K2 INC
Form 10-Q
August 09, 2004

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 June 30, 2004

Commission File No. 1-4290

K2 INC.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	**95-2077125**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**
2051 Palomar Airport Road	
Carlsbad, California	**92009**

(Address of Principal Executive Offices)	(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 x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x No ¨

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of July 31, 2004.

Common Stock, par value $1.00	46,651,747 Shares

FORM 10-Q QUARTERLY REPORT

PART - 1 FINANCIAL INFORMATION

Item 1. Financial Statements

STATEMENTS OF CONSOLIDATED CONDENSED INCOME

(Thousands, except per share figures)

	Three months ended June 30		Six months ended June 30	
	2004	**2003**	**2004**	**2003**
	(Unaudited)			
Net sales	$ 250,987	$ 199,671	$ 528,351	$ 356,791
Cost of products sold	173,622	139,454	364,353	249,430
Gross profit	77,365	60,217	163,998	107,361
Selling expenses	41,566	30,444	83,613	53,614
General and administrative expenses	23,354	19,679	48,418	34,899
Operating income	12,445	10,094	31,967	18,848
Interest expense	3,210	2,814	6,512	4,608
Debt extinguishment costs				6,745
Other income, net	(125)	(1,604)	(178)	(1,600)
Income before income taxes	9,360	8,884	25,633	9,095
Provision for income taxes	3,182	3,110	8,715	3,184
Net income	$ 6,178	$ 5,774	$ 16,918	$ 5,911
Basic earnings per share:				
Net income	$ 0.18	$ 0.22	$ 0.48	$ 0.27
Diluted earnings per share:				
Net income	$ 0.16	$ 0.19	$ 0.43	$ 0.26
Basic shares outstanding	35,273	26,832	34,894	21,954
Diluted shares outstanding	44,019	30,733	43,659	23,034

See notes to consolidated condensed financial statements.

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CONSOLIDATED CONDENSED BALANCE SHEETS

(Thousands, except number of shares)

	June 30 2004	December 31 2003
	(Unaudited)	
Assets		
Current Assets		
Cash and cash equivalents	$ 18,173	$ 21,256
Accounts receivable, net	217,741	224,818
Inventories, net	212,534	237,152
Deferred taxes and income taxes receivable	34,678	40,023
Prepaid expenses and other current assets	16,862	13,083
Total current assets	499,988	536,332
Property, plant and equipment	221,775	204,738
Less allowance for depreciation and amortization	125,224	113,716
	96,551	91,022
Goodwill	189,431	147,047
Intangible assets, net	82,409	81,800
Other	19,243	15,670
Total Assets	$ 887,622	$ 871,871
Liabilities and Shareholders Equity		
Current Liabilities		
Bank loans	$ 7,225	$ 10,751
Accounts payable	52,452	77,304
Accrued payroll and related	31,626	33,040
Other accrued liabilities	70,417	61,540
Current portion of long-term debt	36,215	72,126
Total current liabilities	197,935	254,761
Long-term pension liabilities	11,173	11,173
Long-term debt	59,034	35,194
Deferred taxes	38,636	38,636
Convertible subordinated debentures	98,301	98,067
Commitments and Contingencies		
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 2004 and 60,000,000 in 2003, issued and outstanding shares 36,327,121 in 2004 and 34,146,798 in 2003	36,327	34,147
Additional paid-in capital	342,123	313,142
Retained earnings	124,535	107,617
Employee Stock Ownership Plan and stock option loans	(1,160)	(1,214)
Treasury shares at cost, 747,234 shares in 2004 and 2003	(9,107)	(9,107)
Accumulated other comprehensive loss	(10,175)	(10,545)

Total Shareholders Equity	482,543	434,040
Total Liabilities and Shareholders Equity	$ 887,622	$ 871,871

See notes to consolidated condensed financial statements.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

(Thousands)

