inc. ("IMG") that provides for the termination of the Salt Life brand license agreements entered into between Delta and IMG (as agent on behalf of Salt Life Holdings) prior to the Salt Life Acquisition as well as the agency agreement entered into between Salt Life Holdings and IMG prior to the Salt Life Acquisition. In addition, the IMG Agreement provides that Delta and Salt Life Holdings are released from all obligations and liabilities under those agreements or relating to the Salt Life Acquisition. Pursuant to the IMG Agreement, To The Game and IMG entered into a new, multi-year agency agreement whereby IMG will represent To The Game with respect to the licensing of the Salt Life brand in connection with certain product and service categories. To The Game agreed to pay IMG installments totaling $3,500,000 to terminate the existing arrangements. As a result, the above-referenced $3,000,000 indemnification asset was released from escrow during the quarter ended December 28, 2013, and applied towards these payment obligations, along with additional amounts previously accrued for royalty obligations under the above-referenced Salt Life brand license agreements. In accordance with the payment terms, To The Game remitted an initial $1.55 million payment and the first $195 thousand installment during the March 2014 quarter. As of March 29, 2014, there are nine quarterly installments of $195 thousand remaining. We have recorded the fair value of the liability as of March 29, 2014, on our financials with $0.6 million in accrued expenses and $0.9 million in other liabilities.

The Salt Life Acquisition continues our strategy of building lifestyle brands that take advantage of our creative capabilities, vertical manufacturing platform and international sourcing competencies. Prior to the Salt Life Acquisition, To The Game sold Salt Life-branded products under exclusive license agreements which began in January 2011. As such, the results of Salt Life sales have been included in the Condensed Consolidated Financial Statements since that time.

We accounted for the Salt Life Acquisition pursuant to ASC 805, Business Combinations, with purchase price allocated based upon fair value. We have identified certain intangible assets associated with Salt Life, including trade name and trademarks, license agreements,

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non-compete agreements and goodwill. The total amount of goodwill is expected to be deductible for tax purposes. Components of the intangible assets recorded at acquisition are as follows:

| | | Economic Life |
|---|---|---|
| Goodwill | $19,917 | N/A |
| | | |
| Intangibles: | | |
| Tradename/trademarks | 16,000 | 30 yrs |
| License agreements | 2,100 | 15 – 30 yrs |
| Non-compete agreements | 770 | 6.6 yrs |
| Total intangibles | 18,870 | |
| | | |
| Total goodwill and intangibles | $38,787 | |

We are currently in the process of finalizing the valuations and thus the initial allocation of the purchase price is subject to change until the allocation is finalized.

Note E—Inventories

Inventories, net of reserves of $6.5 million as of March 29, 2014, and $6.9 million as of September 28, 2013, consist of the following (in thousands):

| | March 29, 2014 | September 28, 2013 |
|---|---|---|
| Raw materials | $10,950 | $11,917 |
| Work in process | 15,731 | 15,121 |
| Finished goods | 144,104 | 138,152 |
| | $170,785 | $165,190 |

Raw materials include finished yarn and direct materials for the basics segment and include direct embellishment materials and undecorated garments and headwear for the branded segment. We regularly review inventory quantities on hand and record reserves for obsolescence, excess quantities, irregulars and slow-moving inventory based on historical selling prices, current market conditions, and forecasted product demand, to reduce inventory to its net realizable value.

Note F—Debt

On May 27, 2011, Delta Apparel, Soffe, Junkfood, To The Game and Art Gun entered into a Fourth Amended and Restated Loan and Security Agreement (the "Loan Agreement") with the financial institutions named in the Loan Agreement as Lenders, Wells Fargo Bank, National Association, as Administrative Agent, Bank of America, N.A., as Syndication Agent, Wells Fargo Capital Finance, LLC, as Sole Lead Arranger, and Wells Fargo Capital Finance, LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Joint Bookrunners.

On August 27, 2013, Delta Apparel, To The Game, Junkfood, Soffe and Art Gun entered into a Consent and First Amendment to the Fourth Amended and Restated Loan and Security Agreement with Wells Fargo Bank, National Association and the other lenders set forth therein (the "Amended Loan Agreement"). Pursuant to the Amended Loan Agreement, in general and among other things, (1) the lenders and agent parties consented to the Salt Life Acquisition, (2) the maturity of the loans (other than the below referenced first in last out Tranche B ("FILO Tranche B")) under the Amended Loan Agreement was extended one year to May 27, 2017, (3) the lenders consented to Delta Apparel's Honduran subsidiaries borrowing up to an additional $10,000,000 from a certain Honduran bank in connection with the purchase of certain equipment, and (4) the FILO Tranche B was added to provide Delta Apparel and its affiliate parties to the Amended Loan Agreement an additional 5% borrowing availability with respect to eligible accounts receivable and eligible inventory. The FILO Tranche B, and only the FILO Tranche B, will terminate by August 27, 2015 (subject to earlier cancellation by Delta Apparel), has a maximum borrowing availability of $10,000,000, and includes interest rates between 150 and 200 basis points higher than the rates applicable to the other loans available under the Amended Loan Agreement.

Pursuant to the Amended Loan Agreement, our line of credit is $145 million (subject to borrowing base limitations). Provided that no event of default exists, we have the option to increase the maximum credit available under the facility to $200 million (subject to borrowing base limitations), conditioned upon the Administrative Agent's ability to secure additional commitments and customary closing conditions.

As of March 24, 2014, we had $110.0 million outstanding under our U.S. credit facility at an average interest rate of 2.6%, and had the ability to borrow an additional $27.0 million. Our credit facility includes a financial covenant requiring that if the amount of availability

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falls below an amount equal to 12.5% of the lesser of the borrowing base or $145 million, our Fixed Charge Coverage Ratio (“FCCR”) (as defined in the Amended Loan Agreement) for the preceding 12-month period must not be less than 1.1 to 1.0. As availability was above the minimum, we were not subject to the FCCR covenant at March 29, 2014. At March 29, 2014, and September 28, 2013, there was $8.5 million and $9.9 million, respectively, of retained earnings free of restrictions to make cash dividends or stock repurchases.

The Amended Loan Agreement contains a subjective acceleration clause and a “springing” lockbox arrangement (as defined in FASB Codification No. 470, Debt ("ASC 470")), whereby remittances from customers will be forwarded to our general bank account and will not reduce the outstanding debt until and unless a specified event or an event of default occurs. Pursuant to ASC 470, we classify borrowings under the Amended Loan Agreement as long-term debt.

