Differential Brands Group Inc.
Form 10-Q
November 14, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from to

Commission File Number: 0-18926

DIFFERENTIAL BRANDS GROUP INC.

(Exact name of registrant as specified in its charter)

Delaware	11-2928178
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1231 South Gerhart Avenue, Commerce, California	90022
(Address of principal executive offices)	(Zip Code)

(323) 890-1800

(Registrant's telephone number, including area code)

N/A

(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

The number of shares of the registrant's common stock outstanding as of November 14, 2016 was 13,083,923.

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DIFFERENTIAL BRANDS GROUP INC. AND SUBSIDIARIES

INDEX TO QUARTERLY REPORT ON FORM 10-Q

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EXPLANATORY NOTE

Differential Brands Group Inc. and subsidiaries ("we," "us," "our," the "Company" or "Differential") began operations in 1987 as Innovo, Inc. Since our founding, we have evolved from producing craft and accessory products to designing and selling apparel products bearing the Hudson® and Robert Graham® and as of July 18, 2016, the SWIMS® brand names. Prior to the Joe's Asset Sale discussed below, we also designed and sold apparel products bearing the various Joe's ® brand names.

As previously reported, on September 11, 2015, we completed the sale of certain of our operating and intellectual property assets related to the business operated under the brand names "Joe's Jeans," "Joe's," "Joe's JD" and "else" (the "Joe's Business") to GBG USA Inc., a Delaware corporation ("GBG"), and the sale of certain of our intellectual property assets related to the Joe's Business to Joe's Holdings LLC, a Delaware limited liability company ("Joe's Holdings"), for an aggregate purchase price of $80 million (the "Joe's Asset Sale"). The proceeds of the Joe's Asset Sale were used to repay all of our indebtedness outstanding under the term loan credit agreement, dated September 30, 2013 (the "Garrison Term Loan Credit Agreement"), with Garrison Loan Agency Services LLC ("Garrison") and a portion of our indebtedness outstanding under our revolving credit agreement (the "CIT Revolving Credit Agreement"), dated September 30, 2013, as amended, with CIT Commercial Services, Inc. ("CIT"), a unit of CIT Group. In November 2014, we had received an initial notice of default and event of default and demand for payment of default interest from Garrison under the Garrison Term Loan Credit Agreement, which also triggered a default and event of default under the terms of the CIT Revolving Credit Agreement and our separate factoring facility with CIT. On February 10, 2015, we had received additional notices of default and events of default for failure to comply with certain financial and other covenants and a demand for continued payment of default interest from both Garrison and CIT. As a result of the repayment based on the proceeds of the Joe's Asset Sale, the Garrison Term Loan Credit Agreement was paid in full and terminated on September 11, 2015, and we entered into the amended and restated revolving credit agreement (the "CIT Amended and Restated Revolving Credit Agreement"), dated September 11, 2015, which provided for a maximum credit availability of $7.5 million and waived certain defaults that remained in effect until the closing of the RG Merger (as defined below).

Additionally, as previously reported, on January 28, 2016, we completed the acquisition (the "RG Merger") of all of the outstanding equity interests of RG Parent LLC and its subsidiaries ("Robert Graham" or "RG"), a business engaged in the design, development, sales and licensing of apparel products and accessories that bear the brand name Robert Graham® (the "Robert Graham Business"), as contemplated by the Agreement and Plan of Merger, dated as of September 8, 2015 (the "RG Merger Agreement"), by and among RG, JJ Merger Sub, LLC ("RG Merger Sub") and us, for an aggregate of $81.0 million in cash and 8,825,461 shares of our common stock, par value $0.10 per share ("common stock") (after giving effect to the Reverse Stock Split (as defined below)). Pursuant to the RG Merger Agreement, among other things, RG Merger Sub was merged with and into RG, so that RG, as the surviving entity, became our wholly-owned subsidiary. The aggregate cash consideration was used to repay $19.0 million of RG's outstanding loans and indebtedness under its revolving credit agreement with J.P. Morgan Chase Bank, N.A. On the RG Merger's closing date, all outstanding loans under the CIT Amended and Restated Revolving Credit Agreement were repaid and it was terminated in connection with entering into (i) a new credit and security agreement (as later amended, the "ABL Credit Agreement") with Wells Fargo Bank, National Association, as lender, (ii) a new credit and security agreement with TCW Asset Management Company, as agent, and the lenders party thereto (as later amended, the "Term Credit Agreement"), and (iii) an amended and restated deferred purchase factoring agreement with CIT.

Effective upon consummation of the RG Merger, we changed our name from “Joe’s Jeans Inc.” to “Differential Brands Group Inc.” and our trading symbol from “JOEZ” to “DFBG,” and effected a reverse stock split (the “Reverse Stock Split”) of our issued and outstanding common stock such that each 30 shares of our issued and outstanding common stock were reclassified into one share of our issued and outstanding common stock, which Reverse Stock Split did not change the par value or the amount of authorized shares of our common stock. The primary purpose of the Reverse Stock Split was to increase the per-share market price of our common stock in order to maintain our listing on The Nasdaq Capital Market maintained by The Nasdaq Stock Market LLC (“NASDAQ”). Unless otherwise indicated, all share amounts in this Quarterly Report on Form 10-Q (this “Quarterly Report”) have been adjusted to reflect the Reverse Stock Split.

After the closing of the Joe’s Asset Sale on September 11, 2015, we retained and operated 32 Joe’s® brand retail stores, of which we transferred 18 retail stores to GBG on January 28, 2016 for no additional consideration. As of February 29, 2016, the remaining 14 Joe’s® brand retail stores were closed and are reported as discontinued operations.

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GBG supplied Joe’s® branded merchandise to the retail stores for resale under a license from Joe’s Holdings until the stores were transferred or closed.

The RG Merger has been accounted for as a reverse merger and recapitalization. As a result of the RG Merger, RG is a wholly-owned subsidiary of the Company, the Company no longer owns certain assets and intellectual property of the Joe’s Business and the Company retains ownership of the businesses associated with its Hudson® brand (the “Hudson Business”). The former RG members own a majority of our issued and outstanding equity after the RG Merger. Under the acquisition method, RG is deemed the accounting acquirer for financial reporting purposes, with the Company, as the legal acquirer, being viewed as the accounting acquiree. As a result, the assets, liabilities and operations reflected in the historical condensed consolidated financial statements and elsewhere in this Quarterly Report prior to the RG Merger are those of RG and will be recorded at the historical cost basis and the Company’s future periodic reports will reflect RG’s historical financial condition and results of operations for comparative purposes. For the nine months ended September 30, 2016, the Company’s condensed consolidated financial statements include: (i) from January 1, 2016 up to the day prior to the closing of the RG Merger on January 28, 2016, the results of operations and cash flows of RG; (ii) from and after the RG Merger’s closing date on January 28, 2016, the results of continuing operations, cash flows and, as applicable, the assets and liabilities of the combined company, comprising the Company’s Hudson Business and RG; (iii) from and after the RG Merger’s closing date on January 28, 2016, the results of the discontinued operations from the Joe’s® brand retail stores that were not transferred to GBG but that closed as of February 29, 2016; and (iv) from and after the acquisition of SWIMS AS (“SWIMS”) on July 18, 2016, the results of continuing operations and cash flows and, as applicable, the assets and liabilities of SWIMS.

