

K2 INC
Form 10-Q
November 14, 2003

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 Quarter Ended September 30, 2003

Commission File No. 1-4290

K2 INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State of Incorporation)

2051 Palomar Airport Road Carlsbad, California
(Address of principal executive offices)

95-2077125
(I.R.S. Employer Identification No.)

92009
(Zip Code)

Registrant's telephone number, including area code (760) 494-1000

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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 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 October 31, 2003

Common Stock, par value \$1

28,521,798 Shares

FORM 10-Q QUARTERLY REPORT

PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

STATEMENTS OF CONDENSED CONSOLIDATED INCOME

(Thousands, except per share figures)

| | Three months | | Nine months | |
|-------------------------------------|--------------------|------------|--------------------|------------|
| | ended September 30 | | ended September 30 | |
| | 2003 | 2002 | 2003 | 2002 |
| | (Unaudited) | | | |
| Net sales | \$ 167,963 | \$ 149,787 | \$ 524,754 | \$ 454,463 |
| Cost of products sold | 113,094 | 102,280 | 362,524 | 319,569 |
| Gross profit | 54,869 | 47,507 | 162,230 | 134,894 |
| Selling expenses | 29,500 | 23,337 | 83,114 | 65,166 |
| General and administrative expenses | 17,614 | 16,037 | 52,513 | 44,890 |
| Operating income | 7,755 | 8,133 | 26,603 | 24,838 |
| Interest expense | 2,640 | 2,263 | 7,248 | 7,130 |
| Debt extinguishment costs | | | 6,745 | |
| Other income, net | (54) | (72) | (1,654) | (59) |
| Income before income taxes | 5,169 | 5,942 | 14,264 | 17,767 |
| Provision for income taxes | 1,808 | 2,079 | 4,992 | 6,218 |
| Net income | \$ 3,361 | \$ 3,863 | \$ 9,272 | \$ 11,549 |
| Basic earnings per share: | | | | |
| Net income | \$ 0.12 | \$ 0.22 | \$ 0.39 | \$ 0.64 |
| Diluted earnings per share: | | | | |
| Net income | \$ 0.12 | \$ 0.21 | \$ 0.38 | \$ 0.64 |
| Basic shares outstanding | 27,274 | 17,942 | 23,576 | 17,941 |
| Diluted shares outstanding | 34,487 | 18,012 | 26,623 | 17,975 |

See notes to consolidated condensed financial statements.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Thousands, except number of shares)

| | September 30 | December 31 |
|--|--------------------|-------------------|
| | 2003 | 2002 |
| | <u>(Unaudited)</u> | |
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 14,615 | \$ 11,228 |
| Accounts receivable, net | 176,922 | 143,062 |
| Inventories, net | 200,756 | 144,246 |
| Deferred taxes | 37,975 | 17,225 |
| Prepaid expenses and other current assets | 12,903 | 8,163 |
| | <u>443,171</u> | <u>323,924</u> |
| Total current assets | 443,171 | 323,924 |
| Property, plant and equipment | 182,905 | 169,937 |
| Less allowance for depreciation and amortization | 106,827 | 106,574 |
| | <u>76,078</u> | <u>63,363</u> |
| Intangible assets, net | 127,444 | 43,382 |
| Other | 13,085 | 7,741 |
| | <u>140,529</u> | <u>51,123</u> |
| Total Assets | <u>\$ 659,778</u> | <u>\$ 438,410</u> |
| Liabilities and Shareholders Equity | | |
| Current Liabilities | | |
| Bank loans | \$ 8,116 | \$ 6,261 |
| Accounts payable | 52,004 | 44,915 |
| Accrued payroll and related | 26,623 | 17,459 |
| Other accruals | 57,300 | 29,815 |
| Current portion of long-term debt | 6,667 | 16,852 |
| | <u>150,710</u> | <u>115,302</u> |
| Total current liabilities | 150,710 | 115,302 |
| Long-term pension liabilities | 12,553 | 12,553 |
| Long-term debt | 35,079 | 73,007 |
| Deferred taxes | 18,952 | 6,252 |
| Convertible subordinated debentures | 97,951 | |
| Commitments and Contingencies | | |
| Shareholders Equity | | |
| Preferred Stock, \$1 par value, authorized 12,500,000 shares, none issued | | |
| Common Stock, \$1 par value, authorized 60,000,000 shares, issued shares - 29,017,414 in 2003 and 18,689,310 in 2002 | 29,017 | 18,689 |
| Additional paid-in capital | 231,004 | 143,365 |
| Retained earnings | 105,465 | 96,193 |
| Employee Stock Ownership Plan and stock option loans | (1,206) | (1,380) |
| Treasury shares at cost, 747,234 shares in 2003 and 2002 | (9,117) | (9,117) |
| Accumulated other comprehensive loss | (10,630) | (16,454) |
| | <u>235,533</u> | <u>110,286</u> |

