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S2 GOLF INC
Form 10-Q
May 11, 2001

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended March 30, 2001.

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: 0-14146

S2 GOLF INC.

(Exact Name of Registrant as Specified in its Charter)

New Jersey

(State or other jurisdiction of incorporation or organization)

22-2388568

(I.R.S. Employer Identification No.)

18 Gloria Lane, Fairfield, NJ

(Address of Principal Executive Office)

07004

(Zip Code)

(973) 227-7783

(Registrant's telephone number, including area code)

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
--- ---

On March 30, 2001, 3,223,039 shares of common stock, \$.01 par value, were issued and outstanding.

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S2 GOLF INC.
FORM 10-Q

For Quarterly Period Ended March 30, 2001

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

S2 GOLF INC.
BALANCE SHEETS
AS OF MARCH 30, 2001 (UNAUDITED)
AND DECEMBER 31, 2000 (AUDITED)

| | March 30, 2001 ---- | December 31, 2000 ---- |
|-----------------------------------|---------------------------|------------------------------|
| ASSETS | | |
| Current Assets | | |
| Cash | \$ 18,203 | \$ 9,886 |
| Accounts Receivable - Net | 4,621,028 | 3,567,768 |
| Inventories | 5,060,697 | 4,046,122 |
| Prepaid Expenses | 347,690 | 205,982 |
| Deferred Income Taxes | 226,000 | 214,000 |
| | ----- | ----- |
| Total Current Assets | 10,273,618 | 8,043,758 |
| Plant and Equipment - Net | 196,758 | 195,907 |
| Non-Current Deferred Income Taxes | 0 | 6,000 |
| Goodwill | 5,224,424 | 5,307,919 |

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| | | |
|--------------------------------------|--------------|---------------|
| Other Assets Net | 121,294 | 125,056 |
| | ----- | ----- |
| Total Assets | 15,816,094 | 13,678,640 |
| | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Current Portion Long Term Debt | \$1,307,242 | \$1,447,189 |
| Short term Borrowings | 5,023,560 | 3,460,828 |
| Accounts Payable | 1,514,825 | 936,614 |
| Accrued Expenses | 499,578 | 442,335 |
| Other Current Liabilities | 67,338 | 83,847 |
| | ----- | ----- |
| Total Current Liabilities | 8,412,543 | 6,370,813 |
| Long-Term Liabilities | | |
| Long-Term Debt, less current portion | 425,000 | 509,847 |
| Other Long-Term Liabilities | 7,901 | 2,258 |
| Non-current Deferred Income Taxes | 1,000 | 0 |
| | ----- | ----- |
| Total Liabilities | 8,846,444 | 6,882,918 |
| | ----- | ----- |
| Shareholders' Equity | | |
| Common Stock, \$.01 Par; 12,000,000 | | |
| Shares Authorized: 3,223,039 & | | |
| 3,223,039 Issued & Outstanding | | |
| at March 30, 2001 and | | |
| December 31, 2000, respectively | | |
| | 32,231 | 32,231 |
| Additional Paid in Capital | 6,347,757 | 6,347,757 |
| Retained Earnings | 589,662 | 415,734 |
| | ----- | ----- |
| Total Shareholders' Equity | 6,969,650 | 6,795,722 |
| | ----- | ----- |
| Total Liabilities and | | |
| Shareholders' | | |
| Equity | \$15,816,094 | \$ 13,678,640 |
| | ===== | ===== |

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

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S2 GOLF INC.
STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED
MARCH 30, 2001 AND MARCH 31, 2000
(UNAUDITED)

| | March 30, 2001 | March 31, 2000 |
|--------------------|-------------------|-------------------|
| Net Sales | \$ 4,521,595 | \$ 2,864,670 |
| Cost of Goods Sold | 2,649,891 | 1,913,827 |
| | ----- | ----- |
| Gross Profit | 1,871,704 | 950,843 |
| | ----- | ----- |