Prior to the RG Merger, RG and the Company had different fiscal year ends, with RG’s fiscal year ending on December 31 and the Company’s fiscal year ending on November 30. In connection with the RG Merger, the Company changed its fiscal year end to December 31. The accounting policies of the Company are similar in all material respects to those of RG, except as set forth in our accompanying notes to unaudited condensed consolidated financial statements.

The Company continues to be a “smaller reporting company,” as defined under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) following the RG Merger.

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PART I — FINANCIAL INFORMATION

Item 1.Financial Statements.

DIFFERENTIAL BRANDS GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	September 30, 2016 (unaudited)	December 31, 2015 (note 1)
ASSETS		
Current assets		
Cash and cash equivalents	$ 4,424	$ 1,966
Factored accounts receivable, net	18,856	4,917
Accounts receivable, net	2,937	1,836
Royalties receivable	552	547
Inventories	29,849	15,353
Prepaid expenses and other current assets	2,607	1,351
Total current assets	59,225	25,970
Property and equipment, net	12,897	13,406
Goodwill	10,728	2,286
Trade names and other intangibles, net	91,758	39,823
Other assets	493	1,374
Total assets	$ 175,101	$ 82,859
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 22,168	$ 13,084
Short-term convertible notes	12,777	—
Cash advances from customers	1,705	—
Current portion of long-term debt	1,063	—
Current portion of loan payable	—	1,167
Total current liabilities	37,713	14,251
Long-term debt, net of current portion	47,445	—
Line of credit	13,590	17,013
Convertible notes	12,452	—
Deferred income taxes, net	10,378	—
Deferred rent	3,641	3,568
Other liabilities	81	—
Loan payable, net of current portion	—	486

Total liabilities		125,300		35,318
Commitments and contingencies				
Equity				
Preferred members		—		24,798
Common members		—		22,743
Series A convertible preferred stock, \$0.10 par value: 50 and 0 shares authorized, issued and outstanding at September 30, 2016 and December 31, 2015, respectively		5		—
Common stock, \$0.10 par value: 100,000 and 0 shares authorized, 13,082 and 0 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively		1,309		—
Additional paid-in capital		58,616		—
Accumulated other comprehensive income		704		—
Accumulated deficit		(10,833)		—
Total equity		49,801		47,541
Total liabilities and equity	$	175,101	$	82,859

See accompanying notes to unaudited condensed consolidated financial statements.

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DIFFERENTIAL BRANDS GROUP INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND

COMPREHENSIVE (LOSS) INCOME

(in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net sales	$ 41,160	$ 17,605	$ 107,248	$ 52,809
Cost of goods sold	20,832	6,634	49,518	20,001
Gross profit	20,328	10,971	57,730	32,808
Operating expenses				
Selling, general and administrative	21,115	9,808	60,262	29,359
Depreciation and amortization	1,593	915	4,456	2,748
Retail store impairment	—	—	279	—
	22,708	10,723	64,997	32,107
Operating (loss) income	(2,380)	248	(7,267)	701
Interest expense, net	2,090	134	5,426	402
Other expense, net	121	—	121	—
(Loss) income before income tax	(4,591)	114	(12,814)	299
Income tax (benefit) provision	(1,770)	78	(1,193)	194
(Loss) income from continuing operations	(2,821)	36	(11,621)	105
Loss from discontinued operations, net of tax	—	—	(1,286)	—
Net (loss) income	$ (2,821)	$ 36	$ (12,907)	$ 105
(Loss) earnings per common share - basic				
(Loss) earnings from continuing operations	$ (0.22)	$ 0.00	$ (0.95)	$ 0.01
Loss from discontinued operations	—	—	(0.11)	—
(Loss) earnings per common share - basic	$ (0.22)	$ 0.00	$ (1.06)	$ 0.01
(Loss) earnings per common share - diluted				
(Loss) earnings from continuing operations	$ (0.22)	$ 0.00	$ (0.95)	$ 0.01
Loss from discontinued operations	—	—	(0.11)	—
(Loss) earnings per common share - diluted	$ (0.22)	$ 0.00	$ (1.06)	$ 0.01
Weighted average shares outstanding				
Basic	12,953	8,825	12,222	8,825
Diluted	12,953	8,825	12,222	8,825
Net (loss) income	$ (2,821)	$ 36	$ (12,907)	$ 105
Other comprehensive income item, net of tax:				

Foreign currency translation	704	—	704	—
Other comprehensive income	704	—	704	—
Comprehensive (loss) income	$ (2,117)	$ 36	$ (12,203)	$ 105

See accompanying notes to unaudited condensed consolidated financial statements.

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DIFFERENTIAL BRANDS GROUP INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine months ended September 30, 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net cash (used in) provided by continuing operating activities	$ (19,374)	$ 1,768
Net cash used in discontinued operating activities	(1,384)	—
Net cash (used in) provided by operating activities	(20,758)	1,768
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash paid in reverse acquisition with Robert Graham, net of cash acquired	(6,538)	—
(Payment) refund of security deposit	(37)	38
Purchases of property and equipment	(1,337)	(3,362)
Cash paid for the acquisition of SWIMS, net of cash acquired	(11,828)	—
Net cash used in investing activities	(19,740)	(3,324)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of Series A convertible preferred stock, net of offering costs	49,881	—
Proceeds from term debt	50,000	—
Repayment of new term loan	(375)	—
Proceeds from line of credit	14,143	—
Proceeds from short term convertible note	13,000	—
Repayment of terminated line of credit and loan payable	(23,349)	—
Payment of deferred financing costs	(1,584)	—
Redemption of unit holders	(58,218)	—
Proceeds from customer cash advances	812	—
Payment of loan payable	—	(875)
Proceeds from line of credit	—	2,499
Payment of accrued distribution to members	(1,366)	(376)
Net cash provided by financing activities	42,944	1,248
Effect of exchange rate changes on cash	12	—
NET CHANGE IN CASH AND CASH EQUIVALENTS	2,458	(308)
CASH AND CASH EQUIVALENTS, at beginning of period	1,966	792
CASH AND CASH EQUIVALENTS, at end of period	$ 4,424	$ 484

Supplemental disclosures of cash flow information:		
Interest paid	$ 3,038	$ 354
Income taxes paid	$ 2,642	$ 90
Supplemental disclosures of non-cash financing activities:		
Reclassification of other assets to offering costs	$ 812	$ —
Reclassification of other assets to deferred financing costs	$ 349	$ —
Issuance of convertible notes	$ 16,565	$ —
Common stock issued in reverse acquisition with Robert Graham	$ 20,000	$ —
Common stock issued in acquisition of SWIMS	$ 1,750	$ —
Debt discount recorded in connection with short term convertible note	$ 465	$ —
Warrants issued in acquisition of SWIMS	$ 45	$ —

See accompanying notes to unaudited condensed consolidated financial statements.