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| | | |
|--|------------|------------|
| Total Shareholders' Equity | 344,533 | 231,296 |
| Total Liabilities and Shareholders' Equity | \$ 659,778 | \$ 438,410 |

See notes to consolidated condensed financial statements.

STATEMENTS OF CONDENSED CONSOLIDATED CASH FLOWS

(Thousands)

| | Nine months | |
|---|--------------------|-----------------|
| | ended September 30 | |
| | 2003 | 2002 |
| | (Unaudited) | |
| Operating Activities | | |
| Net Income | \$ 9,272 | \$ 11,549 |
| Adjustments to reconcile net income from operations to net cash provided by operating activities: | | |
| Gain on sale of operating division | (1,504) | |
| Depreciation and amortization | 14,275 | 11,273 |
| Deferred taxes | 0 | 2,366 |
| Repurchase of previously securitized receivables | | (51,827) |
| Changes in noncash current assets and current liabilities | 27,522 | 42,330 |
| Net cash provided by operating activities | 49,565 | 15,691 |
| Investing Activities | | |
| Property, plant & equipment expenditures | (15,067) | (5,863) |
| Disposals of property, plant & equipment | 21 | (58) |
| Cash merger costs for business acquisition, net of cash acquired | (3,654) | |
| Purchase of businesses, net of cash acquired | (12,646) | |
| Proceeds received from sale of operating division | 20,132 | |
| Other items, net | 1,137 | (2,472) |
| Net cash used in investing activities | (10,077) | (8,393) |
| Financing Activities | | |
| Issuance of convertible subordinated debentures | 100,000 | |
| Borrowings under long-term debt | 388,507 | 47,250 |
| Net borrowings under (payments on) accounts receivable purchase facility | (25,702) | 20,702 |
| Payments of long-term debt | (492,874) | (81,990) |
| Net increase in short-term bank loans | 1,885 | 2,744 |
| Debt issuance costs | (7,917) | |
| Net cash used in financing activities | (36,101) | (11,294) |
| Net increase (decrease) in cash and cash equivalents | 3,387 | (3,996) |
| Cash and cash equivalents at beginning of year | 11,228 | 11,416 |
| Cash and cash equivalents at end of period | \$ 14,615 | \$ 7,420 |

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

September 30, 2003

NOTE 1 Basis of Presentation

The accompanying unaudited condensed consolidated 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 nine month periods ended September 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003.

The balance sheet at December 31, 2002 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. The balance sheet at September 30, 2003 includes the balance sheet of Rawlings Sporting Goods Company, Inc. (Rawlings) and Worth, Inc. (Worth) which K2 acquired on March 26, 2003 and September 16, 2003, respectively, but the December 31, 2002 balance sheet does not reflect the acquisitions. As a result, certain balance sheet accounts such as accounts receivable, inventories, deferred taxes, intangible assets, accounts payable, accrued liabilities, common stock and additional paid in capital show significant increases from December 31, 2002.

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, 2002.

NOTE 2 Balance Sheet Details and Summary of Significant Accounting Policies

Accounts Receivable and Allowances

Accounts receivable are net of allowances for doubtful accounts of \$8,831,000 at September 30, 2003 and \$7,838,000 at December 31, 2002.