In conjunction with the Salt Life Acquisition, we issued two promissory notes in the aggregate principal of $22.0 million. The promissory notes are zero-interest notes and state that interest will be imputed as required under Section 1274 of the Internal Revenue Code. We have imputed interest at 1.92% and 3.62% on the promissory notes that mature on June 30, 2016, and June 30, 2019, respectively. At March 29, 2014, the discounted value of the promissory notes was $20.7 million.

In March 2011, we extinguished our existing debt with Banco Ficohsa, a Honduran bank, and entered into a new credit facility with it. The credit facility is secured by a first-priority lien on the assets of our Honduran operations and the loan is not guaranteed by the U.S. entity. The installment portion of the credit facility carries a fixed interest rate of 7% for a term of seven years and is denominated in U.S. dollars. As of March 29, 2014, we had $3.9 million outstanding on the installment portion of this loan. The revolving credit portion of the loan has a 7% fixed interest rate with an ongoing 18-month term (expiring March 2019) and is denominated in U.S. dollars. The revolving credit facility requires minimum payments during each 6-month period of the 18-month term; however, the loan agreement permits additional drawdowns to the extent payments are made, if certain objective covenants are met. The current revolving Honduran debt, by its nature, is not long-term, as it requires scheduled payments each six months. However, as the loan agreement permits us to re-borrow funds up to the amount repaid, subject to certain objective covenants, and we intend to re-borrow funds, subject to the objective covenants, the amounts have been classified as long-term debt. As of March 29, 2014, we had $3.9 million outstanding under the revolving portion of the credit facility.

In October 2013, we entered into two new term loan agreements with Banco Ficohsa to finance our Honduran expansion project. These also are not guaranteed by the U.S. entity and are secured by a first-priority lien on the assets of our Honduran operations. The first loan, an eighteen month agreement for $1.8 million with a 7% fixed interest rate, is denominated in U.S. dollars, and has ratable monthly principal and interest payments due through the end of the term. As of March 29, 2014, we had $1.3 million outstanding on this loan agreement. The second loan, a seven-year agreement for $4.2 million with a 7% fixed interest rate, is denominated in U.S. dollars and has ratable monthly principal and interest payments due through the end of the term. As of March 29, 2014, we had $4.0 million outstanding on this loan agreement. The carrying value of these term loans approximates the fair value.

Note G—Selling, General and Administrative Expense

We include in selling, general and administrative ("SG&A") expenses costs incurred subsequent to the receipt of finished goods at our distribution facilities, such as the cost of stocking, warehousing, picking and packing, and shipping goods for delivery to our customers. Distribution costs included in SG&A expenses totaled $4.5 million and $4.4 million for the three months ended March 29, 2014, and March 30, 3013, respectively. Distribution costs included in SG&A for the six months ended March 29, 2014, and March 30, 2013, were $8.4 million and $8.6 million, respectively. In addition, SG&A expenses include costs related to sales associates, administrative personnel cost, advertising and marketing expenses, royalty payments on licensed products and other general and administrative expenses.

Note H—Stock-Based Compensation

On November 11, 2010, the Delta Apparel, Inc. shareholders approved the Delta Apparel, Inc. 2010 Stock Plan ("2010 Stock Plan"). Upon shareholder approval of the 2010 Stock Plan, no additional awards have been or will be granted under either the Delta Apparel Stock Option Plan ("Option Plan") or the Delta Apparel Incentive Stock Award Plan

("Award Plan"); instead, all stock awards have and will be granted under the 2010 Stock Plan. The aggregate number of shares of common stock that may be delivered under the 2010 Stock Plan is 500,000 plus any shares of common stock subject to outstanding awards under the Option Plan or Award Plan that are subsequently forfeited or terminated for any reason before being exercised. We expense stock compensation costs in the SG&A expense line items of our Condensed Consolidated Statements of Operations over the vesting periods of each grant. Total stock-based compensation for the three months ending March 29, 2014, and March 30, 2013, was $0.4 million and $0.6 million, respectively. For the six months ending March 29, 2014, and March 30, 2013, total stock based compensation was $0.9 million and $0.4 million, respectively.

2010 Stock Plan

As of March 29, 2014, there was $1.0 million of total unrecognized compensation cost related to non-vested awards granted under the 2010 Stock Plan. This cost is expected to be recognized over a period of 1.4 years. No awards were granted under the 2010 Stock Plan during the quarter ended March 29, 2014.

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Option Plan
All options granted under the Option Plan have vested. As such, no expense was recognized during the six months ended March 29, 2014, or for the six months ended March 30, 2013. During the three and six months ended March 29, 2014, vested options representing 46,500 and 74,500 shares, respectively, of our common stock were exercised, and the shares issued, in accordance with their respective agreements.
Award Plan
All awards granted under the Award Plan have vested and been exercised, and no awards remain outstanding.

Note I—Purchase Contracts
We have entered into agreements, and have fixed prices, to purchase yarn, natural gas, finished fabric, and finished apparel and headwear products. At March 29, 2014, minimum payments under these contracts were as follows (in thousands):

| | |
|---|---|
| Yarn | $30,290 |
| Natural gas | 345 |
| Finished fabric | 1,830 |
| Finished products | 21,106 |
| | $53,571 |