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| | | |
|--------------------------------------------------------|------------|------------|
| Operating Expenses: | | |
| Selling | 823,633 | 433,134 |
| General & Administrative | 661,459 | 306,153 |
| | ----- | ----- |
| Total Operating Expenses | 1,485,092 | 739,287 |
| Operating Income | 386,612 | 211,556 |
| | ----- | ----- |
| Other (Income) Expense | | |
| Interest Expense | 109,770 | 20,691 |
| Other Income | (40,459) | |
| | ----- | ----- |
| | 69,311 | 20,691 |
| | ----- | ----- |
| Income Before Income Taxes | 317,301 | 190,865 |
| Provision for Income Taxes | 143,373 | 76,828 |
| | ----- | ----- |
| Net Income | \$ 173,928 | \$ 114,037 |
| | ===== | ===== |
| Earnings per Common Share - Basic | \$ 0.05 | \$ 0.05 |
| | ===== | ===== |
| - Diluted | \$ 0.05 | \$ 0.05 |
| | ===== | ===== |
| Weighted Average Number of Common Shares Outstanding - | | |
| Basic | 3,223,039 | 2,220,113 |
| Diluted | 3,269,285 | 2,268,279 |

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

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S2 GOLF INC.
STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED
MARCH 30, 2001 AND MARCH 31, 2000
(UNAUDITED)

| | March 30, 2001 ---- | March 31, 2000 ---- |
|-----------------------------------------------------------------------------------------|---------------------------|---------------------------|
| OPERATING ACTIVITIES | | |
| Net Income | \$173,928 | \$114,037 |
| Adjustments to Reconcile Net Income to Net Cash Provided By Operating Activities: | | |
| Depreciation | 26,588 | 14,462 |
| Amortization | 91,413 | |
| Deferred Income Taxes | (5,000) | (15,900) |
| Allowance for Doubtful Accounts | 60,389 | |
| Changes in Assets and Liabilities: | | |
| Accounts Receivable | (1,113,649) | (1,144,283) |
| Inventories | (1,014,575) | (142,727) |

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| | | |
|-------------------------------------------------|-------------|-----------|
| Prepaid Expenses | (141,708) | 44,841 |
| Other Assets | 3,762 | 0 |
| Accounts Payable | 578,211 | 629,819 |
| Accrued Expenses | 57,243 | 111,940 |
| Other Current and Non-Current Liabilities | (16,509) | (14,822) |
| | ----- | ----- |
| NET CASH USED IN OPERATIONS | (1,299,907) | (402,633) |
| | ----- | ----- |
| INVESTING ACTIVITIES | | |
| Purchase of Equipment | (35,357) | (25,364) |
| | ----- | ----- |
| FINANCING ACTIVITIES | | |
| Repayments of long-term debt | (219,151) | |
| Proceeds from Revolving Line of Credit, Net | 1,562,732 | 427,997 |
| | ----- | ----- |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 1,343,581 | 427,997 |
| | ----- | ----- |
| INCREASE IN CASH | 8,317 | 0 |
| CASH - BEGINNING OF PERIOD | 9,886 | 150 |
| | ----- | ----- |
| CASH - END OF PERIOD | \$18,203 | \$150 |
| | ===== | ===== |
| SUPPLEMENTAL CASH FLOW DISCLOSURES | | |
| Cash Paid During the Year For: | | |
| Interest | \$138,136 | \$20,691 |
| | ===== | ===== |
| Income Taxes | \$60,000 | \$0 |
| | ===== | ===== |

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE STATEMENTS

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NOTES TO FINANCIAL STATEMENTS

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited financial statements of S2 Golf Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting. In the opinion of management, all material adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 30, 2001 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2001. The unaudited financial statements and related notes are presented as permitted by Form 10-Q and do not contain certain information

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included in the Company's annual financial statements and notes thereto. For further information, refer to the Company's annual financial statements and notes thereto included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2000.

1) EARNINGS PER SHARE

Basic earnings per share ("EPS") excludes dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if stock options or other contracts to issue common stock were exercised and resulted in the issuance of common stock that then shared in the earnings of the Company. Diluted EPS is computed using the treasury stock method when the effect of common stock equivalents would be dilutive. The only reconciling item between the denominator used to calculate basic EPS and the denominator used to calculate diluted EPS is the dilutive effect of stock options issued to employees of the Company and other parties. The Company has issued no other potentially dilutive common stock equivalents.