Inventories

The components of inventories consisted of the following:

September 30 December 31

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| | <u>2003</u> | <u>2002</u> |
|-----------------|-------------------|-------------------|
| | (Thousands) | |
| Finished goods | \$ 158,986 | \$ 104,204 |
| Work in process | 9,785 | 10,741 |
| Raw materials | 31,985 | 29,301 |
| | <u>\$ 200,756</u> | <u>\$ 144,246</u> |

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

NOTE 2 Balance Sheet Details and Summary of Significant Accounting Policies (Continued)

Newly Adopted Accounting Standards

In December 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. SFAS No. 148 amends SFAS No. 123, *Accounting for Stock-Based Compensation* to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for interim and annual periods beginning after December 15, 2002.

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:

| | Three months ended | | Nine months ended | |
|--|---|-----------------|-------------------|------------------|
| | September 30 | | September 30 | |
| | 2003 | 2002 | 2003 | 2002 |
| | (Thousands, except per share data, percentage data and expected life) | | | |
| Net income as reported | \$ 3,361 | \$ 3,863 | \$ 9,272 | \$ 11,549 |
| Less: Total stock-based compensation expense determined under fair value based method for all awards, net of taxes | 258 | 135 | 527 | 405 |
| | <u>\$ 3,103</u> | <u>\$ 3,728</u> | <u>\$ 8,745</u> | <u>\$ 11,144</u> |
| Earnings per share: | | | | |
| Basic - as reported | \$ 0.12 | \$ 0.22 | \$ 0.39 | \$ 0.64 |
| Basic - pro forma | \$ 0.11 | \$ 0.21 | \$ 0.37 | \$ 0.62 |
| Diluted - as reported | \$ 0.12 | \$ 0.21 | \$ 0.38 | \$ 0.64 |
| Diluted - pro forma | \$ 0.11 | \$ 0.21 | \$ 0.36 | \$ 0.62 |
| Risk free interest rate | 3.33% | 2.53% | 3.33% | 2.53% |

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| | | | | |
|--------------------------|---------|---------|---------|---------|
| Expected life of options | 5 years | 5 years | 5 years | 5 years |
| Expected volatility | 50.4% | 43.6% | 50.4% | 43.6% |

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

Note 3 Acquisitions

Worth Acquisition

On September 16, 2003, K2 completed the acquisition of Worth, Inc. (Worth) in a cash and stock merger transaction. Worth, a privately held company founded in 1912, is a marketer and manufacturer of bats, balls, gloves and accessories for the softball and baseball industry. Additionally, through its deBeer division, Worth is a producer of equipment for lacrosse. Under the terms of the merger agreement, K2 acquired all of the issued and outstanding shares of Worth common stock and issued approximately 0.9 million shares of K2's common stock to the former owners of Worth along with a cash payment of \$12.6 million, resulting in a preliminary purchase price of approximately \$27.4 million plus merger costs of approximately \$1.4 million. The valuation of the common stock issued in connection with the acquisition was \$17.078 per share based on the average of the quoted market price of K2 stock for the 5 trading days before the completion of the acquisition. In connection with the acquisition, K2 paid off Worth's long-term and seasonal working capital debt of approximately \$15 million.

The transaction was accounted for under the purchase method of accounting, accordingly, the purchased assets and liabilities assumed were recorded at their estimated fair values at the date of acquisition. The following table summarizes the total preliminary purchase price allocation of the fair value of the assets acquired and liabilities assumed:

| | <i>In thousands</i> |
|---|---------------------|
| Total preliminary purchase price, including estimated merger expenses (a) | \$ 28,798 |
| Total current assets | \$ 21,087 |
| Property, plant and equipment | 6,334 |
| Deferred taxes and other assets | 1,488 |
| | <hr/> |
| Net tangible assets acquired (b) | 28,909 |
| Total liabilities assumed (c) | 22,660 |
| | <hr/> |
| Net assets acquired (b) - (c) = (d) | 6,249 |
| | <hr/> |
| Net intangible assets acquired (a) - (d) | \$ 22,549 |
| | <hr/> |

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

Note 3 Acquisitions (Continued)

This preliminary allocation assumes the excess purchase price will be allocated to goodwill, and is thus not amortized. The final allocation, however, could include identifiable assets with finite and indefinite lives separate from goodwill. Should there be assets with finite lives, those assets would be subject to amortization resulting in additional amortization expense. The final allocation of the preliminary purchase price will be completed during the 2003 fourth quarter based on K2's final evaluation of such assets and liabilities. The results of the operations of Worth were included in the consolidated financial statements of K2 beginning on the date of acquisition. The September 30, 2003 balance sheet of Worth was included in the consolidated condensed financial statements of K2 at September 30, 2003.