Note J—Business Segments
We operate our business in two distinct segments: branded and basics. Although the two segments are similar in their production processes and regulatory environments, they are distinct in their economic characteristics, products and distribution methods.
The branded segment is comprised of our business units focused on specialized apparel garments and headwear to meet consumer preferences and fashion trends, and includes Soffe, Junkfood, To The Game and Art Gun. These branded embellished and unembellished products are sold through specialty and boutique shops, upscale and traditional department stores, mid-tier retailers, sporting goods stores, college bookstores and the U.S. military. Products in this segment are marketed under our lifestyle brands of Soffe®, Intensity Athletics®, Junk Food®, The Game®, American Threads by The Game, and Salt Life®, as well as other labels.
The basics segment is comprised of our business units primarily focused on garment styles that are characterized by low fashion risk, and includes our Delta Activewear business which sells undecorated catalog tees and private label products. We market, distribute and manufacture unembellished knit apparel under the main brands of Delta Pro Weight® and Delta Magnum Weight® for sale to a diversified audience ranging from large licensed screen printers to small independent businesses. We also manufacture private label products for major branded sportswear companies, retailers, corporate industry programs, and sports licensed apparel marketers. Typically these products are sold with value-added services such as embellishment, hangtags, ticketing, and hangers so that they are fully ready for retail.
Robert W. Humphreys, our chief operating decision maker, and management evaluate performance and allocate resources based on profit or loss from operations before interest, income taxes and special charges (“segment operating earnings (loss)”). Our segment operating earnings (loss) may not be comparable to similarly titled measures used by other companies. Intercompany transfers between operating segments are transacted at cost and have been eliminated within the segment amounts shown in the following table.
Information about our operations as of and for the three and six months ended March 29, 2014, and March 30, 2013, by operating segment, is as follows (in thousands):

| | Basics | Branded | Consolidated |
|---|---|---|---|
| Three months ended March 29, 2014 | | | |
| Net sales | $64,134 | $50,324 | $114,458 |
| Segment operating earnings (loss) | 1,098 | (264) | 834 |
| Segment assets * | 171,223 | 187,035 | 358,258 |
| | | | |
| Three months ended March 30, 2013 | | | |

| | | | |
|---|---|---|---|
| Net sales | $67,445 | $52,647 | $120,092 |
| Segment operating earnings (loss) | 3,655 | (1,091) | 2,564 |
| Segment assets * | 166,771 | 153,327 | 320,098 |

* All goodwill and intangibles on our balance sheet are included in the branded segment.

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| | Basics | Branded | Consolidated |
|---|---|---|---|
| Six months ended March 29, 2014 | | | |
| Net sales | $122,712 | $91,758 | $214,470 |
| Segment operating earnings (loss) | 3,546 | (3,387) | 159 |
| | | | |
| Six months ended March 30. 2013 | | | |
| Net sales | $126,247 | $100,595 | $226,842 |
| Segment operating earnings (loss) | 7,296 | (3,886) | 3,410 |

The following reconciles the segment operating earnings to the Company's consolidated (loss) income before provision for (benefit from) income taxes (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | March 29, 2014 | March 30, 2013 | March 29, 2014 | March 30, 2013 |
| Segment operating earnings | $834 | $2,564 | $159 | $3,410 |
| Unallocated interest expense | 1,455 | 1,015 | 2,913 | 1,902 |
| Consolidated (loss) income before provision for (benefit from) income taxes | $(621) | $1,549 | $(2,754) | $1,508 |

Note K—Income Taxes

Our effective income tax rate for the six months ended March 29, 2014, was 14.3%, compared to an effective rate of (9.6)% for the same period in the prior year and an effective rate of 7.3% for the fiscal year ended June 29, 2013. We benefit from having income in foreign jurisdictions that are either exempt from income taxes or have tax rates lower than the United States. Based on our current projected pre-tax income and the anticipated amount of U.S. taxable income compared to profits maintained in the offshore taxable and tax-free jurisdictions, our estimated effective income tax rate for the fiscal year ending September 27, 2014, is expected to be approximately 14%. Changes in the mix of U.S. taxable income compared to profits maintained in tax-free jurisdictions, however, can have a significant impact on our overall effective tax rate.

We file income tax returns in the U.S. federal jurisdiction and various state, local and foreign jurisdictions. In the December quarter of fiscal year 2013, the Internal Revenue Service commenced an examination of our U.S. income tax returns for fiscal year 2010 (tax year 2009). Upon filing the carryback of our net operating losses from fiscal year 2012 to our fiscal years 2011 and 2010 (tax years 2011 and 2010) and receiving a cash refund of the taxes previously paid, the Internal Revenue Service expanded the examination to include our U.S. income tax returns for our 2011 and 2012 fiscal years. This examination was concluded in January 2014, and no tax deficiency was found. Based on the conclusion of the audit, these returns are no longer subject to further examination by the Internal Revenue Service. However, net operating loss carryforwards remain subject to examination to the extent they are carried forward and impact a year that is open to examination by taxing authorities. The tax years 2009 to 2013, according to statute and with few exceptions, remain open to examination by various state, local and foreign jurisdictions.

Note L—Derivatives and Fair Value Measurements

From time to time, we may use interest rate swaps or other instruments to manage our interest rate exposure and reduce the impact of future interest rate changes. These financial instruments are not used for trading or speculative purposes.

| | Effective Date | Notational Amount | Fixed LIBOR Rate | Maturity Date |
|---|---|---|---|---|
| Interest Rate Swap | September 9, 2013 | $15 million | 1.1700% | September 9, 2016 |
| Interest Rate Swap | September 9, 2013 | $15 million | 1.6480% | September 11, 2017 |
| Interest Rate Swap | September 19, 2013 | $15 million | 1.0030% | September 19, 2016 |
| Interest Rate Swap | September 19, 2013 | $15 million | 1.4490% | September 19, 2017 |
| Interest Rate Swap | September 1, 2011 | $10 million | 1.0700% | September 1, 2014 |

From time to time, we may purchase cotton option contracts to economically hedge the risk related to market fluctuations in the cost of cotton used in our operations. We do not receive hedge accounting treatment for these derivatives. As such the realized and unrealized gains and losses associated with them are recorded within cost of goods sold on the Condensed Consolidated Statement of Operations. The fair value of the cotton option contracts is included in the prepaid and other current assets line item on our Condensed Consolidated Balance Sheets.

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FASB Codification No. 820, Fair Value Measurements and Disclosures (“ASC 820”), defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Assets and liabilities measured at fair value are grouped in three levels. The levels prioritize the inputs used to measure the fair value of the assets or liabilities. These levels are:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – Inputs other than quoted prices that are observable for assets and liabilities, either directly or indirectly. These inputs include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are less active.

Level 3 – Unobservable inputs that are supported by little or no market activity for assets or liabilities and includes certain pricing models, discounted cash flow methodologies and similar techniques.