	Six months ended June 30	
	2004	**2003**
Operating Activities		
Net income	$ 16,918	$ 5,911
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of operating division		(1,504)
Depreciation and amortization	12,743	10,095
Deferred taxes	6,782	559
Changes in current assets and current liabilities	20,517	48,180
Net cash provided by operating activities	56,960	63,241
Investing Activities		
Property, plant & equipment expenditures	(14,258)	(7,948)
Disposals of property, plant & equipment	406	(11)
Purchase of businesses, net of cash acquired	(28,672)	(3,002)
Proceeds received from sale of operating division		19,000
Other items, net	(5,291)	(49)
Net cash provided by (used in) investing activities	(47,815)	7,990
Financing Activities		
Issuance of convertible subordinated debentures		100,000
Borrowings under long-term debt	379,149	338,007
Payments of long-term debt	(391,942)	(448,849)
Net payments on accounts receivable purchase facility		(25,702)
Net decrease in short-term bank loans	(3,526)	(137)
Debt issuance costs		(7,491)
Proceeds received from exercise of stock options	4,091	2,589
Net cash used in financing activities	(12,228)	(41,583)
Net increase (decrease) in cash and cash equivalents	(3,083)	29,648
Cash and cash equivalents at beginning of year	21,256	11,228
Cash and cash equivalents at end of period	$ 18,173	$ 40,876

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

June 30, 2004

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 three and six month periods ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

The consolidated condensed balance sheet at December 31, 2003 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 reports its financial statements using a 13 week quarter ending on the last Sunday of March, June, September and December. 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 (K2 s) Annual Report on Form 10-K for the year ended December 31, 2003.

NOTE 2 - Summary of Significant Accounting Policies

Accounts Receivable and Allowances

Accounts receivable are net of allowances for doubtful accounts of $8,728,000 at June 30, 2004 and $7,558,000 at December 31, 2003.

Inventories

The components of inventories consisted of the following:

	June 30, 2004	December 31, 2003
	(Thousands)	
Finished goods	$ 147,480	$ 180,379
Work in process	13,060	10,843
Raw materials	51,994	45,930
	$ 212,534	$ 237,152

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

NOTE 2 - Summary of Significant Accounting Policies (Continued)

Warranty

K2 records the estimated cost of product warranties at the time sales are recognized. K2 estimates warranty obligation by reference to historical product warranty return rates, material usage and service delivery costs incurred in correcting the product. Should actual product warranty return rates, material usage or service delivery costs differ from the historical rates, revisions to the estimated warranty liability would be required.

The following activity related to product warranty liabilities:

	Three Months Ended June 30		Six Months Ended June 30	
(Thousands)	**2004**	**2003**	**2004**	**2003**
Beginning Balance	$ 5,520	$ 3,477	$ 5,526	$ 2,954
Charged to costs and expenses	1,586	1,066	3,117	2,109
Increase to reserve resulting from acquisitions	325		325	420
Amounts charged to reserve	(966)	(736)	(2,503)	(1,676)
Ending Balance	$ 6,465	$ 3,807	$ 6,465	$ 3,807

Newly Adopted Accounting Standards

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities and issued FIN 46(R) in December 2003, which amended FIN 46. FIN 46 requires certain variable interest entities to be consolidated in certain circumstances by the primary beneficiary even if it lacks a controlling financial interest. Adopting FIN 46 and FIN 46(R) did not have an impact on K2 s operational results or financial position since K2 does not have any variable interest entities.

During 2003, the FASB revised SFAS 132, Employers Disclosures about Pensions and Other Postretirement Benefits : This statement revises employers disclosures about pension plans and other postretirement benefit plans. It requires disclosures beyond those in the original SFAS 132 about the assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined postretirement plans.

In addition, the revised statement requires interim-period disclosures regarding the amount of net periodic benefit cost recognized and the total amount of the employers contributions paid and expected to be paid during the current fiscal year. It does not change the measurement or recognition of those plans.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

NOTE 2 - Summary of Significant Accounting Policies (Continued)

The following table provides the components of benefit costs for the three and six months ended June 30:

	For the three months ended June 30		For the six months ended June 30	
(Thousands)	**2004**	**2003**	**2004**	**2003**
Service cost	$ 450	$ 420	$ 900	$ 840
Interest cost	1,030	1,030	2,060	2,060
Expected return on assets	(910)	(890)	(1,820)	(1,780)
Amortization of:				
Prior service cost	15	20	30	40
Actuarial loss	135	260	270	520
Curtailment/settlement loss recognized		10		20
Total net periodic benefit cost	$ 720	$ 850	$ 1,440	$ 1,700

K2 s expected cash contribution to its pension plans in 2004 is $4,000,000. During the three and six months ended June 30, 2004, K2 made contributions totaling approximately $507,000 to the pension plans.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