2) INVENTORIES

Inventories are valued at the lower of cost, determined on the basis of the first-in, first-out method, or market.

Inventories at March 30, 2001 and December 31, 2000 consisted of the following components:

| | 3/30/01 | 12/31/00 |
|----------------|-------------|-------------|
| | ----- | ----- |
| Raw Materials | \$4,261,107 | \$3,404,600 |
| Finished Goods | 799,590 | 641,522 |
| | ----- | ----- |
| | \$5,060,697 | \$4,046,122 |
| | ===== | ===== |

3) SHORT TERM BORROWINGS

The Company has a secured revolving line of credit allowing a maximum credit limit of \$8,000,000, less 50% of the aggregate face amount of all outstanding letters of credit, and subject to various borrowing bases through September 30, 2003. The availability of funds under this line of credit varies as it is based, in part, on a borrowing base of 80% of eligible accounts receivable and 60% of qualified inventory. Substantially all of the Company's assets are used as collateral for the credit line. Interest rates are

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at prime plus one-quarter percent, paid monthly; the interest rate was 8.25% as of March 30, 2001 and 9.75% as of December 31, 2000. The Company's availability on the line of credit, as of March 30, 2001, was approximately \$325,130.

The credit facility contains certain covenants, which, among other items, require the maintenance of certain financial ratios including tangible net worth and working capital. Any event of default under the credit facility permits the lender to cease making additional loans thereunder. The Company was in compliance with all covenants and conditions of the facility as of March 30, 2001.

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4) QUARTERLY ENDS

The Company reports its interim financial statements as of the Friday closest to month-end of the quarter. Therefore, the interim quarters for fiscal 2001 will end on March 30, 2001, June 29, 2001, and September 28, 2001. The Company reports its year-end financial statements as of December 31.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Net Sales for the three-months ended March 30, 2001 were \$4,521,595, compared to \$2,864,670 for the same period in 2000. Management attributes this 57.8% increase in sales over the same period in the prior year primarily due to the acquisitions of the Nancy Lopez and Lady Fairway product lines. These acquisitions accounted for approximately \$1,775,000 of the \$1,656,925 increase, offset by a decline of approximately \$118,000 in the Square Two brand. The primary reason for the decline in the Square Two brand was a softening of demand for the men's clubs. The Square Two women's clubs increased 15%.

Gross profit as a percentage of sales for the three-month period ended March 30, 2001 was 41.4%, as compared to 33.2% for the same period in 2000. Management attributes this increase to the higher margin sales of the Nancy Lopez Golf brand and the Lady Fairway brand along with lower component pricing for the Square Two brand.

Selling expenses for the three-month period ended March 30, 2001 were \$823,633, compared to \$433,134 for the same period in 2000. This three-month difference is the result of increased expenses of approximately \$142,000 due to the Lady Fairway acquisition, as well as increased PGA show expense, advertising, public relations and commissions. In addition, the Company incurred player endorsements during the three-month period ended March 30, 2001 that did not exist in the three-month period ended March 31, 2000, which was approximately \$50,000.

General and Administrative expenses for the three-month period ended March 30, 2001 were \$661,459, compared to \$306,153 for the same period in 2000. This is due primarily to increased expenses of approximately \$142,000 due to Lady Fairway acquisition as well as increased salaries and wages, printing, professional and legal fees and amortization of goodwill for both Nancy Lopez Golf and Lady Fairway.

Interest expense for the three-month period ended March 30, 2001 was \$109,770, compared to \$20,691 for the same period in 2000. The average loan balance for the three-month period ended March 30,

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2001 was \$4,379,130 compared to an average loan balance of \$1,179,442 for the three-month period ended March 31, 2000. This increase in the average outstanding balance resulted mainly from the Nancy Lopez Golf acquisition, as well as from increased inventory. The Nancy Lopez Golf acquisition, which occurred on July 31, 2000, was a cash purchase of approximately \$3,645,000 after post-closing adjustments, which the Company funded with a term loan of \$900,000 and the existing line of credit. Interest expense for the three-month period ended March 30, 2001 also includes \$25,000 projected interest expense on the Promissory Note with a maturity date of December 31, 2001 that the Company issued in connection with the Lady Fairway acquisition.

