

K2 INC  
Form 10-Q  
November 08, 2006

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**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, 2006

Commission File No. 1-4290

**K2 INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State of Incorporation)

**95-2077125**  
(I.R.S. Employer Identification No.)

**5818 El Camino Real Carlsbad, California**  
(Address of principal executive offices)

**92008**  
(Zip Code)

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

Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report:

Not applicable

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (check one).

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

At November 6, 2006 there were 49,330,541 shares of Common Stock (\$1.00 par value) outstanding.

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## PART - 1 FINANCIAL INFORMATION

**ITEM 1 FINANCIAL STATEMENTS**  
**CONSOLIDATED CONDENSED STATEMENTS OF INCOME (Unaudited)**

(Thousands, except per share figures)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net sales	\$ 356,884	\$ 340,352	\$ 1,006,097	\$ 960,068
Cost of products sold	219,174	215,225	653,267	632,364
Gross profit	137,710	125,127	352,830	327,704
Selling expenses	61,649	57,305	181,207	170,522
General and administrative expenses	37,371	35,809	111,147	106,812
Operating income	38,690	32,013	60,476	50,370
Interest expense	7,263	7,519	21,832	22,057
Other income, net	(1,127)	(583)	(2,662)	(2,421)
Income before income taxes	32,554	25,077	41,306	30,734
Provision for income taxes	11,036	8,337	14,003	10,217
Net income	\$ 21,518	\$ 16,740	\$ 27,303	\$ 20,517
Basic earnings per share:				
Net income	\$ 0.46	\$ 0.36	\$ 0.58	\$ 0.44
Diluted earnings per share:				
Net income	\$ 0.40	\$ 0.32	\$ 0.54	\$ 0.42
Basic shares outstanding	47,084	46,326	46,971	46,240
Diluted shares outstanding	55,412	55,190	55,388	55,224

See notes to consolidated condensed financial statements

**CONSOLIDATED CONDENSED BALANCE SHEETS**

	September 30, 2006 (unaudited) (Thousands, except share data)	December 31, 2005
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 11,314	\$ 11,797
Accounts receivable, less allowances for doubtful accounts of \$20,125 (2006) and \$15,922 (2005)	363,247	380,442
Inventories, net	393,508	359,028
Deferred income taxes	4,204	5,044
Prepaid expenses and other current assets	28,455	21,905
Total current assets	800,728	778,216
Property, plant and equipment	311,759	295,202
Less allowance for depreciation and amortization	171,028	151,147
	140,731	144,055
<b>Other Assets</b>		
Goodwill	109,448	107,027
Tradenames	116,901	117,001
Other intangible assets, net	17,353	19,988
Other	23,499	24,289
Total Assets	\$ 1,208,660	\$ 1,190,576
<b>Liabilities and Shareholders Equity</b>		
<b>Current Liabilities</b>		
Bank loans	\$ 39,019	\$ 24,296
Accounts payable	77,515	93,470
Income taxes payable	40,167	31,946
Accrued payroll and related	46,946	40,555
Other accruals	89,344	85,256
Current portion of long-term debt	3,131	33,265
Total current liabilities	296,122	308,788
Long-term pension liabilities	26,758	26,758
Long-term debt	272,693	280,717
Deferred income taxes	21,286	21,286
Convertible debentures	99,354	99,003
<b>Shareholders Equity</b>		
Preferred Stock, \$1 par value, authorized 12,500,000 shares, none issued		
Common Stock, \$1 par value, authorized 110,000,000 shares in 2006 and 2005, issued shares - 47,904,860 in 2006 and 47,663,227 in 2005	47,905	47,663
Additional paid-in capital	506,463	503,624
Retained deficit	(37,700)	(65,003)
Treasury shares at cost, 763,140 shares in 2006 and 2005	(9,360)	(9,360)
Accumulated other comprehensive loss	(14,861)	(22,900)
Total Shareholders Equity	492,447	454,024
Total Liabilities and Shareholders Equity	\$ 1,208,660	\$ 1,190,576

See notes to consolidated condensed financial statements



**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)**

	<b>Nine Months Ended September 30, 2006                      2005 (Thousands)</b>	
<b>Operating Activities</b>		
Net Income	\$ 27,303	\$ 20,517
Adjustments to reconcile net income to net cash provided by operating activities:		
(Gain) / loss on sale of assets	(3,259)	100
Depreciation and amortization	26,943	26,900
Non-cash share-based compensation charges	1,772	618
Deferred taxes	790	8,731
Changes in current assets and current liabilities	(14,759)	(51,005)
<b>Net cash provided by operating activities</b>	<b>38,790</b>	<b>5,861</b>
<b>Investing Activities</b>		
Property, plant and equipment expenditures	(19,571)	(29,086)
Proceeds from sale of property, plant and equipment	7,209	4,769
Purchase of businesses, net of cash acquired	(3,083)	(17,184)
Other items, net	(2,306)	5,536
<b>Net cash used in investing activities</b>	<b>(17,751)</b>	<b>(35,965)</b>
<b>Financing Activities</b>		
Borrowings under long-term debt	785,872	783,500
Payments of long-term debt	(823,679)	(760,191)
Net increase / (decrease) in short-term bank loans	14,723	(1,316)
Exercise of stock options	1,308	475
<b>Net cash (used in)/ provided by financing activities</b>	<b>(21,776)</b>	<b>22,468</b>
Effects of foreign exchange rates on cash and cash equivalents	254	(539)
<b>Net decrease in cash and cash equivalents</b>	<b>(483)</b>	<b>(8,175)</b>
Cash and cash equivalents at beginning of year	11,797	25,633
<b>Cash and cash equivalents at end of period</b>	<b>\$ 11,314</b>	<b>\$ 17,458</b>

See notes to consolidated condensed financial statements

**K2 INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

**September 30, 2006**

**NOTE 1 - Basis of Presentation**

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine month period ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

The consolidated condensed balance sheet at December 31, 2005 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

K2 Inc. ( K2 or the Company ) reports its financial statements using a 52/53 week year with a 13 week quarter ending on the closest Sunday to the end of March, June, September and December. Fiscal year 2006 includes 53 weeks versus 52 weeks in 2005 fiscal year, and the first quarter 2006 includes 14 weeks versus 13 weeks in the first quarter 2005. For purposes of the consolidated financial statements, the end of each quarter is stated as of March 31, June 30, September 30 and December 31, respectively.