Rawlings Acquisition

On March 26, 2003, K2 completed the acquisition of Rawlings Sporting Goods Company, Inc. (Rawlings), a designer, manufacturer and marketer of equipment and apparel for baseball, basketball and football, in an all-stock merger transaction. Under the terms of the merger, each share of Rawlings common stock was converted into 1.080 shares of K2 common stock. Based on the number of common shares outstanding of Rawlings, approximately 8.8 million shares of K2's common stock were issued to the Rawlings shareholders, and the purchase price of the transaction was valued at approximately \$76.8 million plus merger costs of approximately \$5.1 million. The purchase price included K2 stock options issued in exchange for Rawlings stock options outstanding at the time of the acquisition valued at approximately \$4.6 million. The valuation of the common stock issued in connection with the acquisition was \$8.194 per share based on the average of the quoted market price K2 stock for the 5 trading days before the completion of the acquisition. The value of the K2 stock options issued in exchange for the Rawlings stock options outstanding was based on a Black-Scholes estimate using the following assumptions: risk free interest rate of 1.72%, volatility of K2 stock of 0.507 and expected life of 2.75 years. In connection with the acquisition, K2 paid off Rawlings' long-term and seasonal working capital debt of approximately \$64 million.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

Note 3 Acquisitions (Continued)

The Rawlings transaction was accounted for under the purchase method of accounting, accordingly, the purchased assets and liabilities assumed were recorded at their estimated fair values at the date of acquisition. The following table summarizes the total purchase price, estimated fair values of the assets acquired and liabilities assumed, and the resulting net intangible assets acquired at the date of the acquisition:

| | <i>In thousands</i> | |
|---|---------------------|-------------------|
| Total purchase price, including estimated merger expenses and value of K2 stock options issued in exchange for Rawlings stock options outstanding (a) | | \$ 81,928 |
| Total current assets | \$ 101,574 | |
| Property, plant and equipment | 7,357 | |
| Deferred taxes and other assets | 8,361 | |
| | <u> </u> | |
| Net tangible assets acquired (b) | 117,292 | |
| Total liabilities assumed (c) | 95,328 | |
| | <u> </u> | |
| Net assets acquired (b) - (c) = (d) | | 21,964 |
| | | <u> </u> |
| Net intangible assets acquired (a) - (d) | | \$ 59,964 |
| | | <u> </u> |

The purchase price allocation resulted in an excess of the purchase price over net tangible assets acquired of \$60.0 million. Based on a valuation completed by K2 during the 2003 second quarter, this excess amount was allocated to intangible assets with definite and indefinite lives including: patents of \$1.6 million with an average life of 9 years; customer contracts of \$4.2 million with an average life of 11 years; licensing arrangements of \$3.8 million with an average life of 6 years; tradenames/trademarks with indefinite lives not subject to amortization of \$21.5 million; and goodwill not subject to amortization of \$28.9 million.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

Note 3 Acquisitions (Continued)

The following summarized unaudited pro forma results of operations of K2 assume the acquisition of Rawlings and Worth had occurred as of the beginning of the respective periods. 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 | | For the nine months | |
|----------------------------|----------------------|------------|---------------------|------------|
| | ended September 30 | | ended September 30 | |
| | 2003 | 2002 | 2003 | 2002 |
| Net sales | \$ 174,586 | \$ 181,474 | \$ 627,238 | \$ 633,263 |
| Operating income | 5,417 | 1,544 | 35,590 | 31,506 |
| Net income | 1,756 | (791) | 14,233 | 14,424 |
| Diluted earnings per share | \$ 0.07 | \$ (0.01) | \$ 0.49 | \$ 0.50 |