The following financial assets (liabilities) are measured at fair value on a recurring basis (in thousands):

| | Fair Value Measurements Using | | | |
|---|---|---|---|---|
| Period Ended | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Interest Rate Swaps | | | | |
| March 29, 2014 | $(641) | — | $(641) | — |
| September 28, 2013 | $(906) | — | $(906) | — |
| Cotton Options | | | | |
| March 29, 2014 | $652 | $652 | — | — |
| September 28, 2013 | — | — | — | — |
| Contingent Consideration | | | | |
| March 29, 2014 | $(3,525) | — | — | $(3,525) |
| September 28, 2013 | $(3,400) | — | — | $(3,400) |

The fair value of the interest rate swap agreements were derived from discounted cash flow analysis based on the terms of the contract and the forward interest rate curves adjusted for our credit risk, which fall in Level 2 of the fair value hierarchy.

The fair value of the cotton option contracts were established based on the daily mark for identical assets on the open market as of the close of business on March 28, 2014, the last business day prior to our quarter ended March 29, 2014, which fall in Level 1 of the fair value hierarchy.

The Salt Life Acquisition included contingent consideration payable in cash after the end of calendar year 2019 if financial performance targets involving the sale of Salt Life-branded products are met during the 2019 calendar year. We used the historical results and projected cash flows based on the contractually defined terms, discounted as necessary, to estimate the fair value of the contingent consideration for Salt Life at acquisition, as well as to remeasure the contingent consideration related to the acquisitions of Salt Life and Art Gun at each reporting period. Accordingly, the fair value measurement for contingent consideration falls in Level 3 of the fair value hierarchy. During the three and six months ended March 29, 2014, we expensed $0.1 million related to the change in fair value of the contingent consideration associated with the Salt Life Acquisition as a result of the passage of time. At March 29, 2014, we had $3.5 million accrued in contingent consideration related to the Salt Life Acquisition. Contingent consideration related to the acquisition of Art Gun remains de minimis.

The following table summarizes the fair value and presentation in the Condensed Consolidated Balance Sheets for derivatives related to our interest swap agreements as of March 29, 2014, and June 29, 2013.

| | March 29, 2014 | September 28, 2013 |
|---|---|---|
| Accrued expenses | $(36) | $(100) |

| | | |
|---|---|---|
| Deferred tax liabilities | 247 | 349 |
| Other liabilities | (605) | (806) |
| Accumulated other comprehensive loss | $(394) | $(557) |

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Assets Measured at Fair Value on a Non-Recurring Basis

Intangible assets acquired in connection with the Salt Life Acquisition are identified by type in Note D—Salt Life Acquisition and have been valued on a preliminary basis. These preliminary valuations included significant unobservable inputs (Level 3).

Note M—Legal Proceedings

Consumer Product Safety Commission

We previously received an inquiry from the U.S. Consumer Product Safety Commission (“Commission”) regarding a children's drawstring hoodie product sourced, distributed and sold by Junkfood, and its compliance with applicable product safety standards. The Commission subsequently investigated the matter, including whether Junkfood complied with the reporting requirements of the Consumer Product Safety Act (“CPSA”), and the garments in question were ultimately recalled. On or about July 25, 2012, Junkfood received notification from the Commission staff alleging that Junkfood knowingly violated CPSA Section 15(b) and that the staff will recommend to the Commission a $900,000 civil penalty. We contend that the Commission's allegations are without merit.

On August 27, 2012, Junkfood responded to the Commission staff regarding its recommended penalty, setting forth a number of defenses and mitigating factors that could result in a much lower penalty, if any, ultimately imposed by a court should the matter proceed to litigation. On March 27, 2013, and on several subsequent occasions, the Commission requested additional information from Junkfood regarding the matter and Junkfood has since responded. Junkfood recently received an additional request for information from the Commission in the form of a subpoena and Junkfood is currently in the process of responding. While we will continue to defend against these allegations, we believe a risk of loss is probable. Based upon current information, including the terms of previously published Commission settlements and related product recall notices, should the Commission seek enforcement of the recommended civil penalty and ultimately prevail on its claims at trial we believe there is a range of likely outcomes between $25,000 and an amount exceeding $900,000, along with interest and the Commission's costs and fees. During the quarter ended June 30, 2012, we recorded a liability for what we believe to be the most likely outcome within this range, and this liability remains recorded as of March 29, 2014.

California Wage and Hour Litigation

We were served with a complaint in the Superior Court of the State of California, County of Los Angeles, on or about March 13, 2013, by a former employee of our Delta Activewear business unit at our Santa Fe Springs, California distribution facility alleging violations of California wage and hour laws and unfair business practices with respect to meal and rest periods, compensation and wage statements, and related claims (the "Complaint"). The Complaint is brought as a class action and seeks to include all of our Delta Activewear business unit's current and certain former employees within California who are or were non-exempt under applicable wage and hour laws. The Complaint also names as defendants Junkfood, Soffe, an independent contractor of Soffe, and a former employee, and seeks to include all current and certain former employees of Junkfood, Soffe and the Soffe independent contractor within California who are or were non-exempt under applicable wage and hour laws. The Complaint seeks injunctive and declaratory relief, monetary damages and compensation, penalties, attorneys' fees and costs, and pre-judgment interest. The discovery process in this matter is ongoing and the issue of class certification remains pending.

While we will continue to vigorously defend this action and believe we have a number of meritorious defenses to the claims alleged, we believe a risk of loss is probable. Based upon current information, we believe there is a range of likely outcomes between approximately $15,000 and $975,000. During the quarter ended September 28, 2013, we recorded a liability for the most likely outcome within this range. However, depending upon the scope and size of any certified class and whether any of the claims alleged ultimately prevail at trial, we could be required to pay amounts exceeding $975,000.

Other

In addition, at times we are party to various legal claims, actions and complaints. We believe that, as a result of legal defenses, insurance arrangements, and indemnification provisions with parties believed to be financially capable, such actions should not have a material effect on our operations, financial condition, or liquidity.

Note N—Repurchase of Common Stock

As of June 29, 2013, our Board of Directors had authorized management to use up to $30.0 million to repurchase Delta Apparel stock in open market transactions under our Stock Repurchase Program.

During the March quarter of fiscal years 2014 and 2013, we purchased 12,118 shares and 103,571 shares, respectively, of our common stock for a total cost of $0.2 million and $1.5 million, respectively. Through March 29, 2014, we have purchased 2,055,689 shares of our common stock for an aggregate of $24.3 million since the inception of the Stock Repurchase Program. All purchases were made at the discretion of management and pursuant to the safe harbor provisions of SEC Rule 10b-18. As of March 29, 2014, $5.7 million remained available for future purchases under our Stock Repurchase Program, which does not have an expiration date.