NOTE 3 Stock Based Compensation

K2 applies the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation,* which allows entities to continue to apply the provisions of Accounting Principles Board (*APB*) Opinion No. 25 *Accounting for Stock Issued to Employees,* and related interpretations and provide pro forma net income and pro forma net income per share disclosures for employee stock option grants made as if the fair-value-based method defined in SFAS No. 123 had been applied. K2 has elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure provisions of SFAS No. 123. As such, compensation expense for stock options issued to employees is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Had compensation cost been determined based upon the fair value at the grant date for K2 s stock options under SFAS No. 123 using the Black Scholes option pricing model, pro forma net income and pro forma net income per share, including the following weighted average assumptions used in these calculations, would have been as follows:

	For the three months ended June 30		For the six months ended June 30	
	2004	**2003**	**2004**	**2003**
	(Thousands, except per share data, percentage data and expected life)			
Net income as reported	$ 6,178	$ 5,774	$ 16,918	$ 5,911
Less: Total stock-based compensation expense determined under fair value based method for all awards, net of taxes	384	95	768	190
Net income, adjusted	$ 5,794	$ 5,679	$ 16,150	$ 5,721
Earnings per share:				
Basic - as reported	$ 0.18	$ 0.22	$ 0.48	$ 0.27
Basic - pro forma	$ 0.16	$ 0.21	$ 0.46	$ 0.26
Diluted - as reported	$ 0.16	$ 0.19	$ 0.43	$ 0.26
Diluted - pro forma	$ 0.15	$ 0.18	$ 0.41	$ 0.25
Risk free interest rate	3.60%	2.71%	3.60%	2.71%
Expected life of options	5 years	5 years	5 years	5 years
Expected volatility	43.2%	49.8%	43.2%	49.8%
Expected dividend yield				

On May 13, 2004, K2 s shareholders approved the K2 Inc. 2004 Long-Term Incentive Plan (the Plan), which authorizes the Board of Directors, or a committee thereof, to grant stock options, stock appreciation rights, restricted shares, restricted stock units, and other stock-based or performance awards. All employees, non-employee directors, officers, manager and key employees of K2 and its subsidiaries are eligible to participate in the Plan. The number of shares authorized for grant under the Plan is 2,000,000, with 500,000 permitted to be in the form of restricted stock, restricted stock units, other stock-based awards or performance awards. At June 30, 2004, 913,000 shares were available for future grants.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

Note 4 - Acquisitions

2004 First Quarter Acquisition Activity:

On January 23, 2004, K2 completed the acquisition of Fotoball USA, Inc., (Fotoball), a marketer and manufacturer of souvenir and promotional products, principally for team sports, in a stock-for-stock exchange offer/merger transaction. Under the terms of the merger, each outstanding share of Fotoball common stock was converted into 0.2757 shares of common stock of K2 for a total of approximately 1.0 million shares of K2 s common stock. The transaction was valued at approximately $16.9 million plus estimated merger costs of approximately $1.1 million. The purchase price included fully vested K2 stock options issued in exchange for Fotoball stock options outstanding at the time of the acquisition with a value of approximately $1.5 million. The value of the K2 stock options issued in exchange for the Fotoball stock options outstanding was based on a Black-Scholes estimate using the following assumptions: risk free interest rate of 3.00%, volatility of K2 stock of 0.478 and expected life of 4.00 years. The results of the operations of Fotoball were included in the consolidated financial statements of K2 beginning with the date of the merger. Subsequent to the completion of the merger, K2 changed the name of Fotoball to K2 Licensing & Promotions, Inc.

This transaction has been accounted for under the purchase method of accounting, and accordingly the purchased assets and assumed liabilities are recorded at their estimated fair values at the date of the merger. The purchase price allocation resulted in an excess of the purchase price over net tangible assets acquired of $11.1 million. Based on an independent third party valuation completed during the 2004 second quarter, this excess amount was allocated to intangible assets/(liabilities) with definite and indefinite lives including: customer relationships of $1.5 million with an average life of 6.9 years; licensing agreements of ($1.0) million with an average life of 2.3 years; non-compete agreements of $0.1 million with an average life of 2.5 years; trademarks with an indefinite life not subject to amortization of $0.9 million; and goodwill not subject to amortization of $9.6 million.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

Note 4-Acquisitions (Continued)

2004 Second Quarter Acquisition Activity:

On April 19, 2004, K2 completed the acquisition of substantially all of the assets of Worr Game Products, Inc., and All-Cad Manufacturing, Inc., (collectively, Worr Games), businesses engaged in the design, manufacturing, selling and distribution of premium paintball markers. The purchase price for these assets was paid in a combination of cash and the issuance of 304,340 shares of K2 common stock. The results of the operations of Worr Games were included in the consolidated financial statements of K2 beginning with the date of the acquisition.