During the nine months ended September 30, 2003, K2 also completed two additional acquisitions for a total combined purchase price of approximately \$2.9 million. The Consolidated Financial Statements include the operating results of each business from the date of acquisition. Pro forma results of operations 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 results.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

NOTE 4 Sale of Operating Division

On May 27, 2003, K2 completed the sale of the assets of the composite utility and decorative light pole product lines (the Division) of its industrial products segment to GTG Temporary, LLC, a subsidiary of Genlyte Thomas Group LLC. The Division was sold for approximately \$20.1 million in cash and the assumption of certain liabilities by the buyer. The gain on the sale of the Division of \$1.5 million (\$1.0 million, net of taxes) includes an estimate of the costs of disposal and amounts related to the retention of certain liabilities by K2.

NOTE 5 Intangible Assets

The components of intangible assets consisted of the following:

| | September 30 | December 31 |
|--|-------------------|------------------|
| | 2003 | 2002 |
| | _____ | _____ |
| | (Thousands) | |
| Intangibles subject to amortization: | | |
| Net carrying amount: | | |
| Patents | \$ 3,677 | \$ 1,873 |
| Customer contracts | 3,979 | |
| Licensing agreements | 3,483 | |
| Intangibles not subject to amortization (by segment): | | |
| Net carrying amount: | | |
| Sporting goods | 112,020 | 37,224 |
| Other recreational | 1,059 | 1,059 |
| Industrial | 3,226 | 3,226 |
| | _____ | _____ |
| | 116,305 | 41,509 |
| Total intangible assets, net | \$ 127,444 | \$ 43,382 |
| | _____ | _____ |

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

NOTE 6 Borrowings and Other Financial Instruments

On June 10, 2003, K2 completed the placement of \$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 \$13.143 per share. The net proceeds from the sale were used to pay off the outstanding balance under K2 s \$205 million revolving credit facility with the remaining cash proceeds to be used for general corporate purposes. The debentures are redeemable by K2 in whole or in part at K2 s option on or after June 15, 2008 at the redemption prices set forth in the purchase agreement for these debentures.

On February 14, 2003, K2 completed the placement of \$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 \$11.92 per share. Pursuant to the agreement for these debentures, the noteholders also initially received warrants to purchase 524,329 additional shares of K2 s common stock at \$13.91 per share, exercisable within the five year period ended February 14, 2008 (the Warrants). On June 4, 2003, in consideration for an amendment to permit the issuance of the 5% Debentures, the Warrants were repriced to \$11.92 per share and the noteholders were issued additional warrants to purchase 243,260 shares of K2 s common stock at \$13.14 per share (the Additional Warrants). The Additional Warrants are exercisable within the three year period ended February 14, 2006. In connection with the amendment to the exercise price of the Warrants, a Black-Scholes option valuation model was used to calculate the additional fair market value related to the repricing of the Warrants. Based on a risk free interest rate of 2.13%, K2 s stock volatility of 35%, and the remaining term of the original five years, K2 assigned an additional fair market value of \$267,000 to the repricing of the Warrants. K2 also assigned a fair market value of \$358,000 to the Additional Warrants based on a risk free interest rate of 1.46%, K2 s stock volatility of 35%, and the three year term, placing the total fair market value of the Warrants and Additional Warrants at \$2,303,000. The aggregate unamortized fair market value of \$2,166,000 is reflected as a reduction of the face amount of the 7.25% Debentures on K2 s balance sheet which will be amortized using the effective interest method through the exercise periods, thereby increasing the carrying value of the debentures.

K2 s principal long-term borrowing facility is a \$205 million revolving credit facility (Credit Facility), secured by all of K2 s assets in the United States, Canada and England. The Credit Facility is expandable to \$230 million subject to certain conditions. The Credit Facility has a \$75 million limit for the issuance of letters of credit. Actual borrowing availability under the Credit 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. The Credit Facility expires on March 31, 2006.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

NOTE 6 Borrowings and Other Financial Instruments (Continued)

At September 30, 2003, there were \$25.1 million of borrowings with an effective interest rate of 4.50% and \$26.1 million of letters of credit outstanding under the Credit Facility. Pursuant to the terms of the Credit Facility, an additional \$104.5 million was available for borrowing at September 30, 2003.

