

PHOENIX FOOTWEAR GROUP INC

Form 10-Q

August 16, 2005

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**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q**

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended July 2, 2005

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 001-31309

PHOENIX FOOTWEAR GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

15-0327010

(State or Other Jurisdiction of
Incorporation or Organization)

IRS Employer
Identification No.)

5759 Fleet Street, Suite 220, Carlsbad,
California

92008

(Address of Principal Executive Offices)

(Zip Code)

(760) 602-9688

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

CLASS
Common, \$0.01 par value

OUTSTANDING AT JULY 30, 2005
8,366,547

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QUARTERLY REPORT ON FORM 10-Q
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PHOENIX FOOTWEAR GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(unaudited)

	July 2, 2005	January 1, 2005
ASSETS		
CURRENT ASSETS:		
Cash	\$ 670,000	\$ 694,000
Accounts receivable (less allowances of \$1,137,000 in 2005 and \$1,567,000 in 2004)	15,288,000	11,177,000
Inventories-net	32,228,000	28,317,000
Other receivable	38,000	911,000
Other current assets	3,555,000	2,971,000
Deferred income tax asset	255,000	256,000
 Total current assets	 52,034,000	 44,326,000
PLANT AND EQUIPMENT Net	4,054,000	3,530,000
OTHER ASSETS:		
Other assets net	1,178,000	121,000
Goodwill	41,559,000	27,500,000
Unamortizable intangibles	17,975,000	17,975,000
Intangible assets, net	10,209,000	4,728,000
 Total other assets	 70,921,000	 50,324,000
 TOTAL ASSETS	 \$ 127,009,000	 \$ 98,180,000
 LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 8,173,000	\$ 7,568,000
Accrued expenses	3,649,000	3,543,000
Notes payable current	2,200,000	3,656,000
Other current liabilities	1,000,000	400,000
 Total current liabilities	 15,022,000	 15,167,000
OTHER LIABILITIES:		
Notes payable noncurrent	25,800,000	10,451,000
Note payable, line of credit	20,650,000	12,500,000
Other long-term liabilities	3,054,000	1,111,000
Deferred income tax liability	9,263,000	9,265,000
 Total other liabilities	 58,767,000	 33,327,000
 Total liabilities	 73,789,000	 48,494,000
STOCKHOLDERS EQUITY:		
	84,000	78,000

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Common stock, \$.01 par value	50,000,000 shares authorized; 8,367,000		
	and 7,858,000 shares issued in 2005 and 2004, respectively		
Additional paid-in-capital		45,763,000	42,685,000
Retained earnings		8,444,000	8,303,000
		54,291,000	51,066,000
Less: Treasury stock at cost, 378,000 and 504,000 shares in 2005 and 2004, respectively		(1,071,000)	(1,380,000)
Total stockholders' equity		53,220,000	49,686,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		\$127,009,000	\$98,180,000

See notes to consolidated condensed financial statements.

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PHOENIX FOOTWEAR GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended		Six Months Ended	
	July 2, 2005	June 26, 2004	July 2, 2005	June 26, 2004
NET SALES	\$ 15,353,000	\$ 13,876,000	\$ 41,753,000	\$ 32,514,000
COST OF GOODS SOLD	9,481,000	7,587,000	25,323,000	18,079,000
GROSS PROFIT	5,872,000	6,289,000	16,430,000	14,435,000
OPERATING EXPENSES:				
Selling, general and administrative expenses	7,063,000	5,021,000	14,608,000	10,832,000
Other expenses net	2,000	26,000	615,000	60,000
Total operating expenses	7,065,000	5,047,000	15,223,000	10,892,000
OPERATING INCOME (LOSS)	(1,193,000)	1,242,000	1,207,000	3,543,000
INTEREST EXPENSE	533,000	134,000	965,000	304,000
EARNINGS (LOSS) BEFORE INCOME TAXES	(1,726,000)	1,108,000	242,000	3,239,000
INCOME TAX PROVISION (BENEFIT)	(685,000)	465,000	102,000	1,360,000
NET EARNINGS (LOSS)	\$ (1,041,000)	\$ 643,000	\$ 140,000	\$ 1,879,000
NET EARNINGS (LOSS) PER SHARE (Note 5)				
Basic	\$ (.14)	\$.14	\$.02	\$.41
Diluted	\$ (.14)	\$.12	\$.02	\$.36
SHARES OUTSTANDING:				
Basic	7,630,056	4,628,987	7,532,290	4,580,134
Diluted	7,630,056	5,321,659	7,909,540	5,221,499

See notes to consolidated financial statements.