Also, on April 19, 2004, K2 completed the acquisition of substantially all of the assets of IPI Innovations, Inc., (IPI), a business engaged in the design, manufacturing, selling and distribution of rack mounting systems, and other products and accessories for all-terrain vehicles. The purchase price for these assets was paid in a combination of cash and the issuance of 326,101 shares of K2 common stock. The results of the operations of IPI were included in the consolidated financial statements of K2 beginning with the date of the acquisition.

On May 12, 2004, K2 completed the acquisition of substantially all of the assets of Ex Officio, a leader in the design and manufacture, sale and distribution of men and women s apparel for the outdoor and adventure travel apparel for men and women, in an all cash transaction. Ex Officio s products are characterized by technical features, performance fabrics, and outdoor styles, and are used in a variety of activities including fishing, kayaking, trekking, exploring, and other leisure activities. Ex Officio also markets a line of insect repellent clothing under the Buzz Off® brand. The results of the operations of Ex Officio were included in the consolidated financial statements of K2 beginning with the date of the acquisition.

The three transactions completed during the 2004 second quarter were accounted for under the purchase method of accounting, and accordingly the purchased assets and liabilities were recorded at their estimated fair values at the date of the acquisition. The combined preliminary purchase price allocation for the three acquisitions resulted in an excess of the purchase price over net tangible assets acquired of $30.7 million. These preliminary allocations assume the excess purchase price of the acquisitions will be allocated to goodwill, and is thus not amortized. The final allocations, however, could include identifiable intangible assets with finite and indefinite lives separate from goodwill. Should there be assets with finite lives, those assets will be subject to amortization resulting in additional amortization expense. The final allocations of the purchase price will be completed during the 2004 year based on K2 s final evaluation of such assets and liabilities.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

Note 4-Acquisitions (Continued)

During 2003, K2 completed seven acquisitions, including the acquisitions of Rawlings Sporting Goods Company, Inc. (Rawlings), on March 26, 2003, Worth, Inc. (Worth), on September 16, 2003 and Brass Eagle, Inc. (Brass Eagle), on December 8, 2003 as well as four smaller acquisitions.

The consolidated condensed statements of income for the quarter and six months ended June 30, 2004 includes the operating results of each of the businesses acquired in 2003 and of the businesses acquired in 2004 since their respective acquisitions dates, however the consolidated condensed statements of income for the quarter and six months ended June 30, 2003 includes only the results of Rawlings since the acquisition of Rawlings was completed on March 26, 2003, and all other acquisitions mentioned above were completed subsequent to June 30, 2003.

The purchase price of one of the smaller acquisitions made during 2003 is subject to earn out provisions which is currently estimated to result in an additional all cash payment of approximately $7.1 million to the selling shareholders in cash in the third quarter of 2004.

The following presents the summarized unaudited pro forma results of operations of K2 with Rawlings, Worth and Brass Eagle as if these acquisitions had occurred as of the beginning of the respective periods presented. Pro forma results of the additional acquisitions completed during 2003 and 2004 have not been presented because the effects of these additional acquisitions were not material on either an individual basis or aggregate basis to K2 s consolidated results of operations. This pro forma information does not purport to be indicative of what would have occurred had the acquisition been made as of those dates, or of results which may occur in the future:

Pro Forma Information (Unaudited)

(Thousands, except per share amounts)

	For the three months ended June 30,		For the six months ended June 30,	
	2004	**2003**	**2004**	**2003**
Net sales	$ 250,987	$ 236,663	$ 528,351	$ 490,907
Operating income	12,445	10,293	31,967	29,770
Net income	6,178	5,515	16,918	12,316
Diluted earnings per share	$ 0.16	$ 0.15	$ 0.43	$ 0.37

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

Note 4-Acquisitions (Continued)

During 2003 and 2004, K2 approved restructuring and exit plans related to the closure of certain facilities of the acquired companies. In accordance with EITF 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination, during 2003 and 2004, K2 established reserves for employee severance, employee relocation costs and lease termination costs totaling approximately $5.1 million and $0.3 million, respectively. These reserves were recognized as assumed liabilities of the acquired companies. The reserves established were not individually significant to any of K2 s acquisitions during 2003 or 2004.