At September 30, 2003, in addition to the Credit Facility, K2 also had a \$16.7 million term loan payable in equal monthly installments through March 31, 2006 with an effective interest rate of 5.15% and \$8.1 million outstanding under foreign lending arrangements.

NOTE 7 Accumulated Other Comprehensive Loss

The components of other comprehensive loss are as follows:

| | Currency Translation Adjustments | Additional Minimum Pension Liability | Derivative Financial Instruments | Total |
|---|--|--|--|-------------------|
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| | (Thousands) | | | |
| Balance at December 31, 2002 | \$ (11,080) | \$ (4,904) | \$ (470) | \$ (16,454) |
| Currency translation adjustment | 6,011 | | | 6,011 |
| Reclassification adjustment for amounts recognized in cost of sales | | | 470 | 470 |
| Change in fair value of derivatives, net of \$354 in taxes | | | (657) | (657) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Balance at September 30, 2003 | \$ (5,069) | \$ (4,904) | \$ (657) | \$ (10,630) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

Total comprehensive income was \$7.1 million and \$5.0 million for the three months ended September 30, 2003 and 2002, respectively. Total comprehensive income was \$15.1 million and \$18.4 million for the nine months ended September 30, 2003 and 2002, 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)

September 30, 2003

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 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 3,249,084 and 1,929,961 shares of common stock were outstanding at September 30, 2003 and September 30, 2002, respectively. At September 30, 2003, shares of common stock issuable upon conversion of the \$100 million of convertible debentures totaling 7,803,742 and warrants to purchase 767,589 of shares of common stock were outstanding. For the three and nine month periods ended September 30, 2003, 433,500 and 495,710 stock options, respectively were excluded since their inclusion would have been antidilutive. For nine month period ended September 30, 2003, 767,589 warrants were also excluded since their inclusion would have been antidilutive. The EPS calculation for the three and nine month period ended September 30, 2003 also excluded 2,097,282 shares from the issuance of \$25 million convertible subordinated debentures in February 2003, since their inclusion would have also been antidilutive. For the three and nine month periods ended September 30, 2002, 928,461 and 1,175,265 stock options, respectively, were excluded since their inclusion would have been antidilutive.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

NOTE 8 Earnings Per Share Data (Continued)

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

| | Three months ended | | Nine months ended | |
|--|---------------------------------------|----------|-------------------|-----------|
| | September 30 | | September 30 | |
| | 2003 | 2002 | 2003 | 2002 |
| | (Thousands, except per share amounts) | | | |
| Determination of diluted number of shares: | | | | |
| Average common shares outstanding | 27,274 | 17,942 | 23,576 | 17,941 |
| Assumed conversion of dilutive stock options and warrants | 1,507 | 70 | 722 | 34 |
| Assumed conversion of subordinated debentures | 5,706 | | 2,325 | |
| Diluted average common shares outstanding (b) | 34,487 | 18,012 | 26,623 | 17,975 |
| Calculation of diluted earnings per share: | | | | |
| Net income | \$ 3,361 | \$ 3,863 | \$ 9,272 | \$ 11,549 |
| Add: interest component on assumed conversion of subordinated debentures, net of taxes | 609 | | 745 | |
| Net income, adjusted (a) | \$ 3,970 | \$ 3,863 | \$ 10,017 | \$ 11,549 |
| Diluted earnings per share (a/b) | \$ 0.12 | \$ 0.21 | \$ 0.38 | \$ 0.64 |