The following table summarizes the purchases of our common stock for the quarter ended March 29, 2014:

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| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Dollar Value of Shares that May Yet Be Purchased Under the Plans | |
|---|---|---|---|---|---|
| December 29, 2013 to February 1, 2014 | — | — | — | $5.9 | million |
| February 2, 2014 to March 1, 2014 | 12,118 | $14.82 | 12,118 | $5.7 | million |
| March 2, 2014 to March 29, 2014 | — | — | — | $5.7 | million |
| Total | 12,118 | $14.82 | 12,118 | $5.7 | million |

Note O—License Agreements

We have entered into license agreements that provide for royalty payments of net sales of licensed products as set forth in the agreements. These license agreements are within our branded segment. We have incurred royalty expense (included in SG&A expenses) of approximately $2.0 million and $3.0 million in the March quarter of fiscal years 2014 and 2013, respectively. For the six months ended March 29, 2014 and March 30, 2013, we incurred royalty expenses of $4.4 million and $6.7 million, respectively.

At March 29, 2014, based on minimum sales requirements, future minimum royalty payments required under these license agreements were as follows (in thousands):

| Fiscal Year | Amount |
|---|---|
| 2014 | $483 |
| 2015 | 1,055 |
| 2016 | 186 |
| 2017 | 34 |
| | $1,758 |

Note P—Goodwill and Intangible Assets

Components of intangible assets consist of the following (in thousands):

| | March 29, 2014 | | | September 28, 2013 | | | |
|---|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net Value | Cost | Accumulated Amortization | Net Value | Economic Life |
| Goodwill | $36,729 | $ — | $36,729 | $36,729 | $ — | $36,729 | N/A |
| Intangibles: | | | | | | | |
| Tradename/trademarks | $17,530 | $ (976 ) | $16,554 | $17,530 | $ (672 ) | $16,858 | 20 – 30 yrs |
| Customer relationships | 7,220 | (3,117 ) | 4,103 | 7,220 | (2,937 ) | 4,283 | 20 yrs |
| Technology | 1,220 | (520 ) | 700 | 1,220 | (459 ) | 761 | 10 yrs |
| License agreements | 2,100 | (62 ) | 2,038 | 2,100 | (10 ) | 2,090 | 15 – 30 yrs |
| Non-compete agreements | 1,287 | (517 ) | 770 | 1,287 | (442 ) | 845 | 4 – 8.5 yrs |
| Total intangibles | $29,357 | $ (5,192 ) | $24,165 | $29,357 | $ (4,520 ) | $24,837 | |

Amortization expense for intangible assets was $0.4 million for the three months ended March 29, 2014, and $0.2 million for the three months ended March 30, 2013. Amortization expense for intangible assets was $0.7 million for the six months ended March 29, 2014, and $0.3 million for the six months ended March 30, 2013. Amortization expense is estimated to be approximately $1.4 million each for fiscal years 2014 and 2015 and $1.3 million for fiscal years 2016, 2017 and 2018.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Note Regarding Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by or on behalf of the Company. We may from time to time make written or oral statements that are “forward-looking,” including statements contained in this

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report and other filings with the SEC in our press releases, in oral statements, and in other reports to our shareholders.
All statements, other than statements of historical fact, which address activities, events or developments that we expect or anticipate will or may occur in the future are forward-looking statements. The words “estimate”, “project”, “forecast”, “anticipate”, “expect”, “intend”, “believe” and similar expressions, and discussions of strategy or intentions, are intended to identify forward-looking statements.
The forward-looking statements in this Form 10-Q are based on our expectations and are necessarily dependent upon assumptions, estimates and data that we believe are reasonable and accurate but may be incorrect, incomplete or imprecise. Forward-looking statements are also subject to a number of business risks and uncertainties, any of which could cause actual results to differ materially from those set forth in or implied by the forward-looking statements.
The risks and uncertainties include, among others:

- the volatility and uncertainty of cotton and other raw material prices;
- the general U.S. and international economic conditions;
- deterioration in the financial condition of our customers and suppliers and changes in the operations and strategies of our customers and suppliers;
- the competitive conditions in the apparel and textile industries;
- our ability to predict or react to changing consumer preferences or trends;
- pricing pressures and the implementation of cost reduction strategies;
- changes in the economic, political and social stability of our offshore locations;
- our ability to retain key management;
- the effect of unseasonable weather conditions on purchases of our products;
- significant changes in our effective tax rate;
- any restrictions on our ability to borrow capital or service our indebtedness;
- interest rate fluctuations increasing our obligations under our variable rate indebtedness;
- the ability to raise additional capital;
- the ability to grow, achieve synergies and realize the expected profitability of recent acquisitions;
- the volatility and uncertainty of energy and fuel prices;
- any material disruptions in our information systems related to our business operations;
- any data security or privacy breaches;
- any significant interruptions within our distribution network;
- changes in or our ability to comply with safety, health and environmental regulations;
- any significant litigation in either domestic or international jurisdictions;
- the ability to protect our trademarks and other intellectual property;
- the ability to obtain and renew our significant license agreements;
- the impairment of acquired intangible assets;
- changes in e-commerce laws and regulations;
- changes to international trade regulations;
- changes in employment laws or regulations or our relationship with our employees;
- cost increases and reduction in future profitability due to recent healthcare legislation;
- foreign currency exchange rate fluctuations;
- violations of manufacturing or employee safety standards, labor laws, or unethical business practices by our suppliers and independent contractors;
- the illiquidity of our shares;
- price volatility in our shares and the general volatility of the stock market; and
- the costs required to comply with the regulatory landscape regarding public company governance and disclosure.

A detailed discussion of significant risk factors that have the potential to cause actual results to differ materially from our expectations is described under the subheading "Risk Factors" in our Form 10-K for our fiscal year ended June 29, 2013, filed with the SEC. Any forward-looking statements in this Form 10-Q do not purport to be predictions of future events or circumstances and may not be realized. Any forward-looking statements are made only as of the date of this Form 10-Q and we do not undertake publicly to update or revise the forward-looking statements even if it becomes clear that any projected results will not be realized.

The risks described in our Form 10-K for our fiscal year ended June 29, 2013, and in this Form 10-Q are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition, and/or operating results.

