DELTA APPAREL, INC
Form 10-Q
February 09, 2016
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended January 2, 2016
OR

o 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 1-15583
DELTA APPAREL, INC.

(Exact name of registrant as specified in its charter)

GEORGIA	58-2508794
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
322 South Main Street	
Greenville, SC	29601
(Address of principal executive offices)	(Zip Code)

(864) 232-5200

(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 þ No o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No o

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 the definitions of a “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of January 27, 2016, there were outstanding 7,747,557 shares of the registrant’s common stock, par value of $0.01 per share, which is the only class of outstanding common or voting stock of the registrant.

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PART 1. FINANCIAL INFORMATION
Item 1. Financial Statements
Delta Apparel, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(Amounts in thousands, except share amounts and per share data)
(Unaudited)

	January 2, 2016	October 3, 2015
Assets		
Current assets:		
Cash and cash equivalents	$296	$300
Accounts receivable, less allowances of $2,969 and $2,984, respectively	48,364	62,741
Income tax receivable	627	—
Inventories, net	159,208	148,372
Prepaid expenses and other current assets	6,603	4,124
Total current assets	215,098	215,537
Property, plant and equipment, net of accumulated depreciation of $83,289 and $81,376, respectively	41,057	39,653
Goodwill	36,729	36,729
Intangibles, net	21,830	22,162
Deferred income taxes	6,300	7,294
Other assets	3,403	3,528
Total assets	$324,417	$324,903
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$52,284	$53,349
Accrued expenses	16,854	20,661
Income tax payable	—	87
Current portion of long-term debt	8,413	8,340
Total current liabilities	77,551	82,437
Long-term debt, less current maturities	97,768	93,872
Other liabilities	1,571	995
Contingent consideration	2,900	3,100
Total liabilities	$179,790	$180,404
Shareholders' equity:		
Preferred stock—$0.01 par value, 2,000,000 shares authorized, none issued and outstanding	—	—
Common stock —$0.01 par value, 15,000,000 shares authorized, 9,646,972 shares issued, and 7,758,965 and 7,797,166 shares outstanding as of January 2, 2016 and October 3, 2015, respectively	96	96
Additional paid-in capital	59,408	59,399
Retained earnings	108,396	107,715
Accumulated other comprehensive loss	(203)	(429)
Treasury stock —1,888,007 and 1,849,806 shares as of January 2, 2016 and October 3, 2015, respectively	(23,070)	(22,282)

Total shareholders’ equity	144,627	144,499
Total liabilities and shareholders' equity	$324,417	$324,903

See accompanying Notes to Condensed Consolidated Financial Statements.

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Delta Apparel, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
(Amounts in thousands, except per share data)
(Unaudited)

	Three Months Ended	
	January 2, 2016	December 27, 2014
Net sales	$90,171	$93,381
Cost of goods sold	71,292	78,055
Gross profit	18,879	15,326
Selling, general and administrative expenses	16,892	18,540
Change in fair value of contingent consideration	(200)	65
Other income, net	(40)	(62)
Operating income (loss)	2,227	(3,217)
Interest expense, net	1,276	1,528
Income (loss) before provision (benefit) from income taxes	951	(4,745)
Provision (benefit) from income taxes	270	(534)
Net income (loss)	$681	$(4,211)
Basic earnings (loss) per share	$0.09	$(0.53)
Diluted earnings (loss) per share	$0.09	$(0.53)
Weighted average number of shares outstanding	7,761	7,881
Dilutive effect of stock options and awards	193	—
Weighted average number of shares assuming dilution	7,954	7,881

See accompanying Notes to Condensed Consolidated Financial Statements.

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Delta Apparel, Inc. and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income (Loss)
(Amounts in thousands)
(Unaudited)

	Three Months Ended	
	January 2, 2016	December 27, 2014
Net income (loss)	$681	$(4,211)
Net unrealized gain (loss) on cash flow hedges, net of tax	226	(4)
Comprehensive income (loss)	$907	$(4,215)

See accompanying Notes to Condensed Consolidated Financial Statements.