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DIFFERENTIAL BRANDS GROUP INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(in thousands)

	Common Stock		Preferred Series A		Additional	Accumulated Other Comprehensive	Accumulated	Preferred Members		Common Members	
	Shares	Par Value	Shares	Par Value	Paid-In Capital	Income	Deficit	Units	Amount	Units	Amount
1,	—	$ —	—	$ —	$ —	$ —	$ —	5,100	$ 25,375	4,900	$ 23,298
	—	—	—	—	—	—	—	—	13	—	(389)
	—	—	—	—	—	—	—	—	53	—	52
15	—	$ —	—	$ —	$ —	$ —	$ —	5,100	$ 25,441	4,900	$ 22,961
1,	—	$ —	—	$ —	$ —	$ —	$ —	5,100	$ 24,798	4,900	$ 22,743
RG	—	—	—	—	—	—	—	—	(1,058)	—	(1,016)
nit	—	—	—	—	—	—	—	—	(29,313)	—	(28,905
n	8,825	883	—	—	(13,634)	—	—	(5,100)	5,573	(4,900)	7,178
on am	3,509	351	—	—	19,649	—	—	—	—	—	—
	—	—	—	—	—	—	(10,833)	—	—	—	—
s A et of	—	—	50	5	49,064	—	—	—	—	—	—
	—	—	—	—	849	—	—	—	—	—	—
n	45	5	—	—	498	—	—	—	—	—	—
	703	70	—	—	1,680	—	—	—	—	—	—

non

nts	—	—	—	—	510	—	—	—	—	—	—
	—	—	—	—	—	704	—	—	—	—	—
16	13,082	$ 1,309	50	$ 5	$ 58,616	$ 704	$ (10,833)	—	$ —	—	$ —

See accompanying notes to unaudited condensed consolidated financial statements.

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DIFFERENTIAL BRANDS GROUP INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2016

NOTE 1 — BASIS OF PRESENTATION

Our principal business activity involves the design, development and worldwide marketing of apparel products, which include denim jeans, related casual wear and accessories bearing the brand name Hudson®, the design, development, sales and licensing of apparel products and accessories bearing the brand name Robert Graham® and the design, development, sales and licensing of footwear and accessories bearing the brand name SWIMS®. Our primary current operating subsidiaries are Robert Graham, Hudson Clothing, LLC (“Hudson”) and as of July 18, 2016, DFBG Swims, LLC (“DFBG Swims”) (see “Note 4 –Acquisition of SWIMS”). In addition, we have other non-operating subsidiaries. All significant inter-company transactions have been eliminated in consolidation.

On January 28, 2016, we completed the RG Merger. We refer you to the “Explanatory Note” on page 1 for the definitions of the capitalized terms used in this Quarterly Report. As a result of the RG Merger, RG is a wholly-owned subsidiary of the Company and RG’s former members own a majority of our issued and outstanding equity. Additionally, the Company owns the Robert Graham Business, no longer owns the Joe’s Business and has retained ownership of the Hudson Business. The RG Merger has been accounted for as a reverse merger and recapitalization, such that, under the acquisition method, RG has been deemed the accounting acquirer for financial reporting purposes, with the Company, as the legal acquirer, viewed as the accounting acquiree. As a result, the assets, liabilities and operations reflected in the historical condensed consolidated financial statements and elsewhere in this Quarterly Report prior to the RG Merger are those of RG and are recorded at the historical cost basis. For the nine months ended September 30, 2016, the Company’s condensed consolidated financial statements include: (i) from January 1, 2016 up to the day prior to the closing of the RG Merger on January 28, 2016, the results of operations and cash flows of RG; and (ii) from and after the RG Merger’s closing date on January 28, 2016, the results of continuing operations and cash flows and, as applicable, the assets and liabilities of the combined company, comprising the Company’s Hudson Business and Robert Graham Business; (iii) from and after the RG Merger’s closing date on January 28, 2016, the results of the discontinued operations from the Joe’s® brand retail stores that were not transferred to GBG but that closed as of February 29, 2016; (iv) from and after the acquisition of SWIMS (as defined in Note 4) on July 18, 2016, the results of continuing operations and cash flows and, as applicable, the assets and liabilities of SWIMS.

In connection with the RG Merger, we changed our fiscal year end to December 31 and report our results with RG as the accounting acquirer. Certain reclassifications have been made to prior year amounts within the accompanying condensed consolidated balance sheets and unaudited condensed consolidated statements of cash flows to conform to the current period presentation.

Our reportable business segments are Wholesale, Consumer Direct and Corporate and other. Because RG has been accounted for as the accounting acquirer as a result of the RG Merger, we have adopted RG’s three subdivisions as our reportable segments for all operations of our combined Company for periods after the RG Merger’s closing date. For periods before the RG Merger's closing date, our discussion of reportable segments reflects only the operations of RG. We manage, evaluate and aggregate our operating segments for segment reporting purposes primarily on the basis of business activity and operation. Our Wholesale segment is comprised of sales of our products to premium department stores, boutiques, retailers, specialty stores and international customers, and records expenses from sales and customer service departments, trade shows, warehouse distribution, product samples and customer service departments. Our Consumer Direct segment is comprised of sales to consumers through our Robert Graham® brand full-price retail stores and outlet stores, through our SWIMS® brand outlet store in Oslo, Norway and through our online retail sites at www.hudsonjeans.com, www.robertgraham.us and www.swims.com. Our Corporate and other segment is comprised of revenue from trademark licensing agreements and expenses from corporate operations, which include the executive, finance, legal, information technology, accounting, human resources, design and production departments and general brand marketing and advertising expenses associated with our brands.