The following table summarizes the activity in 2003 and 2004:

	Employee Severance	Employee Relocation	Subtotal	Lease Termination Costs	Total
			(Thousands)		
Reserves established in conjunction with 2003 acquisitions	$ 2,951	$ 916	$ 3,867	$ 1,203	$ 5,070
Utilized in 2003:	(640)		(640)		(640)
Balance December 31, 2003	$ 2,311	$ 916	$ 3,227	$ 1,203	$ 4,430
Reserves established in conjunction with 2004 acquisitions	75		75	250	325
Utilized in 2004:	(335)	(90)	(425)	(308)	(733)
Balance June 30, 2004	$ 2,051	$ 826	$ 2,877	$ 1,145	$ 4,022

K2 believes that the remaining reserves for restructuring are adequate to complete its restructuring and exit plans.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

NOTE 5 Intangible Assets and Goodwill

The components of intangible assets and goodwill consisted of the following:

		June 30, 2004			December 31, 2003		
	Weighted Average Useful Life	Gross Amount	Accumulated Amortization	Net Book Value	Gross Amount	Accumulated Amortization	Net Book Value
				(Thousands)			
Intangibles subject to amortization:							
Patents	8.7 years	$ 12,428	$ 2,297	$ 10,131	$ 12,129	$ 1,836	$ 10,293
Customer contracts/relationships	8.5years	8,072	913	7,159	6,576	393	6,183
Licensing agreements	5.2 years	2,849	622	2,227	3,800	475	3,325
Tradenames/trademarks	5.2 years	335	39	296	335	7	328
Other miscellaneous	1.1 years	362	17	345	277		277
		24,046	3,888	20,158	23,117	2,711	20,406
Intangibles not subject to amortization:							
(by segment)							
Tradename							
Action sports		28,794		28,794	28,794		28,794
Team sports		33,457		33,457	32,600		32,600
		62,251		62,251	61,394		61,394
Total intangibles		86,297	3,888	82,409	84,511	2,711	81,800
Goodwill							
Marine and outdoor		20,071		20,071	11,396		11,396
Action sports		101,870		101,870	77,558		77,558
Team sports		67,490		67,490	58,093		58,093
		189,431		189,431	147,047		147,047
Total intangibles and goodwill		$ 275,728	$ 3,888	$ 271,840	$ 231,558	$ 2,711	$ 228,847

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

NOTE 5 Intangible Assets and Goodwill (Continued)

The increase in intangibles subject to and not subject to amortization and goodwill at June 30, 2004 from December 31, 2003 is primarily due to K2 s acquisition activities during 2004 as follows:

	December 31, 2003 Net Book Value	2004 Activity: Acquisition of Fotoball	2004 Activity: Other Acquisitions	2004 Activity: Other Activity	2004 Activity: Amortization	June 30, 2004 Net Book Value
			(Thousands)			
Intangibles subject to amortization:						
Patents	$ 10,293			366	$ (528)	$ 10,131
Customer contracts/relationships	6,183	1,496			(520)	7,159
Licensing agreements	3,325	(951)			(147)	2,227
Tradenames/trademarks	328				(32)	296
Other miscellaneous	277	85			(17)	345
	20,406	630		366	(1,244)	20,158
Intangibles not subject to amortization: (by segment)						
Tradename						
Action sports	28,794					28,794
Team sports	32,600	857				33,457
	61,394	857				62,251
Total intangibles	81,800	1,487		366	(1,244)	82,409
Goodwill						
Marine and outdoor	11,396		7,912	763		20,071
Action sports	77,558		22,783	1,529		101,870
Team sports	58,093	9,615		(218)		67,490
	147,047	9,615	30,695	2,074		189,431
Total intangibles and goodwill	$ 228,847	$ 11,102	$ 30,695	$ 2,440	$ (1,244)	$ 271,840