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PHOENIX FOOTWEAR GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended	
	July 2, 2005	June 26, 2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	\$ 140,000	\$ 1,879,000
Adjustments to reconcile net earnings to net cash used by operating activities:		
Depreciation and amortization	846,000	364,000
Allocation of shares in defined contribution plan	467,000	427,000
Changes in assets and liabilities (net of impact of acquisitions):		
(Increase) decrease in:		
Accounts receivable net	1,749,000	(1,167,000)
Inventories net	1,508,000	310,000
Other current receivable	873,000	(165,000)
Prepaid income tax		(783,000)
Other current assets	43,000	(1,067,000)
Other noncurrent assets	(2,694,000)	572,000
Increase (decrease) in:		
Accounts payable	(2,922,000)	535,000
Accrued expenses	(283,000)	(70,000)
Other liabilities	(449,000)	
Income taxes payable		(111,000)
Net cash (used by) provided by operating activities	(722,000)	724,000
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of equipment	(221,000)	(554,000)
Proceeds from disposal of property and equipment	3,000	
Acquisitions, net of cash acquired	(20,335,000)	
Net cash used by investing activities	(20,553,000)	(554,000)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings (payments) on note payable-line of credit	32,674,000	(280,000)
Proceeds from notes payable	28,000,000	
Repayments of notes payable	(38,671,000)	(1,209,000)
Bank overdraft		48,000
Issuance of common stock	327,000	313,000
Debt issuance and other costs	(1,079,000)	
Purchases of treasury stock		(100,000)
Net cash provided by (used by) financing activities	21,251,000	(1,228,000)
NET DECREASE IN CASH	(24,000)	(1,058,000)
CASH Beginning of period	694,000	1,058,000

CASH	End of period	\$	670,000	\$
SUPPLEMENTAL CASH FLOW INFORMATION				
Cash paid during the period for:				
Interest		\$	872,000	\$ 311,000
Income taxes		\$		\$ 2,255,000

See notes to consolidated condensed financial statements.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Unaudited)

Description of Business and Summary of Significant Accounting Policies**1. Basis of Presentation**

The accompanying unaudited consolidated condensed financial statements of Phoenix Footwear Group, Inc. (the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments which are of a normal recurring nature, necessary for fair presentation have been included in the accompanying financial statements. These financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company s Annual Report on Form 10-K/A filed with the Securities and Exchange Commission for the fiscal year ended January 1, 2005 and the Company s Form 8-K filed on July 5, 2005, for the significant acquisition of Chambers Belt Company (See Note 10). Amounts related to disclosures of January 1, 2005 balances within these interim statements were derived from the aforementioned 10-K. The results of operations for the three and six months ended July 2, 2005, or for any other interim period, are not necessarily indicative of the results that may be expected for the full year.

Principles of Consolidation

The consolidated financial statements consist of Phoenix Footwear Group, Inc. and its wholly owned subsidiaries, Penobscot Shoe Company (Penobscot), H.S. Trask & Co (Trask), Royal Robbins, Inc. (Robbins), Altama Delta Corporation (Altama) and Chambers Belt Company (Chambers Belt). Intercompany accounts and transactions have been eliminated in consolidation. The results of Altama s and Chamber s operations have been included in the consolidated financial statements since the date of their respective acquisitions.

Accounting Period

Effective January 1, 2003, the Company changed its year-end to a fiscal year that is the 52- or 53-week period ending the Saturday nearest to December 31st. The second quarters consisted of the 13 weeks ended July 2, 2005 and June 26, 2004.

Reclassifications

Certain reclassifications have been made to the 2004 financial statements to conform to the classifications used in 2005.