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Delta Apparel, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Amounts in thousands)
(Unaudited)

	Three Months Ended	
	January 2, 2016	December 27, 2014
Operating activities:		
Net income (loss)	$681	$(4,211)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	2,342	2,427
Amortization of deferred financing fees	125	125
Excess tax benefits from exercise of stock options	(89)	—
Provision for deferred income taxes	994	657
Non-cash stock compensation	412	(66)
Change in the fair value of contingent consideration	(200)	65
(Gain) loss on disposal of equipment	(1)	11
Changes in operating assets and liabilities:		
Accounts receivable	14,377	16,577
Inventories	(10,836)	(13,427)
Prepaid expenses and other assets	(2,479)	(1,176)
Other non-current assets	—	9
Accounts payable	(1,644)	2,240
Accrued expenses	(3,826)	(1,055)
Income tax payable/receivable	(625)	(805)
Other liabilities	(240)	(200)
Net cash (used in) provided by operating activities	(1,009)	1,171
Investing activities:		
Purchases of property and equipment, net	(1,753)	(1,971)
Proceeds from sale of fixed assets	16	—
Net cash used in investing activities	(1,737)	(1,971)
Financing activities:		
Proceeds from long-term debt	118,629	133,124
Repayment of long-term debt	(114,660)	(132,673)
Repayment of capital financing	(36)	—
Payment of deferred financing fees	—	(25)
Repurchase of common stock	(1,117)	—
Payment of withholding taxes on exercise of stock options	(163)	—
Excess tax benefits from exercise of stock options	89	—
Net cash provided by financing activities	2,742	426
Net decrease in cash and cash equivalents	(4)	(374)
Cash and cash equivalents at beginning of period	300	612
Cash and cash equivalents at end of period	$296	$238

Supplemental cash flow information:

Cash paid during the period for interest	$982	$1,182
Cash paid (received) during the period for income taxes, net of refunds received	$33	$(385)
Non-cash financing activity - capital lease agreements	$1,336	$—

See accompanying Notes to Condensed Consolidated Financial Statements.

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Delta Apparel, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)

Note A—Basis of Presentation and Description of Business
We prepared the accompanying interim condensed consolidated financial statements in accordance with the instructions for Form 10-Q 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 ("U.S. GAAP") for complete financial statements. We believe these Condensed Consolidated Financial Statements consist of normal recurring adjustments considered necessary for a fair presentation. Operating results for the three months ended January 2, 2016, are not necessarily indicative of the results that may be expected for our fiscal year ending October 1, 2016. Although our various product lines are sold on a year-round basis, the demand for specific products or styles reflects some seasonality, with sales in our June quarter generally being the highest and sales in our December quarter generally being the lowest. For more information regarding our results of operations and financial position, refer to the Consolidated Financial Statements and footnotes included in our Form 10-K for our fiscal year ended October 3, 2015, filed with the United States Securities and Exchange Commission (“SEC”).
“Delta Apparel”, the “Company”, and “we”, “us” and “our” are used interchangeably to refer to Delta Apparel, Inc. together w our domestic wholly-owned subsidiaries, including M.J. Soffe, LLC (“Soffe”), Junkfood Clothing Company (“Junkfood”), Salt Life, LLC (f/k/a To The Game, LLC) ("Salt Life"), Art Gun, LLC (“Art Gun”), and other international subsidiaries, as appropriate to the context.
Delta Apparel, Inc. is an international apparel design, marketing, manufacturing and sourcing company that features a diverse portfolio of lifestyle basics and branded activewear apparel and headwear. We specialize in selling casual and athletic products through a variety of distribution channels and distribution tiers, including specialty stores, boutiques, department stores, mid and mass channels, e-retailers, and the U.S. military. Our products are also made available direct-to-consumer on our websites. We believe this diversified distribution allows us to capitalize on our strengths to provide casual activewear to consumers purchasing from most types of retailers.
We design and internally manufacture the majority of our products, which allows us to offer a high degree of consistency and quality controls as well as leverage scale efficiencies. One of our strengths is the speed with which we can reach the market from design to delivery. We have manufacturing operations located in the United States, El Salvador, Honduras and Mexico, and use domestic and foreign contractors as additional sources of production. Our distribution facilities are strategically located throughout the United States to better serve our customers with same-day shipping on our catalog products and weekly replenishments to retailers.
We were incorporated in Georgia in 1999 and our headquarters is located at 322 South Main Street, Greenville, South Carolina 29601 (telephone number: 864-232-5200). Our common stock trades on the NYSE MKT under the symbol “DLA”. We operate on a 52-53 week fiscal year ending on the Saturday closest to September 30. Our 2016 fiscal year is a 52-week year and will end on October 1, 2016. Our 2015 fiscal year was a 53-week year and ended on October 3, 2015.