Amortization expense for intangibles subject to amortization was approximately $0.6 million and $1.2 million for the quarter and six months ended June 30, 2004, respectively. Amortization expense of purchased intangible assets subject to amortization is estimated to be approximately $2.9 million during fiscal years ending 2004 through 2008. These estimates are based on the preliminary allocation of the excess purchase price for K2 s second quarter acquisitions being allocated to goodwill. Should the final allocation include identifiable intangible assets with finite lives, those assets would be subject to amortization resulting in increased amortization expense.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

NOTE 5 Intangible Assets (Continued)

Based on the results of the annual impairment tests, K2 determined that no impairment of goodwill existed as of December 31, 2003 and no indicators of impairment were present during the quarter and six months ended June 30, 2004. However, future goodwill impairment tests could result in a charge to earnings. K2 will continue to evaluate goodwill on an annual basis and whenever events and changes in circumstances indicate that there may be a potential impairment.

K2 has evaluated the remaining useful lives of its finite-lived purchased intangible assets to determine if any adjustments to the useful lives were necessary or if any of these assets had indefinite lives and were therefore not subject to amortization. K2 determined that no adjustments to the useful lives of its finite-lived purchased intangible assets were necessary.

NOTE 6 Borrowings and Other Financial Instruments

At June 30, 2004 K2 s principal long-term borrowing facility was a three-year, $205 million revolving Credit Facility (Facility) expiring on March 31, 2006 with several banks and other financial institutions. The Facility was expandable to $230 million subject to certain conditions. The Facility had a $75 million limit for the issuance of letters of credit. Borrowings under the Facility are secured by all of K2 s assets in the United States, Canada and England. Actual borrowing availability under the Facility is based on K2 s trade receivable and inventory levels in the United States, Canada and England, subject to eligibility criteria and defined advance rates. Borrowings under the Facility are subject to an interest rate grid, but as of June 30, 2004 bear a rate equal to the prime rate plus 0.50%, or a LIBOR interest rate plus 2.50%, and the Facility had an unused commitment fee of 0.375% per year. In addition to the Facility, K2 also had an $11.7 million term loan, expiring March 31, 2006, from certain banks participating in the Facility, bearing an interest rate equal to the LIBOR rate plus 4.00% per year, payable in equal monthly installments over the remaining term. The Facility and term loan include various covenants, including requirements that K2 maintain a minimum debt service coverage ratio and tangible net worth, as well as limiting annual capital expenditures and certain investment activities.

At June 30, 2004, borrowings of $83.5 million were outstanding under the Facility and $11.7 million was outstanding under the term loan, bearing average interest rates of 4.30% and 5.18%, respectively. At June 30, 2004 there were also letters of credit outstanding under the Facility of $19.4 million (consisting of $11.4 million of standby letters of credit and $8.0 million of trade letters of credit expiring over the next 12 months). Pursuant to the terms of the Facility, an additional $79.7 million was available for borrowing at June 30, 2004.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

NOTE 6 Borrowings and Other Financial Instruments (Continued)

On July 1, 2004, K2 entered into an Amended and Restated Credit Agreement (Amended Facility) to amend and restate the terms and conditions of the Facility. Many of the terms and conditions of the Facility remain unchanged, however, under the Amended Facility the amount of the revolving aggregate commitment from the banks increased to $250 million (and may be increased to $350 million under certain conditions), the expiration date was extended to July 1, 2009, the limit for letters of credit increased to $100 million, the interest rate grid reflected more favorable terms and certain covenants were modified. The Amended Facility s covenants include requirements that K2 maintain a minimum debt service coverage ratio, as well as limiting annual capital expenditures, indebtedness, dividends and certain investment activities.

On July 1, 2004, in conjunction with the Amended Facility, K2 repaid the $11.7 million term loan outstanding under the Facility. There is no term loan under the Amended Facility.