Our unaudited condensed consolidated financial statements, which comprise the accounts of our wholly-owned subsidiaries (including Hudson from the date of the completion of the RG Merger and DFBG Swims from the date of

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acquisition), for the quarterly and year to date periods ended September 30, 2016 and 2015 and the related footnote information have been prepared on a basis consistent with our audited consolidated financial statements as of December 31, 2015 and 2014 and for the three-year period ended December 31, 2015 (filed as Exhibit 99.1 to Amendment No. 1 to our Current Report on Form 8-K/A, filed with the Securities and Exchange Commission (the "SEC") on March 30, 2016).

These unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information 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 for complete financial statements. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements as of December 31, 2015 and 2014 and for the three-year period ended December 31, 2015 contained in Exhibit 99.1 to Amendment No. 1 to our Current Report on Form 8-K/A, filed with the SEC on March 30, 2016. In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting of normal recurring adjustments), which management considers necessary to present fairly our financial position, results of operations and cash flows for the interim periods presented. The results for the quarterly period ended September 30, 2016 are not necessarily indicative of the results anticipated for the entire year ending December 31, 2016. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results may differ from those estimates.

NOTE 2 — ACCOUNTING POLICIES

Our accounting policies are described in the December 31, 2015 financial statements of RG filed as Exhibit 99.1 to Amendment No. 1 to our Current Report on Form 8-K/A, filed with the SEC on March 30, 2016. The following accounting policies became effective during the nine months ended September 30, 2016:

Discontinued Operations

In accordance with the Financial Accounting Standards Board ("FASB"), Accounting Standards Codification ("ASC"), ASC 205-20, Presentation of Financial Statements – Discontinued Operations, the results of operations of a component of an entity or a group or component of an entity that represents a strategic shift that has, or will have, a major effect on the reporting company's operations that has either been disposed of or is classified as held for sale are required to be reported as discontinued operations in a company's consolidated financial statements. In order to be considered a discontinued operation, both the operations and cash flows of the discontinued component must have been (or will be) eliminated from the ongoing operations of the company and the company will not have any significant continuing involvement in the operations of the discontinued component after the disposal transaction. The accompanying unaudited condensed consolidated financial statements reflect the results of operations of our Joe's Business as discontinued operations.

Stock−Based Compensation

We measure the cost of all employee stock-based compensation awards based on the grant date fair value of those awards and record that cost as compensation expense over the period during which the employee is required to perform service in exchange for the award (generally over the vesting period of the award). An entity may elect either an accelerated recognition method or a straight-line recognition method for awards subject to graded vesting based on a service condition, regardless of how the fair value of the award is measured. For all stock-based compensation awards that contain graded vesting based on service conditions, we have elected to apply a straight-line recognition method to account for these awards.

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Two−Class Earnings Per Share

We calculate basic and diluted earnings per common share using the two-class method. Under the two-class method, net earnings are allocated to each class of common stock and participating security as if all of the net earnings for the period had been distributed. Our participating securities consist of convertible preferred shares that contain a nonforfeitable right to receive dividends and therefore are considered to participate in undistributed earnings with common stockholders.

Preferred Share Dividend

Cumulative dividends on preferred stock are only accrued for when the board of directors declares a dividend. The board of directors has not declared a dividend through September 30, 2016.

Concentration of Risk

Financial instruments that potentially subject us to significant concentrations of credit risk consist principally of cash, cash equivalents, accounts receivable and factor accounts receivable. We maintain cash and cash equivalents with various financial institutions. The policy is designed to limit exposure to any one institution. We perform periodic evaluations of the relative credit rating of those financial institutions that are considered in our investment strategy.

We do not require collateral for trade accounts receivable. However, we sell a portion of our accounts receivable to CIT on a non-recourse basis (see "Note 7 – Factored and Accounts Receivables, Net"). In that instance, we are no longer at risk if the customer fails to pay. For accounts receivable that are not sold to CIT or sold on a recourse basis, we continue to be at risk if these customers fail to pay. We provide an allowance for estimated losses to be incurred in the collection of accounts receivable based upon the aging of outstanding balances and other account monitoring analysis. The net carrying value approximates the fair value for these assets. Such losses have historically been within management's expectations. Uncollectible accounts are written off once collection efforts are deemed by management to have been exhausted.

For the three and nine months ended September 30, 2016 and 2015, sales to customers or customer groups representing greater than 10 percent of net sales are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Customer A	21 %	7 %	22 %	9 %

As of September 30, 2016 and December 31, 2015, this customer represented approximately 36% and 39%, respectively, of our factored accounts receivable in our accompanying condensed consolidated balance sheets.

Comprehensive (Loss) Income

Comprehensive (loss) income represents the change in stockholders' equity resulting from transactions other than stockholder investments and distributions. Accumulated other comprehensive income includes changes in equity that are excluded from our net loss, specifically, unrealized gains and losses on foreign currency translation adjustments and is presented in the consolidated statements of equity. We present the components of comprehensive (loss) income within the consolidated statements of operations and comprehensive (loss) income.

Foreign Currency Translation

Our 100% owned direct foreign operations present their financial reports in the currency used in the economic environment in which they mainly operate, known as the functional currency. Our functional currency consists of the Norwegian Krone for operations in Norway. Assets and liabilities in foreign subsidiaries are translated into U.S. dollars

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at the exchange rate as of September 30, 2016, while the statement of operations is translated at the average exchange rate for the relevant period. Gains and losses from these translations are recognized in foreign currency translation included in accumulated other comprehensive income in the consolidated statements of equity.

Derivative Liabilities

We account for warrants and other derivative financial instruments as either equity or liabilities based upon the characteristics and provisions of each instrument. During the quarter ended September 30, 2016, our warrants that were issued in conjunction with the acquisition of DFBG Swims (see “Note 4 – Acquisition of SWIMS”) were determined to be equity classification. Warrants classified as equity are recorded at fair value as of the date of issuance on our consolidated balance sheets and no further adjustments to their valuation are made. Management estimates the fair value of these warrants using option pricing models and assumptions that are based on the individual characteristics of the warrants or instruments on the valuation date, as well as assumptions for future financings, expected volatility, expected life, yield, and risk-free interest rate.