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Other Income for the three-month period ended March 30, 2001 was \$40,459 compared to \$0 for the same period in 2000. This increase is due to royalty income from international distributors.

The Company's net income for the three-month period ended March 30, 2001 was \$173,928, compared to \$114,037 for the same period in 2000. This increase is the result of a 57.8% increase in net revenue, gross margins improving to 41.4%, offset by increased sales, general and administrative, interest and other expense due to the Nancy Lopez and Lady Fairway acquisitions.

FINANCIAL CONDITION AND LIQUIDITY

The Company's working capital increased by \$188,130 for the three-month period ended March 30, 2001. Current assets increased by \$2,229,860, offset by an increase in current liabilities of \$2,041,730. Accounts receivable increased by approximately \$1,053,000, inventory increased by approximately \$1,015,000 for the three-month period ended March 30, 2001, which was typical for the Company due to the cyclical nature of the golf industry. In addition, prepaid expenses increased approximately \$142,000. The Company's short-term borrowing increased by approximately \$1,563,000, which was a result of the acquisitions, as well as increased inventory. In addition, accounts payable increased by approximately \$578,000 for the three-month period ended March 30, 2001.

Cash used by operations was \$1,299,907 and \$402,633 for the three-month period ending March 30, 2001 and March 31, 2000, respectively. Cash provided by financing activities totaled \$1,343,581 for the three-month period ended March 30, 2001 and \$427,997 for the same three-month period in 2000. During the three-month period ended March 30, 2001 cash used for the payment of equipment purchased was \$35,357 and \$25,364 respectively. Cash paid for interest charges on short and long-term borrowings was \$138,136 and \$20,691 for the three-month periods ended March 30, 2001 and March 31, 2000, respectively.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) The exhibits listed on the attached Exhibit Index are filed as part of this report.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

S2 GOLF INC.

05/11/2001

/s/ Douglas A. Buffington

Dated

By: Douglas A. Buffington
President, Chief Financial Officer,
Chief Operating Officer and Treasurer

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EXHIBIT INDEX

| EXHIBIT NUMBER | DESCRIPTION OF EXHIBIT* |
|----------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1 | Amended and Restated Certificate of Incorporation of the registrant dated June 28, 1991 (incorporated by reference to Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991). |
| 3.2 | Amended and Restated Bylaws of the registrant dated December 6, 1991 (incorporated by reference to Exhibit 3.2 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1991). |
| 4.1 | Common Stock Purchase Warrant in favor of Wesmar Partners dated February 28, 1988 (incorporated by reference to Exhibit 4.4 of the registrant's Registration Statement No. 33-37371 on Form S-3). |
| 4.2 | Common Stock Purchase Warrant in favor of Wesmar Partners dated February 28, 1988 (incorporated by reference to Exhibit 4.5 of the registrant's Registration Statement No. 33-37371 on Form S-3). |
| 4.3 | Stock Option Agreement between the registrant and Wesmar Partners dated February 29, 1988 (incorporated by reference to Exhibit 4.6 of the registrant's Registration Statement No. 33-37371 on Form S-3). |
| 10.0 | Loan and Security Agreement between the registrant and Midlantic Bank, National Association dated December 29, 1994 (incorporated by reference to Exhibit 99 of the registrant's Current Report on Form 8-K dated December 26, 1994). |
| 10.1 | First Amendment to Loan and Security Agreement between the registrant and Midlantic Bank, National Association made as of April 9, 1996 (incorporated by reference to Exhibit 10.1 of the registrant's Annual Report on Form 10-K for the year ended December 31, 2000). |
| 10.2 | Second Amendment to Loan and Security Agreement between registrant and PNC Bank, National Association as successor in interest of Midlantic Bank, National Association made as of December 1, 1997 (incorporated by reference to Exhibit 10.12 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1997). |
| 10.3 | Fourth Amendment to Loan and Security Agreement between the registrant and PNC Bank, National Association dated as of July 31, 2000 (incorporated by reference to Exhibit 10.14 to the registrant's Registration Statement No. 333-47908 on Form S-4). |
| 10.4 | Fifth Amendment to Loan and Security Agreement between the registrant and PNC Bank, National Association made as of January 3, 2001 (incorporated by reference to Exhibit 10.4 of the registrant's Annual Report on Form 10-K for the year ended December 31, 2000). |