The Facility is subject to a Material Adverse Effect clause and the cash received from receivable collections is subject to the control of the lenders via a lock-box arrangement, if average excess availability, as defined, under the Facility falls below $50 million. K2 does not currently expect average excess availability, as defined, to be less than $50 million in the next twelve months. In accordance with the provisions of EITF 95-22, Balance Sheet Classifications of Borrowings Outstanding under Revolving Credit Agreements that include both a Subjective Acceleration Clause and a Lock-Box Arrangement and FASB Technical Bulletin 79-3, Subjective Acceleration Clauses in Long-Term Debt Agreements, K2 has classified approximately $29.5 million of seasonal borrowings outstanding under the Facility at June 30, 2004 as current and the remaining balance of approximately $54.0 million as long-term debt. The Amended Facility does not have a Material Adverse Effect clause.

At June 30, 2004, K2 also had $25.0 million of 7.25% convertible subordinated debentures (7.25% Debentures) due March 2010. The 7.25% Debentures are convertible into 2,097,315 shares of K2 common stock at a conversion price of $11.92 per share. Pursuant to the agreement for these debentures, the noteholders received warrants to purchase 243,260 and 524,329 additional shares of K2 s common stock at exercise prices of $13.14 and $11.92 per share, respectively, exercisable within the three and five year period ended February 14, 2006 and February 14, 2008, respectively (the Warrants). K2 assigned a total fair market value of $2,303,000 to the Warrants. At June 30, 2004, the aggregate unamortized fair market value of $1,699,000 is reflected as a reduction of the face amount of the 7.25% Debentures on K2 s balance sheet which is being amortized to interest expense using the effective interest method through the exercise periods, thereby increasing the carrying value of the debentures.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

NOTE 6 Borrowings and Other Financial Instruments (Continued)

At June 30, 2004, K2 also had $75 million of 5.00% convertible senior debentures (5% Debentures) due June 2010. The 5% Debentures are convertible into 5,706,458 shares of K2 common stock at a conversion price of $13.143 per share. The debentures are redeemable by K2 in whole or in part at K2 s option on or after June 15, 2008 at a redemption price of 101.429% beginning on June 15, 2008 and ending on June 14, 2009, and at 100.714% beginning on June 15, 2009 and ending on June 14, 2010.

At June 30, 2004, K2 also had $7.2 million outstanding under foreign lines of credit.

On July 1, 2004, K2 completed the sale of $200 million in 7.375% senior, unsecured notes (Senior Notes) due July 1, 2014. Interest is payable semi-annually on July 1 and January 1, commencing January 1, 2005. The Senior Notes are redeemable by K2 in whole or in part at K2 s option at any time prior to July 1, 2009 at a price equal to 100% of the principal amount plus accrued and unpaid interest plus a make-whole premium as defined in the indenture. Thereafter, K2 may redeem all or a portion of the notes at the redemption prices set forth in the indenture. The Senior Notes include various incurrence covenants, including limitations on indebtedness, restricted payments and sales of assets. See Note 11, Subsequent Events, for additional information.

NOTE 7 Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

	Currency Translation Adjustments	Additional Minimum Pension Liability	Derivative Financial Instruments	Total
		(Thousands)		
Balance at December 31, 2003	$ (3,133)	$ (5,255)	$ (2,157)	$ (10,545)
Currency translation adjustment	(1,080)			(1,080)
Reclassification adjustment for amounts recognized in cost of sales			1,275	1,275
Change in fair value of derivatives, net of $90 in taxes			175	175
Balance at June 30, 2004	$ (4,213)	$ (5,255)	$ (707)	$ (10,175)

Total comprehensive income was $6.5 million and $7.1 million for the three months ended June 30, 2004 and 2003, respectively. Total comprehensive income was $17.3 million and $8.0 million for the six months ended June 30, 2004 and 2003, respectively. Total comprehensive income includes the net change in accumulated other comprehensive loss for the period.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

NOTE 8- Earnings Per Share Data

Basic earnings per share (EPS) is determined by dividing net income by the weighted average number of shares outstanding during the period. Diluted EPS reflects the potential dilutive effects of stock options and warrants, using the treasury stock method, and of the 5% and 7.25% Debentures using the if converted method. The following represents a reconciliation from basic shares to fully diluted shares for the respective periods. Options to purchase 4,356,473 and 3,593,250 shares of common stock were outstanding at June 30, 2004 and 2003, respectively. At June 30, 2004 and 2003, shares of common stock issuable upon conversion of the 5% and 7.25% Debentures, which in the aggregate is $100 million outstanding, totaling 7,803,742 and warrants to purchase 767,589 shares of common stock were outstanding. For the three and six month periods ended June 30, 2004, 424,283 and 418,046 stock options, respectively, were excluded since their inclusion would have been antidilutive. For the three and six month periods ended June 30, 2003, 806,943 and 828,952 stock options, respectively, were excluded since their inclusion would have been antidilutive. For both the three and six month periods ended June 30, 2003, 767,589 warrants were also excluded since their inclusion would have been antidilutive. The EPS calculation for six months ended June 30, 2003 also excluded 2,097,282 shares from the issuance of the 7.25% Debentures because their inclusion would have also been antidilutive.