NOTE 3 — ADOPTION OF ACCOUNTING PRINCIPLES

In July 2015, FASB issued Accounting Standards Update, (“ASU”) 2015-11, Inventory (Topic 330) - Simplifying the Measurement of Inventory, which will require an entity to measure inventory at the lower of cost or net realizable value. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. We adopted this standard in the first quarter of fiscal 2016 and there was no material impact on our condensed consolidated financial statements and related disclosures.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes, which will require entities to present deferred tax assets (“DTAs”) and deferred tax liabilities (“DTLs”) as noncurrent in a classified balance sheet. ASU 2015-17 simplifies the current guidance, which requires entities to separately present DTAs and DTLs as current and noncurrent in a classified balance sheet. For public entities, the amendments in ASU 2015-17 are effective for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early application is permitted as of the beginning of an interim or annual reporting period. ASU 2015-17 is effective for us beginning January 1, 2017. We adopted this standard in the first quarter of fiscal 2016 and there was no material impact on our condensed consolidated financial statements and related disclosures.

In April and March 2016, the FASB issued ASU 2016-10, Identifying Performance Obligations and Licensing, and ASU 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross versus Net), respectively. ASU 2016-10 clarifies the implementation guidance on licensing and the identification of performance obligations considerations included in ASU 2014-09. ASU 2016-08 provides amendments to clarify the implementation guidance on principal versus agent considerations included in ASU 2014-09. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09. ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The effective date of this pronouncement is for fiscal years beginning after December 15, 2017 with early adoption permitted as of the original effective date. We have not yet adopted this ASU and we are currently evaluating the impact it may have on our condensed consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which affects the accounting for leases. The guidance requires lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by all leases with terms of more than 12 months. The amendment also will require qualitative and quantitative disclosures designed to give financial statement users information on the amount, timing, and uncertainty of cash flows arising from leases. This ASU is effective for fiscal years beginning after December 15, 2018 and interim periods within that reporting period. Early application is permitted. We have not yet adopted this ASU and we are currently evaluating the impact it may have on our condensed consolidated financial statements and related disclosures.

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In March 2016, the FASB issued ASU 2016-09, Compensation—Stock Compensation (Topic 718): Improvements To Employee Share-Based Payment Accounting, which amends ASC Topic 718, relating to employee share-based payment accounting. This guidance simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2016, and interim periods within that reporting period. Early application is permitted. We have not yet adopted this ASU and are currently evaluating the impact it may have on our consolidated financial statements and related disclosures.

In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which changes the presentation of debt issuance costs in financial statements. ASU 2015-03 requires an entity to present such costs on the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs is reported as interest expense. The standard's core principle is debt issuance costs related to a note shall be reported in the balance sheet as a direct deduction from the face amount of that note and that amortization of debt issuance costs also shall be reported as interest expense. We adopted this standard in the first quarter of fiscal 2016 and there was no material impact on our condensed consolidated financial statements and related disclosures.

In May 2016, the FASB issued ASU 2016-12, Revenue from Customers with Contracts (Topic 606) Narrow-Scope Improvements and Practical Expedients. ASU 2016-12 amends certain aspects of ASU 2014-09, "Revenue from Customers with Contracts (Topic 606)." The amendments include the following:

- Collectibility – ASU 2016-12 clarifies the objective of the entity's collectibility assessment and contains new guidance on when an entity would recognize as revenue consideration it receives if the entity concludes that collectibility is not probable.
- Presentation of sales tax and other similar taxes collected from customers – Entities are permitted to present revenue net of sales taxes collected on behalf of governmental authorities (i.e., to exclude from the transaction price sales taxes that meet certain criteria).
- Noncash consideration – An entity's calculation of the transaction price for contracts containing noncash consideration would include the fair value of the noncash consideration to be received as of the contract inception date. Further, subsequent changes in the fair value of noncash consideration after contract inception would be subject to the variable consideration constraint only if the fair value varies for reasons other than its form.
- Contract modifications and completed contracts at transition – The ASU establishes a practical expedient for contract modifications at transition and defines completed contracts as those for which all (or substantially all) revenue was recognized under the applicable revenue guidance before the new revenue standard was initially adopted.
- Transition technical correction – Entities that elect to use the full retrospective transition method to adopt the new revenue standard would no longer be required to disclose the effect of the change in accounting principle on the period of adoption (as is currently required by ASC 250-10-50-1(b)(2)); however, entities would still be required to disclose the effects on preadoption periods that were retrospectively adjusted.

ASU 2016-12 is effective for annual and interim periods beginning on or after December 15, 2017, and early adoption is permitted as of the original effective date of December 31, 2016. We are currently evaluating the impact the adoption of ASU 2016-02 will have on our consolidated financial statements and related disclosures.

In August 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 amends the guidance in ASC 230 on the classification of certain cash receipts and payments in the statement of cash flows. The primary purpose of ASU 2016-15 is to reduce the diversity in practice that has resulted from the lack of consistent principles on this topic. The amendments in ASU 2016-15 add or clarify guidance on eight cash flow issues:

- Debt prepayment or debt extinguishment costs.
- Settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing.
- Contingent consideration payments made after a business combination.

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- Proceeds from the settlement of insurance claims.
- Proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies.
- Distributions received from equity method investees.
- Beneficial interests in securitization transactions.
- Separately identifiable cash flows and application of the predominance principle.

ASU 2016-15 is effective for annual and interim periods beginning after December 15, 2017, and early adoption is permitted for all entities. Entities must apply the guidance retrospectively to all periods presented but may apply it prospectively from the earliest date practicable if retrospective application would be impracticable. We are currently evaluating the impact the adoption of ASU 2016-15 will have on our consolidated financial statements.

NOTE 4 — ACQUISITION OF SWIMS

On July 18, 2016, we completed the acquisition of all of the outstanding share capital of Norwegian private limited company (aksjeselskap) SWIMS AS (“SWIMS”). SWIMS® is a Scandinavian lifestyle brand known for its range of fashion-forward, water-resistant footwear and sportswear. We purchased SWIMS for aggregate consideration of (i) approximately $12.0 million in cash, (ii) 702,943 shares of our common stock and (iii) warrants to purchase an aggregate of 150,000 shares of our common stock with an exercise price of $5.47 per share (the “SWIMS Seller Warrants”). The acquisition was completed pursuant to the Purchase Agreement, dated as of July 18, 2016 (the “SWIMS Purchase Agreement”), between us, our wholly-owned subsidiary DFBG Swims, the shareholders of SWIMS named therein (the “SWIMS Sellers”), Øystein Alexander Eskeland and Atle Søvik, acting jointly as the representatives of the SWIMS Sellers, and, for certain limited purposes, TCP Denim, LLC, TCP RG, LLC and TCP RG II, LLC. Pursuant to the SWIMS Purchase Agreement, DFBG Swims deposited approximately $325,000 of the cash consideration into an escrow account for certain indemnification obligations of the SWIMS Sellers. The SWIMS Purchase Agreement contains customary representations, warranties and covenants of the SWIMS Sellers and us, along with customary post-closing indemnification rights of DFBG Swims. The acquisition qualified as a business combination and was accounted for under the acquisition method of accounting.