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- 10.5 Lease Agreement between the registrant and 12 Gloria Lane Limited Partnership dated June 22, 1989 (incorporated by reference to Exhibit 10.6 of the registrant's Registration Statement No. 33-37371 on Form S-3).
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- 10.6 Modification of Lease Agreement between the registrant and 12 Gloria Lane Industrial Partnership dated October 3, 1995 (incorporated by reference to Exhibit 10.2 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1995).
- 10.7 Lease Modification, Extension, Assignment, Assumption and Consent among Joel Levy as Successor Land Trustee of Trust Number One under Unrecorded Land Trust Agreement dated as of November 29, 1999, Ladies Golf Equipment Company, Inc. and S2 Golf Acquisition Corp., dated as of December 29, 2000 (incorporated by reference to Exhibit 10.7 of the registrant's Annual Report on Form 10-K for the year ended December 31, 2000).
- 10.8 Amended and Restated Licensing Agreement between Ladies Professional Golf Association and the registrant dated January 1, 1999 (incorporated by reference to Exhibit 10.2 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1999).
- 10.9 Endorsement Agreement between the registrant and Kathy Whitworth dated October 13, 1999 (incorporated by reference to Exhibit 10.13 to the registrant's Annual Report on Form 10-K for the year ended December 31, 1999).
- 10.10 Licensing Agreement between Nancy Lopez Enterprises, Inc. and the registrant made as of July 31, 2000 (incorporated by reference to Exhibit 10.10 of the registrant's Annual Report on Form 10-K for the year ended December 31, 2000).
- 10.11 License Agreement between the registrant and Raymond Lanctot Ltee/Ltd. dated June 28, 1999 (incorporated by reference to Exhibit 10.12 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1999).
- 10.12 Asset Purchase Agreement among the registrant, APGC Holdings Company, LLC and The Arnold Palmer Golf Company dated July 31, 2000 (incorporated by reference to Exhibit 2.0 to the registrant's Current Report on Form 8-K reporting the event dated July 31, 2000).
- 10.13 Agreement and Plan of Reorganization, dated as of June 22, 2000, among the registrant, S2 Golf Acquisition Corp., Ladies Golf Equipment Company, Inc., James E. Jones and Brian Christopher (incorporated by reference to Exhibit 2.0 of the registrant's Registration Statement No. 333-47908 on Form S-4).
- 10.14 1992 Stock Plan for Independent Directors of S2 Golf Inc. dated December 28, 1992 (incorporated by reference to Exhibit 10.11 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1992).

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- 10.15** 1998 Employee Stock Plan of the registrant (incorporated by reference to Exhibit 10.15 of the registrant's Annual Report on Form 10-K for the year ended December 31, 2000).
- 10.16** Agreement between the registrant and Randy A. Hamill dated January 2, 1997 (incorporated by reference to Exhibit 10.10 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1997).
- 10.17** Employment Agreement between the registrant and Douglas A. Buffington made April 3,

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2001 and effective as of 1, 2001.

- 10.18** Consulting Services Agreement between the registrant and MR & Associates made as of December 15, 2000, effective as of January 1, 2000 (incorporated by reference to Exhibit 10.18 of the registrant's Annual Report on Form 10-K for the year ended December 31, 2000).
- 10.19** Employment Agreement among the registrant, S2 Golf Acquisition Corp. and James E. Jones dated as of January 1, 2001 (incorporated by reference to Exhibit 10.19 of the registrant's Annual Report on Form 10-K for the year ended December 31, 2000).
- 21.0 Subsidiaries of the registrant (incorporated by reference to Exhibit 21.0 of the registrant's Quarterly Report on Form 10-Q for the quarter ended September 29, 2000).

* In the case of incorporation by reference to documents filed by the registrant under the Securities Exchange Act, the registrant's file number under the Securities Exchange Act is 0-14146.

** Management contract or management compensatory plan or arrangement.

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