The table below outlines the determination of the number of diluted shares of common stock used in the calculation of diluted EPS as well as the calculation of diluted EPS for the periods presented:

	Three months ended June 30		Six months ended June 30	
	2004	**2003**	**2004**	**2003**
	(Thousands, except per share amounts)			
Determination of diluted number of shares:				
Average common shares outstanding	35,273	26,832	34,894	21,954
Assumed conversion of dilutive stock options and warrants	943	536	962	446
Assumed conversion of subordinated debentures	7,803	3,365	7,803	634
Diluted average common shares outstanding (a)	44,019	30,733	43,659	23,034
Calculation of diluted earnings per share:				
Net income	$ 6,178	$ 5,774	$ 16,918	$ 5,911
Add: interest component on assumed conversion of subordinated debentures, net of taxes	918	215	1,836	193
Net income, adjusted (b)	$ 7,096	$ 5,989	$ 18,754	$ 6,104
Diluted earnings per share (b/a)	$ 0.16	$ 0.19	$ 0.43	$ 0.26

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

NOTE 9- Segment Information

As a result of recent acquisitions, beginning in the 2004 first quarter, K2 reclassified its business into the following three segments based on similar product types and distribution channels: Marine and Outdoor, Action Sports and Team Sports.

The Marine and Outdoor segment includes Shakespeare fishing tackle and monofilament products as well as Stearns outdoor products. The Action Sports segment includes skis, snowboards, snowshoes, in-line skates, paintball products and skateboard shoes and apparel. The Team Sports segment includes baseball and softball products and K2 Licensing & Promotion products.

The 2003 periods have been restated to reflect these reclassifications.

The segment information presented below is for the three months ended June 30:

	Net Sales to Unaffiliated Customers		Intersegment Sales		Operating Profit (Loss)	
	2004 (b)	2003 (a)	2004 (b)	2003 (a)	2004 (b)	2003 (a)
			(Millions)			
Marine and Outdoor	$ 107.4	$ 103.4	$ 28.9	$ 22.4	$ 16.4	$ 15.0
Action Sports	81.8	55.4	0.0	0.1	0.6	(2.4)
Team Sports	61.8	40.9			(0.7)	(0.1)
Total segment data	$ 251.0	$ 199.7	$ 28.9	$ 22.5	16.3	12.5
Corporate expenses, net					(3.7)	(2.3)
Gain on sale of operating division						1.5
Interest expense					(3.2)	(2.8)
Income before provision for income taxes					$ 9.4	$ 8.9

(a) Results for the three months ended June 30, 2003 do not include the operating results of any of K2 s acquisitions completed during 2003 and 2004 other than for Rawlings, since these other acquisitions were completed subsequent to the June 30, 2003.

(b) Results for the three months ended June 30, 2004 do not include the sales or operating profit of the composite utility and light pole product lines. K2 sold these product lines in May 2003, and net sales and operating profit for this business in the 2003 second quarter through the date of divestiture were $5.1 million and $9,000, respectively.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

June 30, 2004

NOTE 9- Segment Information (Continued)

The segment information presented below is for the six months ended June 30:

	Net Sales to Unaffiliated Customers		Intersegment Sales		Operating Profit (Loss)	
	2004 (b)	2003 (a)	2004 (b)	2003 (a)	2004 (b)	2003 (a)
			(Millions)			
Marine and Outdoor	$ 206.6	$ 201.8	$ 49.3	$ 36.7	$ 31.7	$ 30.5
Action Sports	165.9	109.8	0.4	0.8	(3.5)	(7.1)
Team Sports	155.9	45.2			10.3	(0.6)
Total segment data	$ 528.4	$ 356.8	$ 49.7	$ 37.5	38.5	22.8
Corporate expenses, net					(6.4)	(3.8