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Business Outlook

The 5% sales decline during the 2014 second quarter was due primarily to unseasonably cold and snowy weather throughout the country, and a weak retail environment. Although sales and profitability in the first half of fiscal 2014 were not what we hoped for, there were many positive things in the second quarter that should bode well for the future.

We have been improving service levels to the private label and activewear marketplace and this has resulted in our winning additional decorated tee programs. So far this year we have shipped nearly $5 million in decorated catalog tees to customers who previously were purchasing undecorated tees. We intend to build on that success in the upcoming quarters. We have also seen interest from several potential new private label customers who have recognized the world-class service levels we can provide to support their growth. Our recently expanded manufacturing and screen-printing capabilities give us the capacity to continue to grow these decorated and undecorated programs in our basics segment.

We recently opened a third party-operated distribution facility in Dallas, Texas to better service a large market for undecorated tees with shorter shipping times and reduced freight costs. We have also added new upscale fleece to our catalog product line that we expect will attract new customers and help reduce some of the seasonality in this segment of our business.

The lower than expected sales volumes in the basics segment have put a damper on the anticipated incremental production we would be able to run through our manufacturing facilities, which will reduce our ability to use our expanded manufacturing capacity in Honduras to leverage against fixed costs and reduce overall product costs. The manufacturing costs in our U.S textile factory run higher than in our Honduran textile facility due to having older, less efficient equipment in the facility coupled with higher U.S. labor and overhead costs. During the March quarter our U.S. textile costs were also unfavorably impacted due to shutdowns caused by the snow and ice that blanketed the southeast. Our U.S. textile facility provides several key things for us. First, it supports our Mexico sewing operations, taking advantage of duty-free sewing through the NAFTA treaty. These goods can then be sold in Canada through our recently opened, third-party operated distribution facility. Second, having textile and sewing operations in more than one region provides a diversified manufacturing platform that is less exposed to natural disasters and political risk. Finally, the U.S. textile facility supports our Made-in-the-USA programs, which are gaining traction with our American Threads by The Game collegiate line. With this in mind, we continue to evaluate different opportunities we have to lower our overall product costs with more efficient and lower cost manufacturing operations.

Art Gun continued its strong growth with online retailers who want the flexibility and no-risk inventory model that the Art Gun service platform provides. During its peak periods, Art Gun is experiencing demand that is exceeding its current capacity. We are evaluating expansion opportunities to ensure we can service our current and future customers to continue Art Gun's consistently rapid growth.

Although Soffe sales were down 12% compared to a year ago, Soffe is showing considerable improvement. Based on sell-through information from retailers, it appears that the new Soffe line launched for spring is being well received by the junior consumer. Slowness at sporting goods retailers hurt Soffe's performance during the March quarter; however, this sales channel has historically been increasing and we believe as weather improves across the country we will see growth return to this sales channel. In the second half of fiscal year 2014, we expect revenue growth at Soffe and its return to profitability.

Junk Food continues to grow its branded presence in boutiques and specialty retailers who love the garment styling and creative graphics that Junk Food offers. The first Junk Food flagship retail store recently opened on fashionable Abbot Kinney Boulevard in Venice, California.

The Game apparel and headwear lines are also winning new programs as college bookstores begin placing orders for the new school year. Our private-label corporate headwear programs continue to perform well with many opportunities for continued growth.

Salt Life, which we acquired in August 2013, increased sales by 28% during the March quarter, bringing its revenue up 29% for the first half of the 2014 fiscal year. Salt Life's sales increase was driven from retail door growth and product expansions, as Salt Life lifestyle products continue to gain popularity with consumers. Since the onset of our involvement with Salt Life we have expanded its geographic base from primarily in Florida to now being in about

2,300 retail doors stretching from Texas up the east coast, as well as in the Caribbean. We continue to expand product offerings in lifestyle and performance products to reach across the large consumer base in fish, dive, board and beach. This not only broadens the retail doors for Salt Life products, but should help expand the average sales per door. We expect sales of Salt Life products to exceed $30 million in calendar year 2014 and to continue producing strong operating profits for us.

We believe that Delta Apparel is in an excellent position for growth as economic conditions improve and consumer buying power is renewed. In the meantime, we will continue to provide high-quality products and services to our customers, while remaining focused on cost savings and efficiency programs that should result in the long-term growth and profitability of Delta Apparel.

EARNINGS GUIDANCE

There are several factors that have negatively impacted financial results in the first half of fiscal year 2014. Net sales in the second half of fiscal year 2014 may not be sufficient to overcome the declines experienced to date. Lower sales, coupled with higher cotton and other input costs that may not be able to be recouped in selling prices, along with higher than expected legal-related costs, leads management at this time to revise guidance for fiscal year 2014. We now expect sales in the range of $480 to $490 million, and earnings in the range of $0.80 to $0.90 per diluted share.

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Results of Operations

Net sales for the the 2014 fiscal March quarter were $114.5 million, a decrease of 4.7% compared to the prior year quarter net sales of $120.1 million. This was primarily due to unseasonably cold weather throughout the country and the weak retail environment prevailing for most of the quarter. For the first six months of fiscal year 2014, sales decreased by 5.5% to $214.5 million, compared to $226.8 million for the first six months of fiscal year 2013. Our direct-to-consumer sales and e-commerce sales represented 2.1% of total revenues for the 2014 fiscal March quarter, a 30 basis point increase over the same period prior year. For the first six months of 2014, our direct-to-consumer and e-commerce sales represented 2.6% of total revenues, a 50 basis point increase over the same period last year.

Gross margins for the 2014 fiscal March quarter declined by 250 basis points from the prior year quarter due primarily to lower average selling prices on catalog basic undecorated tees coupled with higher raw material and other input costs. Gross margins in the first half of fiscal year 2014 declined by 240 basis points from the prior year period.

Selling, general, and administrative, ("SG&A") expenses, were $21.3 million, or 18.6% of sales, for the quarter ended March 29, 2014, compared to $23.7 million, or 19.7% of sales, in the prior year period. For the first six months of fiscal year 2014, SG&A expenses were 19.2% of sales versus 20.1% in the same period of fiscal year 2013. Over the last several quarters we have taken steps to better leverage our back-office functions and reduce overhead expenses in our business. These improvements were partially offset by higher legal costs associated with ongoing litigation and regulatory matters, which have increased SG&A expenses by about 30 basis points.