Note B—Accounting Policies
Our accounting policies are consistent with those described in our Significant Accounting Policies in our Form 10-K for the fiscal year ended October 3, 2015, filed with the SEC.

Note C—New Accounting Standards
Recently Adopted Standards
In November 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes, ("ASU 2015-17"). This new guidance requires businesses to classify deferred tax liabilities and assets on their balance sheets as noncurrent. Under existing accounting, a business must separate deferred income tax liabilities and assets into current and noncurrent. ASU 2015-17 was issued as a way to simplify the way businesses classify deferred tax liabilities and

assets on their balance sheets. Public companies must apply ASU 2015-17 to fiscal years beginning after December 15, 2016. Companies must follow the requirements for interim periods within those fiscal years, but early adoption at the beginning of an interim or annual period is allowed for all entities. ASU 2015-17 was adopted for our fiscal year beginning October 4, 2015. The implementation of ASU 2015-17 was applied retroactively to the October 3, 2015, Condensed Consolidated Balance Sheet included in this Form 10-Q. As a result of this retroactive application, current deferred income tax assets of $7.3 million have been netted with noncurrent deferred income tax liabilities of $7 thousand and reclassified to noncurrent deferred income tax assets.

Standards Not Yet Adopted

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, ("ASU 2014-09"). This new guidance requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. ASU 2014-09 is effective for annual periods beginning after December 15, 2017, for public business entities and permits the use of either the retrospective

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or cumulative effect transition method. Early application is permitted only as of annual reporting periods beginning after December 15, 2016. ASU 2014-09 is therefore effective for our fiscal year beginning September 30, 2018. We are evaluating the effect that ASU 2014-09 will have on our Consolidated Financial Statements and related disclosures.

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory, ("ASU 2015-11"). This new guidance requires an entity to measure inventory at the lower of cost and net realizable value. Currently, entities measure inventory at the lower of cost or market. ASU 2015-11 replaces market with net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured under last-in, first-out or the retail inventory method. ASU 2015-11 requires prospective adoption for inventory measurements for fiscal years beginning after December 15, 2016, and interim periods within those years for public business entities. Early application is permitted. ASU 2015-11 is therefore effective in our fiscal year beginning October 1, 2017. We are evaluating the effect that ASU 2015-11 will have on our Consolidated Financial Statements and related disclosures.

Note D—Sale of The Game

On March 2, 2015, we completed the sale of our The Game branded collegiate headwear and apparel business to David Peyser Sportswear, Inc., owner of MV Sport, Inc. for $14.9 million. The business sold consisted of The Game branded products sold nationally in college bookstores and through team dealers. This transaction further strengthened our balance sheet and enables us to focus on areas of our business that are more strategic to our long-term goals. Our Salt Life business and corporate business, Kudzu, previously operated within To The Game, LLC (now Salt Life, LLC) were not included in the sale of the collegiate part of the business.

The sale included finished goods inventory of $6.0 million, $0.4 million in fixed assets, and $0.1 million in other assets, along with the requirement that we indemnify up to $0.3 million of legal costs associated with a particular litigation matter which was subsequently settled. The transaction did not include accounts receivable which we subsequently collected in the normal course of business and certain undecorated apparel inventory. We incurred $0.4 million in direct selling expenses associated with the transaction. In addition, we incurred certain indirect costs associated with the transaction, including a $0.8 million devaluation of the inventory not included in the sale and $1.4 million in indirect incentive-based expenses.

The pre-tax gain on the sale of The Game assets, inclusive of the direct and indirect expenses, was $5.6 million. The transaction and associated indirect expenses were recorded in our Condensed Consolidated Statements of Operations in our 2015 second quarter as follows: (i) proceeds of $14.9 million less costs of assets sold and direct selling costs resulting in a gain of $7.7 million recorded as a gain on sale of business; (ii) $1.4 million in indirect expenses recorded in our selling, general and administrative expense; and (iii) $0.8 million of indirect expenses recorded in our cost of goods sold. For income tax purposes, this gain and associated indirect expenses were treated as a discrete item and resulted in $2.2 million in income tax expense being recorded in our 2015 second quarter.