To finance the acquisition, we issued the following to our major stockholder Tengram Capital Partners Fund II, L.P. (“Tengram II”): (i) a warrant for the purchase of 500,000 shares of our common stock at an exercise price of $3.00 per share (the “Tengram Warrant”); and (ii) a convertible promissory note with principal of $13.0 million (the “SWIMS Convertible Note”). The SWIMS Convertible Note accrues interest at a rate of 3.75% per annum, compounding on the first day of each month starting August 1, 2016, and will convert, at Tengram II’s option or on the maturity date of January 18, 2017 if not already repaid in cash on or prior to that date, into up to 4,500,000 newly issued shares of our Class A-1 Preferred Stock at a conversion price of $3.00 per share. We are currently evaluating all of our options in order to assess the repayment of the Tengram Warrant at maturity if it is not converted. Additionally, the Class A-1 Preferred Stock will itself be convertible into shares of our common stock at an initial price of $3.00 per share (subject to adjustment), will be entitled to dividends at a rate of 10% per annum payable quarterly in arrears, will be senior to the common stock upon liquidation and will have voting rights on an as-converted basis alongside our common stock. To permit the acquisition, on July 18, 2016, we also entered into (i) a Consent and Amendment No. 1 to our ABL Credit Agreement and accompanying security agreement with Wells Fargo Bank, National Association, as lender, and

(ii) a Consent and Amendment No. 1 to our Term Credit Agreement and accompanying security agreement with TCW Asset Management Company, as agent for the lenders and the lenders party thereto. The Tengram Warrant has an estimated fair value of $465,000, which has been recorded as a debt discount against the proceeds of the SWIMS Convertible Note. Management estimated the fair value of the equity consideration issued with the assistance of a third-party appraisal firm. The estimation of fair value considered key assumptions for discount for lack of marketability and for inputs used in an option pricing model to value warrants.

Business acquisitions are accounted for under the acquisition method by assigning the purchase price to tangible and intangible assets acquired and liabilities assumed. Assets acquired and liabilities assumed are recorded at their fair values and the excess of the purchase price over the amounts assigned is recorded as goodwill. Purchased intangible assets with finite lives are amortized over their estimated useful lives. Goodwill and intangible assets with indefinite lives are not amortized but are tested at least annually for impairment or whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

The purchase price included the issuance of 702,943 shares of common stock that contain restrictions on resale with an estimated fair value of approximately $1,750,000 and the issuance of 150,000 warrants with an estimated fair value of $45,000. Management estimated the fair value of the equity consideration issued with the assistance of a third-party appraisal firm. The estimation of fair value considered key assumptions for discount for lack of marketability and for inputs used in an option pricing model to value warrants. Included in the $13,812,000 is an amount of approximately $325,000 that is being held in escrow to support indemnification obligations. The allocation of the purchase price is in the table below, which is subject to adjustment based upon the completion of purchase price allocations. The following is the total preliminary estimated purchase price allocation based on information available as of September 30, 2016 (in thousands, except share and per share data):

Assets acquired and liabilities assumed:	
Cash and cash equivalents	$ 189
Factored accounts receivable	1,552
Inventories	3,466
Prepaid expenses and other assets	647
Property and equipment	498
Accounts payable and accrued expenses	(1,706)
Deferred income tax liability	(1,995)
Intangible assets acquired:	
Trade name	5,062
Customer relationships	1,964
Non-compete agreements	142
Total	9,819
Excess purchase price over net assets acquired	3,993
Total net assets acquired	$ 13,812
Total purchase price:	
Cash paid to sellers	$ 12,017
Equity consideration issued to sellers (702,943 common shares at $2.49)	1,750
Fair value of warrants issued to sellers	45
Total Purchase Price	$ 13,812

The preliminary purchase price was allocated to the tangible and intangible assets acquired and liabilities assumed based on their preliminary estimated fair values as of the acquisition date. The preliminary fair values of assets acquired and liabilities assumed represent management’s estimate of fair value based on information obtained from various sources, including management’s historical experience and are subject to change if additional information becomes available. We expect to finalize the purchase price allocation as soon as practicable within the measurement period, but no later than one year following the acquisition date. More specifically, the purchase price allocation items to be finalized include the allocation of the fair value of the assets acquired.

The preliminary estimated fair value of the acquired tangible and intangible assets and liabilities assumed were determined using multiple valuation approaches depending on the type of tangible or intangible asset acquired, including but not limited to the income approach, the excess earnings method, the with versus without method, net realizable value method and the relief from royalty method approach.

The preliminary amount of goodwill represents the excess of the preliminary purchase price over the preliminary net identifiable assets acquired and liabilities assumed. Goodwill primarily represents, among other factors,

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the value of synergies expected to be realized by integration with our Company and expected positive cash flow and return on capital projections from the integration. Goodwill arising from the acquisition of SWIMS was determined as the excess of the preliminary purchase price over the preliminary net acquisition date fair values of the acquired assets and the liabilities assumed, and is not deductible for income tax purposes subject to certain tax elections that are currently being considered.

We incurred $877,000 and $1,261,000, respectively, in acquisition-related transaction costs, which are included in selling, general, and administrative expense on our condensed consolidated statements of operations and comprehensive (loss) income for the three and nine month periods ended September 30, 2016, respectively.

Total net sales and operating loss from SWIMS since the date of the acquisition included in the accompanying unaudited condensed consolidated financial statements is $3,539,000 and $1,045,000, respectively.

Pro forma financial information

The following table presents our unaudited pro forma results (in thousands, except per share data) for the three and nine months ended September 30, 2016 and 2015, respectively, as if the RG Merger and SWIMS acquisition had occurred on January 1, 2015.

The pro forma financial information presented includes the effects of adjustments related to the amortization of acquired tangible and intangible assets, and excludes other non-recurring transaction costs directly associated with the acquisition such as legal and other professional service fees. Statutory rates were used to calculate income taxes.

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net sales	$ 41,317	$ 38,958	$ 117,509	$ 116,335
Net loss	$ (1,977)	$ (2,345)	$ (4,451)	$ (5,485)
Weighted average common shares outstanding	13,083	13,083	13,083	13,083
Loss per common share - basic and diluted	$ (0.15)	$ (0.18)	$ (0.34)	$ (0.42)

The pro forma financial information as presented above is for information purposes only and is not necessarily indicative of the actual results that would have been achieved had the RG Merger and SWIMS acquisition occurred at the beginning of the earliest period presented or the results that may be achieved in future period.