The interim financial statements should be read in connection with the financial statements in K2 Inc. 's Annual Report on Form 10-K for the year ended December 31, 2005.

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

**NOTE 2 Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* ( SFAS No. 158 ). SFAS No. 158 requires employers to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position, recognize changes in that funded status in the year in which the changes occur through comprehensive income and measure a plan 's assets and its obligations that determine its funded status as of the end of the employer 's fiscal year. The provisions of SFAS No. 158 are effective for fiscal years ending after December 15, 2006. We are currently assessing the impact the adoption of SFAS No. 158 will have on our consolidated December 31, 2006 financial statements and related footnote disclosures. Based on our preliminary assessment, we do not expect SFAS No. 158 to have a material impact on the December 31, 2006 financial statements.

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K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

September 30, 2006

**NOTE 2 Recent Accounting Pronouncements (Continued)**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ( GAAP ), and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurement where the FASB has previously determined that under those pronouncements fair value is the appropriate measurement. This statement does not require any new fair value measurements but may require companies to change current practice. This statement is effective for those fiscal years beginning after November 15, 2007 and to the interim periods within those fiscal years. We are currently evaluating the impact of the adoption of SFAS No. 157 on purchase price allocations in future business combinations and other areas where fair value measurements are used.

In June 2006, the FASB issued Interpretation ( FIN ) No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. K2 is currently evaluating the impact of this Interpretation on its financial position and results of operations.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Hybrid Financial Instruments* ( SFAS No. 155 ). SFAS No. 155 amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities-a replacement of FASB Statement No. 125* . SFAS No. 155 permits the fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation and clarifies that both interest-only and principal-only strips are not subject to the provision of SFAS No. 133. Further, SFAS No. 155 establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding versus those that are embedded derivatives. Other provisions relate to matters of concentration of credit risk and application of certain provisions to special purpose entities. The effective date for the provisions of SFAS No. 155 is for those instruments acquired or issued after the beginning of our fiscal year 2007. K2 believes that SFAS No. 155 should not have a material impact on its financial position or results of operations.

**NOTE 3 Share-Based Compensation**

Under K2 s 2006, 2005, 2004, 1999 and 1994 Long-Term Incentive Plans ( 2006 Plan, 2005 Plan, 2004 Plan, 1999 Plan and 1994 Plan, respectively), stock options may be granted to eligible directors and key employees of K2 and its subsidiaries at not less than 100% of the market

## K2 INC.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

September 30, 2006

## NOTE 3 Share-Based Compensation (Continued)

value of the shares on the dates of grant. As defined in the 2006 Plan, 2005 Plan and 2004 Plan (collectively, the Plans), share-based awards include awards of shares of stock that are subject to certain restrictions ( Restricted Stock ) and a fixed or variable right to acquire stock, which may or may not be subject to restriction ( Restricted Stock Units ). These Plans also provide for the issuance of Restricted Stock, Restricted Stock Units and other share-based awards that are subject to performance objectives ( Performance Award ). The 2006, 2005, 2004, 1999 and 1994 Plans permit the granting of options for terms not to exceed ten years from date of grant. The options are exercisable on such terms as may be established at the dates of grant and generally vest over three years. Pursuant to the 1994 Plan document, no additional awards may be granted under the 1994 Plan after December 31, 2004.

*Stock Option Activity*

Options granted, exercised, expired and forfeited under the 2006 Plan, 2005 Plan, 2004 Plan, 1999 Plan and 1994 Plan and options assumed from acquisitions for the first nine months of fiscal year 2006 are as follows:

	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at December 31, 2005	4,237,332	\$ 11.60	6.76	
Granted	5,000	10.08		
Exercised	(49,820)	7.99		
Expired	(39,046)	14.92		
Options outstanding at March 31, 2006	4,153,466	\$ 11.61	6.57	
Granted	647,000	11.15		
Exercised	(90,355)	7.60		
Forfeited	(1,500)	11.15		
Expired	(176,496)	14.80		
Options outstanding at June 30, 2006	4,532,115	\$ 11.50	6.93	
Granted	5,400	11.65		
Exercised	(28,518)	7.83		
Forfeited	(5,000)	11.15		
Expired	(129,579)	\$ 12.67		
Options outstanding at September 30, 2006	4,374,418	\$ 11.49	6.70	\$ 6,359,406
Options vested and expected to vest at September 30, 2006	4,354,075	\$ 11.49	0.26	\$ 6,347,462
Options exercisable at September 30, 2006	3,717,918	\$ 11.55	6.19	\$ 5,973,366



**K2 INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

**September 30, 2006**

**NOTE 3 Share-Based Compensation (Continued)**

The weighted-average grant-date fair value of options granted during the three months ended September 30, 2006 was \$5.18. There were no options granted during the three months ended Septem