Net interest expense for the second quarter of fiscal year 2014 was $1.5 million compared to $1.0 million for the same quarter last year. For the first six months of fiscal year 2014, interest expense totaled $2.9 million compared to $1.9 million in the prior year. The increase from the prior year is due primarily to the increased debt related to the Salt Life Acquisition and the Honduran manufacturing expansion.

Our effective income tax benefit for the six months ended March 29, 2014, was 14.3%, compared to an effective tax benefit of 9.6% for the same period last year. We benefit from having income in foreign jurisdictions that are either exempt from income taxes or have tax rates lower than the United States. Based on our current projected pre-tax income and the anticipated amount of U.S. taxable income compared to profits maintained in the offshore taxable and tax-free jurisdictions, our estimated effective income tax rate for the fiscal year ending September 27, 2014, is expected to be approximately 14%.

We had a net loss for the quarter of $0.8 million, or $0.10 per diluted share, compared with net earnings of $1.6 million, or $0.19 per diluted share, in the prior year quarter. Net loss for the first six months of fiscal year 2014 was $2.4 million, or $0.30 per diluted share, compared to earnings of $1.7 million, or $0.19 per diluted share, in the prior year six month period.

At March 29, 2014, accounts receivable were $65.8 million compared to $70.8 million in the prior year March quarter. Days sales outstanding decreased to 51 days as of March 29, 2014, compared to 52 days in the prior year March quarter.

Inventory levels increased $5.0 million from March 30, 2013 to $170.8 million at March 29, 2014. The increase from March 30, 2013 is due to softer than expected sales in the March 2014 quarter.

Capital expenditures were $1.6 million during the second quarter of fiscal year 2014, and $5.6 million in the first six months of fiscal year 2014. Our expenditures primarily related to our manufacturing expansion as well as ongoing enhancements to our information technology structure. Depreciation and amortization, including non-cash compensation, was $2.6 million for the second quarter of fiscal year 2014 and $5.1 million for the first six months of fiscal year 2014.

Total debt at March 29, 2014, which is typically our seasonally highest debt, was $143.8 million compared to $112.9 million a year ago. The increase is principally due to the Salt Life Acquisition and our Honduras expansion.

Branded Segment

Sales in our branded segment were hurt by overall slowness at retail with sales of $50.3 million for the second quarter of fiscal year 2014 compared with $52.6 million in the prior year period. For the first six months of fiscal year 2014, net sales in our branded segment were $91.8 million compared to $100.6 million in the prior year period. Salt Life and Art Gun continued their strong growth trends of the past several quarters but those increases were offset by lower sales at Soffe, Junk Food and The Game. Although Soffe sales were down 12% compared to the 2013 March quarter, the new Soffe junior's offerings and Intensity branded products are regaining traction and showing solid sell-through at retail. Sales of Junk Food products declined by 3% for the March quarter with softness at larger retailer customers nearly being offset by new business that Junk Food continues to generate with boutiques and specialty retailers. Art Gun, with a 34% sales increase over the 2013 March quarter, continued to grow with online retailers who want the flexibility and no-risk inventory model that the Art Gun service platform provides. Despite the 4% sales decline, operating income improved $0.8 million to a loss of $0.3 million, or 0.5% of sales, a 360 basis point improvement from the prior year period. This was due to a decline in SG&A expenses resulting from cost reductions made over the last several quarters. These declines are directly related to the decline in sales. In the first six months of 2014, operating income improved by $0.5 million to a loss of $3.4 million, or 3.7% of sales.

Basics Segment

Net sales in our basics segment were $64.1 million in the second quarter, a 5% decrease from $67.4 million in the prior year period. For the first six months of fiscal year 2014, net sales in our basics segment were $122.7 million compared to $126.2 million in the prior year period. In the March quarter, private label sales were down 17% as customers reduced shipments of products due to softness in their business and changes in product strategy. Sales of catalog basic tees increased 2% during the March quarter based on a 7% increase in unit sales offset by a 5% decrease in average selling prices. Weak market conditions for undecorated tees resulted in significant price discounting and a shift in sales mix to drive volume growth. This, coupled with higher cotton and other input costs, lowered operating margins in the basics segment by 370 basis points to 1.7% of sales in the second quarter of fiscal year 2014, compared to 5.4% of sales in the second quarter of fiscal year 2013. In the first six months of 2014, operating income declined to $3.5 million, or 2.9% of sales, compared to $7.3 million, or 5.8% of sales, for the same period last year.

## Liquidity and Capital Resources

Our primary cash needs are for working capital and capital expenditures, as well as to fund share repurchases under our Stock Repurchase Program. In addition, we may use cash in the future to pay dividends.

### Operating Cash Flows

Operating activities used $4.2 million in cash for the first six months of fiscal years 2014 and 2013. The cash used in our operating activities for the first six months of fiscal year 2014 was primarily to fund our investment in inventory and reduce the amounts owed to our suppliers. This was partially offset by the release of $3.0 million held in an escrow account from the Salt Life Acquisition.

### Investing Cash Flows

Capital expenditures during the first six months of 2014 were $5.6 million compared to $3.8 million for the same period last year. The capital expenditures for the first six months of fiscal year 2014 were primarily related to the expansion of our textile operations, along with investments in our information technology systems. We anticipate our fiscal year 2014 capital expenditures to be approximately $12.0 to 13.0 million. Capital expenditures are expected to primarily include expansion in both of our international and U.S. facilities, information technology projects and branding and point-of-sale displays for our branded products.

### Financing Activities

During the first six months of 2014 cash provided by financing activities was $9.8 million compared to $6.6 million the same period last year. The cash provided by our financing activities funded the our working capital and capital expenditures, as well as our net loss experienced in the first six months of fiscal year 2014.

We believe that the cash flow generated by our operations and funds available under our credit facilities should be sufficient to service our debt payment requirements, satisfy our foreseeable working capital needs, and fund our planned capital expenditures and share repurchases. Any material deterioration in our results of operations, however, may result in our inability to borrow and to issue letters of credit to suppliers under our revolving credit facility, or may cause the borrowing availability under our facility to be insufficient for our needs.