NOTE 5 — RG MERGER AND RELATED TRANSACTIONS

Effective upon consummation of the RG Merger, we changed our name to “Differential Brands Group Inc.” and effected the Reverse Stock Split. The Reverse Stock Split did not change the par value or the amount of authorized shares of our common stock. In connection with the RG Merger, on January 28, 2016, we completed the issuance and sale of an aggregate of fifty thousand (50,000) shares of our preferred stock designated as Series A Convertible Preferred Stock (the “Series A Preferred Stock”), for an aggregate purchase price of $50 million in cash, as contemplated by the stock purchase agreement, dated as of September 8, 2015 (the “RG Stock Purchase Agreement”), by and between us and TCP Denim, LLC.

We used the proceeds from the RG Stock Purchase Agreement and the debt financing provided by the credit facilities under the ABL Credit and Term Credit Agreement (see “Note 16 – Debt and Preferred Stock”) to consummate the RG Merger and the transactions contemplated by the RG Merger Agreement.

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Also in connection with the completion of the RG Merger, on January 28, 2016, we completed the exchange of $38.1 million in the aggregate principal amount of outstanding convertible notes for (i) 1,167,317 shares of common stock (after giving effect to the Reverse Stock Split); (ii) a cash payment of approximately $8.6 million; and (iii) an aggregate principal amount of approximately $16.5 million of modified convertible notes (the “Modified Convertible Notes”), as contemplated by the rollover agreement, dated September 8, 2015 (the “Rollover Agreement”), between us and the holders of the convertible notes.

After the sale of our Joe’s® brand in September 2015, we retained and operated 32 Joe’s® brand retail stores. Pursuant to the terms of a separate agreement, we transferred 18 Joe’s® brand retail stores to the purchaser of the operating assets of our Joe’s® brand on January 28, 2016 for no additional consideration and closed the remaining 14 Joe’s® brand retail stores as of February 29, 2016. The results of operations from the Joe’s® brand have been reported as discontinued operations in the accompanying unaudited condensed consolidated financial statements.

In addition, in connection with the consummation of the RG Merger, we entered into (i) the ABL Credit Agreement with Wells Fargo Bank, National Association, as lender, (ii) the Term Credit Agreement with TCW Asset Management Company, and (iii) the A&R Factoring Agreement (as defined below) with CIT. See “Note 16 – Debt and Preferred Stock” for additional information about the ABL Credit Agreement and Term Credit Agreement and “Note 7 – Factored and Accounts Receivables, Net” for additional information about the factoring agreement.

NOTE 6 — RG MERGER CONSIDERATION

We closed the RG Merger on January 28, 2016. The RG Merger has been accounted for under the acquisition method of accounting with RG as the accounting acquirer. Under the acquisition method of accounting, the purchase price and the net assets acquired and liabilities assumed are recorded based on their estimated fair values as of the closing date of the RG Merger. The excess of purchase price over the net assets acquired is recorded as goodwill. The valuations of intangible assets, property and equipment, fair value of leases, income taxes and certain other items are preliminary. Management expects to finalize the purchase price allocations during fiscal 2016. More specifically, the purchase price allocation items to be finalized include the allocation of the fair value of the assets acquired.

Business acquisitions are accounted for under the acquisition method by assigning the purchase price to tangible and intangible assets acquired and liabilities assumed. Assets acquired and liabilities assumed are recorded at their fair values and the excess of the purchase price over the amounts assigned is recorded as goodwill. Purchased intangible assets with finite lives are amortized over their estimated useful lives. Goodwill and intangible assets with indefinite lives are not amortized but are tested at least annually for impairment or whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

The stock price used to determine the preliminary estimated purchase price allocation is based on the closing price of our common stock as of January 28, 2016, which was $5.70. The equity consideration was based upon the assumption that 3,509,000 shares of common stock were outstanding, which included 2,342,000 shares of common stock outstanding and 1,167,000 total aggregate shares of common stock issued to convertible noteholders upon conversion of the convertible notes into shares of our common stock under the Rollover Agreement. As a result of the Rollover Agreement, immediately after giving effect to the RG Merger and related transactions, the holders of the Modified Convertible Notes owned approximately 14% of the combined company on an as-converted, fully diluted basis.

The assets acquired in this acquisition consisted of tangible and intangible assets and liabilities assumed. The differences between the fair value of the consideration paid and the estimated fair value of the assets and liabilities has been preliminarily recorded as goodwill. The significant factors that resulted in recognition of goodwill were: (a) the purchase price was based upon cash flow and return on capital projections assuming integrations of the companies; and (b) the calculation of the fair value of tangible and intangible assets acquired that qualified for recognition. We have determined on a preliminary basis that the useful life of the acquired trade name asset is indefinite, and therefore, no amortization expense will need to be recognized unless the useful life is determined not to be indefinite. The useful life of the acquired customer relationships are finite and will be amortized over their useful lives. However, we intend to test the assets for impairment if events or changes in circumstances indicate that the assets might be impaired. Additionally, a

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deferred tax liability has been established in the allocation of the purchase price with respect to the identified indefinite long-lived intangible assets acquired.

Under the acquisition method of accounting, the total purchase price is allocated to the preliminary assets acquired and liabilities assumed based on their estimated fair values. We may continue to adjust the preliminary estimated purchase price allocation after obtaining more information regarding asset valuations, liabilities assumed, and revision of preliminary estimates. The following is the total preliminary estimated purchase price allocation based on information available as of September 30, 2016 (in thousands, except share and per share data):

Assets acquired and liabilities assumed:	
Cash and cash equivalents	$ 2,092
Factored accounts receivable	6,719
Accounts receivable	336
Inventories	11,378
Prepaid expenses and other current assets	754
Property and equipment	356
Other assets	352
Accounts payable and accrued expenses	(15,417)
Customer cash advances	(893)
Line of credit	(4,683)
Deferred income tax liability	(9,453)
Other liabilities	(81)
Buy-out payable	(1,668)
Intangible assets acquired:	
Trade name	32,300
Customer relationships	14,100
Total	36,192
Excess purchase price over net assets acquired	4,238
Total net assets acquired	$ 40,430

Total purchase price:	
Cash paid to existing holders of convertible notes	$ 8,630
Fair value of Modified Convertible Notes transferred to the existing holders of convertible notes	11,800
Equity consideration to the Company's stockholders and existing holders of convertible notes (3,508,747 common shares at $5.70)	20,000
Total Purchase Price	$ 40,430

The preliminary estimated fair value of the Modified Convertible Notes was determined by a third-party valuation specialist. The face value of the Modified Convertible Notes in the amount of $16,473,000 was discounted by $4,673,000 to arrive at the fair value of the Modified Convertible Notes. The discount was calculated based on the present values of the contractual cash flows from the Modified Convertible Notes.