Critical Accounting Policies

As of July 2, 2005, the Company s consolidated critical accounting policies and estimates have not changed materially from those set forth in the Annual Report on Form 10-K/A for the year ended January 1, 2005 with the following exception:

On February 24, 2005, the Company authorized an immediate vesting of eligible employee s unvested share options with an exercise price greater than \$6.50 per share. In total, 440,333 options with an average exercise price of \$10.20 immediately vested and have an average remaining contractual life of 8.6 years. The unamortized fair value associated with these accelerated-vest shares in the amount of \$2.5 million amortized immediately. Had the accelerated-vest program not occurred, the related-cost in the fiscal years of 2005, 2006 and 2007 would have included \$1.1 million, \$1.1 million and \$347,000, respectively. In addition to its employee-retention value, the Company s decision to accelerate the vesting of these out-of-the-money options was based upon the accounting of such costs moving from disclosure-only in 2005 to being included in the Company s statement of operations in 2006.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 123R, *Share-Based Compensation*, which supersedes Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. SFAS No. 123R focuses primarily on accounting for transactions in which an entity obtains employee services through share-based payment transactions. SFAS No. 123R requires a public entity to measure the cost of employee services received in exchange for the award of equity investments based on the fair value of the award

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at the date of grant. The cost will be recognized over the period during which an employee is required to provide services in exchange for the award. On April 14, 2005, the Securities and Exchange Commission issued a release announcing the adoption of a new rule delaying the required implementation of SFAS No. 123R. Under this new rule, SFAS No. 123R is effective as of the beginning of the first annual reporting period that begins after June 15, 2005. The impact on net earnings as a result of the adoption of SFAS No. 123R, from a historical perspective, can be found in Note 4 to the Consolidated Financial Statements in this Quarterly Report and in Note 1 to the Consolidated Financial Statements contained in the Company's 2004 Annual Report on Form 10K/A for the year ended January 1, 2005. The Company is currently evaluating the provisions of SFAS No. 123R and will adopt it in the first quarter of 2006, as required.

2. Inventories

The components of inventories are:

	July 2, 2005	January 1, 2005
Raw materials	\$ 3,185,000	\$ 1,861,000
Work in process	1,305,000	807,000
Finished goods	27,738,000	25,649,000
	\$32,228,000	\$28,317,000

3. Goodwill and Intangible Assets

Effective January 1, 2002, the Company adopted SFAS No. 142, Goodwill and Other Intangible Assets. As a result of adopting SFAS No. 142, the Company's goodwill and certain intangible assets are no longer amortized, but are subject to an annual impairment test. Impairment would be examined more frequently if certain indicators are encountered. The Company determined that there was no impairment of goodwill to be recorded during the quarter and six month period ended July 2, 2005. The following sets forth the intangible assets by major asset class:

	Useful Life (Years)	July 2, 2005			January 1, 2005		
		Gross	Accumulated Amortization	Net Book Value	Gross	Accumulated Amortization	Net Book Value
Non-amortizing:							
Trademarks/tradenames and customer relationships		\$17,975,000	\$	\$17,975,000	\$17,975,000	\$	\$17,975,000
Amortizing:							
Customer lists	5-13	6,088,000	454,000	5,634,000	3,222,000	278,000	2,944,000
Other	2-5	5,016,000	441,000	4,575,000	2,021,000	237,000	1,784,000
Total amortizing intangible assets		\$11,104,000	\$895,000	\$10,209,000	\$ 5,243,000	\$515,000	\$ 4,728,000

Intangible assets with definite lives are amortized using the straight-line method over periods ranging from 2 to 13 years. During the three and six month periods ended July 2, 2005 aggregate amortization expense was approximately \$216,000 and \$380,000, respectively. During the three and six month periods ended June 26, 2004 aggregate amortization expense was \$52,000 and \$103,000, respectively. Amortization expense related to intangible assets at July 2, 2005 in each of the next five fiscal years and beyond is expected to be incurred as follows:

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Remainder of 2005	\$ 856,000
2006	1,711,000
2007	1,709,000
2008	1,694,000
2009	1,487,000
Thereafter	2,752,000
	\$10,209,000

Changes in goodwill during the quarter ended July 2, 2005 related primarily to the acquisition of Chambers Belt. The preliminary purchase price allocation of Chambers Belt is subject to refinement based upon management's final conclusions. (See Note 10)

