

K2 INC
Form 10-Q
August 08, 2006

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 June 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 August 3, 2006 there were 47,099,720 shares of Common Stock (\$1.00 par value) outstanding.

PART - 1 FINANCIAL INFORMATION
ITEM 1 FINANCIAL STATEMENTS
CONSOLIDATED CONDENSED STATEMENTS OF INCOME (Unaudited)

(Thousands, except per share figures)

	Three Months		Six Months	
	Ended June 30, 2006	2005	Ended June 30, 2006	2005
Net sales	\$ 301,142	\$ 301,425	\$ 649,213	\$ 619,716
Cost of products sold	198,577	201,667	434,093	417,139
Gross profit	102,565	99,758	215,120	202,577
Selling expenses	57,683	54,502	119,558	113,217
General and administrative expenses	35,703	36,910	73,776	71,003
Operating income	9,179	8,346	21,786	18,357
Interest expense	6,736	7,285	14,569	14,538
Other income, net	(783)	(1,117)	(1,535)	(1,838)
Income before income taxes	3,226	2,178	8,752	5,657
Provision for income taxes	1,083	725	2,967	1,880
Net income	\$ 2,143	\$ 1,453	\$ 5,785	\$ 3,777
Basic earnings per share:				
Net income	\$ 0.05	\$ 0.03	\$ 0.12	\$ 0.08
Diluted earnings per share:				
Net income	\$ 0.05	\$ 0.03	\$ 0.12	\$ 0.08
Basic shares outstanding	47,016	46,216	46,916	46,196
Diluted shares outstanding	47,604	47,373	47,555	47,430

See notes to consolidated condensed financial statements

CONSOLIDATED CONDENSED BALANCE SHEETS

	June 30, 2006 (unaudited) (Thousands, except share data)	December 31, 2005
Assets		
Current Assets		
Cash and cash equivalents	\$ 11,652	\$ 11,797
Accounts receivable, less allowances for doubtful accounts of \$17,929 (2006) and \$15,922 (2005)	276,776	380,442
Inventories, net	383,264	359,028
Deferred income taxes	2,258	5,044
Prepaid expenses and other current assets	25,516	21,905
Total current assets	699,466	778,216
Property, plant and equipment	305,721	295,202
Less allowance for depreciation and amortization	164,782	151,147
	140,939	144,055
Other Assets		
Goodwill	109,557	107,027
Tradenames	117,001	117,001
Other intangible assets, net	18,282	19,988
Other	23,696	24,289
Total Assets	\$ 1,108,941	\$ 1,190,576
Liabilities and Shareholders Equity		
Current Liabilities		
Bank loans	\$ 22,770	\$ 24,296
Accounts payable	72,459	93,470
Income taxes payable	27,787	31,946
Accrued payroll and related	39,434	40,555
Other accruals	82,310	85,256
Current portion of long-term debt	2,933	33,265
Total current liabilities	247,693	308,788
Long-term pension liabilities	26,758	26,758
Long-term debt	242,027	280,717
Deferred income taxes	21,286	21,286
Convertible debentures	99,237	99,003
Shareholders Equity		
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 - 47,834,342 in 2006 and 47,663,227 in 2005	47,834	47,663
Additional paid-in capital	505,527	503,624
Retained deficit	(59,218)	(65,003)
Treasury shares at cost, 763,140 shares in 2006 and 2005	(9,360)	(9,360)
Accumulated other comprehensive loss	(12,843)	(22,900)
Total Shareholders Equity	471,940	454,024
Total Liabilities and Shareholders Equity	\$ 1,108,941	\$ 1,190,576

See notes to consolidated condensed financial statements

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

	Six Months	
	Ended June 30,	
	2006	2005
	(Thousands)	
Operating Activities		
Net Income	\$ 5,785	\$ 3,777
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of operating facility	(1,504)	
Depreciation and amortization	17,791	17,278
Non-cash share-based compensation charges	989	360
Deferred taxes	2,736	1,415
Changes in current assets and current liabilities	54,362	18,652
Net cash provided by operating activities	80,159	41,482
Investing Activities		
Property, plant and equipment expenditures	(11,680)	(17,308)
Proceeds from sale of property, plant and equipment	5,386	872
Purchase of businesses, net of cash acquired	(2,813)	(15,094)
Other items, net	(2,391)	3,098
Net cash used in investing activities	(11,498)	(28,432)
Financing Activities		
Borrowings under long-term debt	530,052	548,000
Payments of long-term debt	(598,840)	(540,525)
Net decrease in short-term bank loans	(1,526)	(24,473)
Exercise of stock options	1,085	397
Net cash used in financing activities	(69,229)	(16,601)
Effects of foreign exchange rates on cash and cash equivalents	423	(632)
Net decrease in cash and cash equivalents	(145)	(4,183)
Cash and cash equivalents at beginning of year	11,797	25,633
Cash and cash equivalents at end of period	\$ 11,652	\$ 21,450

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

June 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 six month period ended June 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) 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 June 2006, the Financial Accounting Standards Board (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 assessing the impact of this Interpretation on its financial position and results of operations.

In February 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 155, *Accounting for Hybrid Financial Instruments*. 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

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2006

NOTE 2 Recent Accounting Pronouncements (Continued)

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 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.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2006

NOTE 3 Share-Based Compensation (Continued)

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 six 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	\$ 5,056,584
Options vested and expected to vest at June 30, 2006	4,508,782	\$ 11.50	0.29	\$ 5,056,382
Options exercisable at June 30, 2006	3,870,615	\$ 11.56	6.42	\$ 5,049,934

The weighted-average grant-date fair value of options granted during the three months ended June 30, 2006 and 2005 was \$5.17 and \$6.70, respectively. The weighted-average grant-date fair value of options granted during the six months ended June 30, 2006 and 2005 was \$5.17 and \$6.70, respectively. Intrinsic value is defined as the difference between the relevant current market value of the common stock and the grant price for options with exercise prices less than the market values on such dates. The total intrinsic value of options exercised during the three months ended June 30, 2006 and 2005 was approximately \$419,000 and \$173,000, respectively. The total intrinsic value of options exercised during the six months ended June 30, 2006 and 2005 was approximately \$595,000 and \$333,000, respectively. Cash received from stock options exercised during the six months ended June 30, 2006 was \$1.1 million and the actual tax benefit realized from these exercises was zero.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2006

NOTE 3 Share-Based Compensation (Continued)

Options are granted at an exercise price equal to the fair market value at the date of grant. Information regarding stock options outstanding as of June 30, 2006 is as follows:

Price Range	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Shares	Weighted Average Exercise Price
\$2.39 - \$7.13	508,213	\$ 6.47	4.07 years	508,213	\$ 6.47
\$7.25 - \$7.30	53,322	7.28	5.09 years		