In addition, we incurred $38,000 and $3,674,000 of non-recurring expenses related to the RG Merger in the three and nine months ended September 30, 2016, respectively, which are included in selling, general and administrative expense on our condensed consolidated statements of operations and comprehensive (loss) income.

Total net sales and operating income from Hudson since the date of the RG Merger included in the accompanying unaudited condensed consolidated financial statements is $54,144,000 and $6,096,000, respectively.

See “Note 4 – Acquisition of SWIMS” for a presentation of our unaudited pro forma results for the three and nine months ended September 30, 2016 and 2015, respectively, as if the RG Merger and SWIMS acquisition had

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occurred on January 1, 2015. These results are not intended to reflect our actual operations had the acquisition occurred on January 1, 2015.

NOTE 7 — FACTORED AND ACCOUNTS RECEIVABLES, NET

A&R Factoring Agreement

In January 2016, in connection with the RG Merger, we entered into the amended and restated deferred purchase factoring agreement with CIT, through our subsidiaries, Robert Graham Designs LLC and Hudson (the "A&R Factoring Agreement"), which replaced all prior agreements relating to factoring and inventory security. The A&R Factoring Agreement provides that we sell and assign to CIT certain of our accounts receivable, including accounts arising from or related to sales of inventory and the rendition of services. Under the A&R Factoring Agreement, we pay a factoring rate of (i) 0.20 percent for certain major department store accounts, (ii) 0.40 percent for all other accounts for which CIT bears the credit risk, subject to discretionary surcharges and (iii) 0.35 percent for accounts for which we bear the credit risk, but in no event less than $3.50 per invoice. The A&R Factoring Agreement may be terminated by CIT upon 60 days' written notice or immediately upon the occurrence of an event of default as defined in the agreement. The A&R Factoring Agreement may be terminated by us upon 60 days' written notice prior to December 31, 2020 or annually with 60 days' written notice prior to December 31 of each year thereafter.

Prior to the RG Merger, we were also party to a deferred purchase factoring arrangement with CIT, which was terminated in connection with the RG Merger. See "Note 16 – Debt and Preferred Stock" below for further discussion of this and other RG debt arrangements prior to the RG Merger.

Factored and accounts receivables consist of the following (in thousands):

	September 30, 2016	December 31, 2015
Non-recourse receivables assigned to factor	$ 20,355	$ 5,456
Client recourse receivables	3,009	637

Total receivables assigned to factor		23,364		6,093
Allowance for customer credits		(4,508)		(1,176)
Factor accounts receivable, net	$	18,856	$	4,917
Non-factored accounts receivable	$	4,299	$	2,392
Allowance for customer credits		(720)		(484)
Allowance for doubtful accounts		(642)		(72)
Accounts receivable, net of allowance	$	2,937	$	1,836
Total factored and accounts receivable, net	$	21,793	$	6,753

Of the total amount of receivables sold by us as of September 30, 2016 and December 31, 2015, we hold the risk of payment of $3,009,000 and $637,000, respectively, in the event of non-payment by the customers.

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NOTE 8 — INVENTORIES

Inventories are valued at the lower of cost or net realizable value with cost determined by the first-in, first-out method. Inventories consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Finished goods	$ 28,069	$ 14,979
Finished goods consigned to others	1,266	69
Work in progress	198	—
Raw materials	316	305
Inventories	$ 29,849	$ 15,353

NOTE 9 — LONG-LIVED AND INTANGIBLE ASSETS AND GOODWILL

Valuation of Long-lived and Intangible Assets and Goodwill

We assess the impairment of indefinite-lived intangible assets and goodwill annually. We assess the impairment of finite-lived assets and intangible assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important that could trigger an impairment review other than on an annual basis include, among others, the following:

- A significant underperformance relative to expected historical or projected future operating results;
- A significant change in the manner of the use of the acquired asset or the strategy for the overall business; or
- A significant negative industry or economic trend.

When we determine that the carrying value of finite-lived assets may not be recoverable based upon the existence of one or more of the aforementioned factors and the carrying value exceeds the estimated undiscounted cash flows expected to be generated by the asset, impairment is measured based on a projected discounted cash flow method using a discount rate determined by management. An asset is considered to be impaired if we determine that the carrying value may not be recoverable based upon our assessment of the asset's ability to generate positive cash flow in future periods or if significant changes our strategic business objectives and utilization of the assets occurred. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the estimated fair value, which is determined based on discounted future cash flows. The impairment loss calculations require management to apply judgment in estimating future cash flows and the discount rates that reflect the risk inherent in future cash flows. Future expected cash flows for store assets are based on management's estimates of future cash flows over the remaining lease period or expected life, if shorter. We consider historical trends, expected future business trends and other factors when estimating each store's future cash flow. We also consider factors such as: the local environment for each store location, including mall traffic and competition; our ability to successfully implement strategic initiatives; and the ability to control variable costs such as cost of sales and payroll, and in some cases, renegotiate lease costs.

During the nine months ended September 30, 2016, we recorded a store impairment charge of $279,000 related to one of our RG retail stores which was closed prior to the lease end date. We did not record any retail store impairment charges in the three months ended September 30, 2016.

We evaluate goodwill for impairment at least annually or whenever events or changes in circumstances indicate that the carrying value may not be recoverable using a two-step process. Under the first of two steps, we compare the fair value of a reporting unit to its carrying amount, including goodwill, to identify a potential impairment. If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for such reporting unit and

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the enterprise must perform step two of the impairment test to measure the impairment, if any. Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation: the fair value of the reporting unit is allocated to all assets and liabilities of that unit (including any unrecognized intangible assets) and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

We review our other indefinite-lived intangible assets for impairment on an annual basis, or when circumstances indicate their carrying value may not be recoverable. We calculate the value of the indefinite-lived intangible assets using a discounted cash flow method, based on the relief from royalty method.

Our annual impairment testing date is December 31 of each year.

Intangible assets as of September 30, 2016 consisted of the following (in thousands):

	Amortization Period	Gross Amount	Accumulated Amortization	Net Amount
Trade names	Indefinite	$ 63,667	$ —	$ 63,667
Customer relationships	7 to 15 Years	35,968	8,017	27,951
Non-compete agreements	3 Years	150	10	140
Total		$ 99,785	$ 8,027	$ 91,758

Intangible assets as of December 31, 2015 consisted of the following (in thousands):

	Amortization Period	Gross Amount	Accumulated Amortization	Net Amount