	July 2, 2005	January 1, 2005
Goodwill		
Balance Forward	\$ 27,500,000	\$ 6,680,000
Impaired		
Acquired	14,059,000	20,820,000
Ending Balance	\$ 41,559,000	\$ 27,500,000

4. Stock-Based Compensation

The Company has elected to follow Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, in accounting for its stock-based compensation. Under APB Opinion No. 25, compensation expense is recognized when the market price of the stock underlying an award on the date of grant exceeds any related exercise price. No employee stock-based compensation expense was recorded for the quarters or six month periods ended July 2, 2005 and June 26, 2004. Pro forma information regarding net earnings and earnings per share as required by SFAS No. 123, and SFAS No. 148 are as follows:

	Three Months Ended		Six Months Ended	
	July 2, 2005	June 26, 2004	July 2, 2005	June 26, 2004
Net earnings (loss), as reported	\$(1,041,000)	\$ 643,000	\$ 140,000	\$ 1,879,000
Add/Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(99,000)	(192,000)	(2,709,000)	(383,000)
Pro forma net earnings (loss)	\$(1,140,000)	\$ 451,000	\$(2,569,000)	\$ 1,496,000
Earnings (loss) per common share:				
Basic as reported	\$ (0.14)	\$ 0.14	\$ 0.02	\$ 0.41
Basic pro forma	\$ (0.15)	\$ 0.10	\$ (0.34)	\$ 0.33
Diluted as reported	\$ (0.14)	\$ 0.12	\$ 0.02	\$ 0.36
Diluted pro forma	\$ (0.15)	\$ 0.08	\$ (0.32)	\$ 0.29

The pro forma amounts reflected above may not be representative of future disclosures since the estimated fair value of stock options is amortized to expense as the options vest and additional options may be granted in future years. The weighted average fair value of the stock options granted was \$3.45 and \$7.10 for the quarters ended July 2, 2005 and June 26, 2004, respectively, and was \$3.45 and \$5.63 for the six months ended July 2, 2005 and June 26, 2004, respectively. The fair value of employee stock options was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended		Six Months Ended	
	July 2, 2005	June 26, 2004	July 2, 2005	June 26, 2004
Dividend yield	0%	0%	0%	0%
Expected volatility from stock	44.78%	39.81%	44.78%	39.81%
Risk free interest rates	4.16%	4.73%	4.16%	4.73%
Expected lives	9 years	10 years	9 years	10 years

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in subjective input assumptions can materially affect the fair value estimates, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of grants under the Company's employee stock-based compensation plans.

5. Per Share Data

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Basic net earnings (loss) per share is computed by dividing net earnings (loss) by the weighted average number of common shares outstanding for the period. Diluted net earnings per share is calculated by dividing net earnings (loss) and the effect of assumed conversions by the weighted average number of common and, when applicable, potential common shares outstanding during the period. A reconciliation of the numerators and denominators of basic and diluted earnings (loss) per share is presented below.

	Three Months Ended		Six Months Ended	
	July 2, 2005	June 26, 2004	July 2, 2005	June 26, 2004
Basic net earnings (loss) per share:				
Net earnings (loss)	\$ (1,041,000)	\$ 643,000	\$ 140,000	\$ 1,879,000
Weighted average common shares outstanding	7,630,056	4,628,987	7,532,290	4,580,134
Basic net earnings (loss) per share	\$ (0.14)	\$ 0.14	\$ 0.02	\$ 0.41
Diluted net earnings (loss) per share:				
Net earnings (loss)	\$ (1,041,000)	\$ 643,000	\$ 140,000	\$ 1,879,000
Weighted average common shares outstanding	7,630,056	4,628,987	7,532,290	4,580,134
Effect of stock options outstanding		692,672	377,250	641,365
Weighted average common and potential common shares outstanding	7,630,056	5,321,659	7,909,540	5,221,499
Diluted net earnings (loss) per share	\$ (0.14)	\$ 0.12	\$ 0.02	\$ 0.36

In addition to shares outstanding held by the public, the Company's defined contribution 401(k) savings plan held approximately 359,000 shares as of July 2, 2005, which were issued during 2001 in connection with the termination of the Company's defined benefit pension plan. These shares, while eligible to vote, are classified as treasury stock and therefore are not outstanding.