### Purchases By Delta Apparel Of Its Own Shares

During the six months ended March 29, 2014, we purchased 12,118 shares of our common stock for a total cost of $0.2 million (see Note N-Repurchase of Common Stock). As of March 29, 2014, we had $5.7 million of our share repurchase authorization remaining. We evaluate current leverage, working capital requirements, the free cash flow outlook, stock valuation and future business opportunities for capital to determine when we believe the repurchase of our stock is a sound investment opportunity that we can pursue without sacrificing future growth plans.

## Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our Condensed Consolidated Financial Statements, which were prepared in accordance with U.S. GAAP. The preparation of our Condensed Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We base our estimates and judgments on historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The most significant estimates and assumptions relate to revenue recognition, accounts receivable and related reserves, inventory and related reserves, the carrying value of goodwill, and the accounting for income taxes.
A detailed discussion of critical accounting policies is contained in the Significant Accounting Policies included in Note 2 to the Audited Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended June 29, 2013, and there have been no changes in those policies since the filing of that Form 10-K with the SEC.

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Environmental and Regulatory Matters
We are subject to various federal, state and local environmental laws and regulations concerning, among other things, wastewater discharges, storm water flows, air emissions and solid waste disposal. Our plants generate very small quantities of hazardous waste, which are either recycled or disposed of off-site. Most of our plants are required to possess one or more environmental permits, and we believe that we are currently in compliance with the requirements of those permits.
The environmental rules applicable to our business are becoming increasingly stringent and we incur capital and other expenditures annually to achieve compliance with environmental standards. We currently do not expect that the amount of expenditures required to comply with environmental laws will have a material adverse affect on our operations, financial condition or liquidity. There can be no assurance, however, that future changes in federal, state, or local regulations, interpretations of existing regulations or the discovery of currently unknown problems or conditions will not require substantial additional expenditures. Similarly, while we believe that we are currently in compliance with all applicable environmental requirements, the extent of our liability, if any, for past failures to comply with laws, regulations or permits applicable to our operations cannot be determined and could have a material adverse effect on our operations, financial condition and liquidity.

Item 3. Quantitative and Qualitative Disclosures About Market Risk
Commodity Risk Sensitivity
We have a supply agreement with Parkdale Mills, Inc. and Parkdale America, LLC (collectively "Parkdale") to supply our yarn requirements until December 31, 2015. Under the supply agreement, we purchase from Parkdale all of our yarn requirements for use in our manufacturing operations, excluding yarns that Parkdale does not manufacture or cannot manufacture due to temporary capacity constraints. The purchase price of yarn is based upon the cost of cotton plus a fixed conversion cost. Thus, we are subject to the commodity risk of cotton prices and cotton price movements, which could result in unfavorable yarn pricing for us. We fix the cotton prices as a component of the purchase price of yarn, pursuant to the supply agreement, in advance of the shipment of finished yarn from Parkdale. Prices are set according to prevailing prices, as reported by the New York Cotton Exchange, at the time we elect to fix specific cotton prices.
Yarn with respect to which we have fixed cotton prices at March 29, 2014, was valued at $30.3 million, and is scheduled for delivery between April 2014 and October 2014. At March 29, 2014, a 10% decline in the market price of the cotton covered by our fixed price yarn would have had a negative impact of approximately $2.2 million on the value of the yarn. This compares to what would have been a negative impact of $1.1 million at the 2013 fiscal year-end based on the yarn with fixed cotton prices at June 29, 2013. The impact of a 10% decline in the market price of the cotton covered by our fixed price yarn would have been greater at March 29, 2014, than at June 29, 2013, due to increased commitments and higher average cost per pound fixed at March 29, 2014, compared to June 29, 2013.
We may use derivatives, including cotton option contracts, to manage our exposure to movements in commodity prices. We do not designate our options as hedge instruments upon inception. Accordingly, we mark to market changes in the fair market value of the options in cost of goods sold in our Condensed Consolidated Statement of Operations.
If Parkdale’s operations are disrupted and it is not able to provide us with our yarn requirements, we may need to obtain yarn from alternative sources. Although alternative sources are presently available, we may not be able to enter into short-term arrangements with substitute suppliers on terms as favorable as our current terms with Parkdale. In addition, the cotton futures we have fixed with Parkdale may not be transferable to alternative yarn suppliers. Because there can be no assurance that we would be able to pass along the higher cost of yarn to our customers, this could have a material adverse effect on our results of operations.
Interest Rate Sensitivity
Our U.S. revolving credit facility provides that the outstanding amounts owed shall bear interest at variable rates. If the amount of outstanding floating rate indebtedness at March 29, 2014, under the U.S. revolving credit facility had been outstanding during the entire three months ended March 29, 2014, and the interest rate on this outstanding indebtedness was increased by 100 basis points, our expense would have increased by approximately $100 thousand,

or 6.9%, of actual interest expense, during the quarter. This compares to an increase of $588 thousand, or 14.7%, for the 2013 fiscal year based on the outstanding floating rate indebtedness at June 29, 2013, or an average of $147 thousand per quarter. The dollar amount, as well as the percentage, of the increase in interest expense is lower as of March 29, 2014, primarily due to the swap agreements that were entered into during the quarter ended September 28, 2013. The actual increase in interest expense resulting from a change in interest rates would depend on the magnitude of the increase in rates and the average principal balance of floating rate indebtedness.

Derivatives

From time to time, we may use interest rate swaps or other instruments to manage our interest rate exposure and reduce the impact of future interest rate changes as described in Note L—Derivatives and Fair Value Measurements.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to reasonably assure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the United States Securities and Exchange Commission’s requirements. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information that we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of March 29, 2014, and, based on their evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures were effective at the evaluation date.

Changes in Internal Control Over Financial Reporting

There was no change during the second quarter of fiscal year 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Note M—Legal Proceedings in Item 1, which is incorporated herein by reference.

Item 1A. Risk Factors

As of March 29, 2014, there have been no material changes to the risk factors set forth in our Form 10-K for our fiscal year ended June 29, 2013.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Repurchases of Common Stock

See Note N—Repurchase of Common Stock and Note F—Debt, in Item 1, which are incorporated herein by reference.

Item 6. Exhibits

Exhibits

| | |
|---|---|
| 31.1 | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase |

| | |
|---|---|
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase |

SIGNATURES

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

DELTA APPAREL, INC.
(Registrant)

Date May 7, 2014

By: /s/ Deborah H. Merrill
Deborah H. Merrill
Vice President, Chief Financial Officer and Treasurer