Note E—Salt Life Acquisition

On August 27, 2013, Salt Life, LLC (f/k/a To The Game, LLC) purchased substantially all of the assets of Salt Life Holdings, LLC ("Salt Life Holdings"), including all of its domestic and international trademark rights in the Salt Life brand (the "Salt Life Acquisition"). The purchase price for the Salt Life Acquisition consisted of: (i) a cash payment at closing of $12,000,000, (ii) a deposit at closing of $3,000,000 into an escrow account to be held to secure indemnification obligations of the seller under the asset purchase agreement and to be held for a period of up to fifty-four months following the closing, and (iii) delivery of two promissory notes in the aggregate principal amount of $22,000,000. An additional amount may be payable in cash after the end of calendar year 2019 if financial performance targets involving the sale of Salt Life-branded products are met during the 2019 calendar year. At acquisition, we recorded an accrual of $3.4 million for the fair value of the contingent consideration associated with the Salt Life Acquisition. We financed the cash portion of the purchase price through our Fourth Amended and Restated Loan and Security Agreement, as amended on August 27, 2013. We expensed all acquisition-related costs, totaling $0.3 million, in the selling, general and administrative expense line item of our Condensed Consolidated Statements of Operations in the quarter ended September 28, 2013.

On December 6, 2013, we entered into an agreement (the "IMG Agreement") with IMG Worldwide, Inc. ("IMG") that provides for the termination of the Salt Life brand license agreements entered into between Delta Apparel and IMG (as agent on behalf of Salt Life Holdings) prior to the Salt Life Acquisition as well as the agency agreement entered into between Salt Life Holdings and IMG prior to the Salt Life Acquisition. In addition, the IMG Agreement provides that Delta Apparel and Salt Life Holdings are released from all obligations and liabilities under those agreements or relating to the Salt Life Acquisition. Pursuant to the IMG Agreement, Salt Life and IMG entered into a separate, multi-year agency agreement, which has since been terminated, whereby IMG represented Salt Life with respect to the licensing of the Salt Life brand in connection with certain product and service categories. Salt Life agreed to pay IMG installments totaling $3,500,000 to terminate these contractual arrangements. As a result, the above-referenced $3,000,000 indemnification asset was released from escrow during the quarter ended December 28, 2013, and applied towards these payment obligations, along with additional amounts previously accrued for royalty obligations under the above-referenced Salt Life brand license agreements. During the years ended October 3, 2015, and September 27, 2014, we made payments of $0.8 million and $2.1 million, respectively, in accordance with the terms of the agreement. As of January 2, 2016, there were 2 quarterly installments of $195 thousand remaining. We have recorded the fair value of the liability as of January 2, 2016, on our financials with $0.4 million in accrued expenses.

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The Salt Life Acquisition continues our strategy of building lifestyle brands that take advantage of our creative capabilities, vertical manufacturing platform and international sourcing competencies. Prior to the Salt Life Acquisition, Salt Life, LLC (f/k/a To The Game, LLC) sold Salt Life-branded products under exclusive license agreements which began in January 2011. As such, the results of Salt Life sales have been included in our Condensed Consolidated Financial Statements since that time.

We accounted for the Salt Life Acquisition pursuant to ASC 805, Business Combinations, with the purchase price allocated based upon fair value. We have identified certain intangible assets associated with Salt Life, including tradenames and trademarks, license agreements, non-compete agreements and goodwill. The total amount of goodwill is expected to be deductible for tax purposes. Components of the intangible assets recorded at acquisition are as follows (in thousands, except economic life data):

		Economic Life
Goodwill	$19,917	N/A
Intangibles:		
Tradename/trademarks	16,000	30 years
License agreements	2,100	15 – 30 years
Non-compete agreements	770	6.6 years
Total intangibles	18,870	
Total goodwill and intangibles	$38,787	

Note F—Inventories

Inventories, net of reserves of $8.7 million and $8.4 million as of January 2, 2016, and October 3, 2015, respectively, consist of the following (in thousands):

	January 2, 2016	October 3, 2015
Raw materials		