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

NOTE 9 Segment Information

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

| | Net Sales to Unaffiliated Customers* | | Intersegment Sales* | | Operating Profit (Loss)* | |
|---|--------------------------------------|-----------------|---------------------|----------------|--------------------------|---------------|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| | (Millions) | | | | | |
| Sporting goods | \$ 134.1 | \$ 115.4 | \$ 23.0 | \$ 17.7 | \$ 8.2 | \$ 11.0 |
| Other recreational | 14.7 | 8.5 | 0.4 | 0.4 | 0.6 | (3.1) |
| Industrial | 19.1 | 25.9 | 0.1 | 0.0 | 1.0 | 1.6 |
| Total segment data | \$ 167.9 | \$ 149.8 | \$ 23.5 | \$ 18.1 | 9.8 | 9.5 |
| Corporate expenses, net | | | | | (2.0) | (1.3) |
| Interest expense | | | | | (2.6) | (2.3) |
| Income before provision for income taxes | | | | | \$ 5.2 | \$ 5.9 |

* Results for the three months ended September 30, 2003 include the sales and operating profit of Rawlings which was acquired by K2 on March 26, 2003.

The segment information presented below is for the nine months ended September 30:

| | Net Sales to Unaffiliated Customers* | | Intersegment Sales* | | Operating Profit (Loss)* | |
|---------------------------|--------------------------------------|-----------------|---------------------|----------------|--------------------------|-------------|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| | (Millions) | | | | | |
| Sporting goods | \$ 409.2 | \$ 343.0 | \$ 59.5 | \$ 57.5 | \$ 25.7 | \$ 25.8 |
| Other recreational | 35.3 | 26.9 | 1.2 | 1.3 | (0.3) | (4.7) |
| Industrial | 80.2 | 84.6 | 0.3 | 0.3 | 7.2 | 8.0 |
| Total segment data | \$ 524.7 | \$ 454.5 | \$ 61.0 | \$ 59.1 | 32.6 | 29.1 |

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| Corporate expenses, net | | | | (5.9) | (4.2) |
|--|--|--|--|---------|---------|
| Gain on sale of operating division | | | | 1.5 | |
| Debt extinguishment costs | | | | (6.7) | |
| Interest expense | | | | (7.2) | (7.1) |
| Income before provision for income taxes | | | | \$ 14.3 | \$ 17.8 |

* Results for the nine months ended September 30, 2003 include the sales and operating profit of Rawlings which was acquired by K2 on March 26, 2003.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

NOTE 10 Contingencies

K2 is subject to various legal actions and proceedings in the normal course of business. While the ultimate outcome of these matters cannot be predicted with certainty, management does not believe these matters will have a material adverse effect on K2's business, financial condition or results of operations.

K2 is one of several named potentially responsible parties (PRP) in three Environmental Protection Agency matters involving discharge of hazardous materials at old waste sites in South Carolina and Michigan. Although environmental laws technically impose joint and several liability upon each PRP at each site, the extent of K2's required financial contribution to the cleanup of these sites is expected to be limited based upon the number and financial strength of the other named PRPs and the volume and types of waste involved which might be attributable to K2.

Environmental and related remediation costs are difficult to quantify for a number of reasons including the number of parties involved, the difficulty in determining the extent of the contamination, the length of time remediation may require, the complexity of environmental regulation and the continuing advancement of remediation technology. K2 accrues for liabilities of this nature when it is probable a liability has been incurred and the amount can be reasonably estimated. At September 30, 2003 and December 31, 2002, K2 had recorded an estimated liability of approximately \$1,100,000 and \$1,308,000, respectively, for environmental liabilities with no insurance recovery expected. The estimates are based on K2's share of the costs to remediate as provided by the PRP's consultants and in ongoing discussions with the EPA or other environmental agencies. The ultimate outcome of this matter cannot be predicted with certainty, however, and taking into consideration reserves provided, management does not believe this matter will have a material adverse effect on K2's financial statements.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2003

NOTE 11 Subsequent Events

On October 17, 2003, K2 completed the acquisition of certain assets and the assumption of certain liabilities of WinterQuest LLC (WinterQuest), a privately held company founded in 1906, which is a marketer and manufacturer of snowshoes under the Tubbs and Atlas brands. The transaction was completed through a new wholly-owned subsidiary of K2, K2 Snowshoes, Inc. The preliminary purchase price consisted of \$7.5 million in cash and the payoff of \$9.1 million in permanent and seasonal debt. The purchase price of the transaction will be finalized in the 2004 second quarter subject to earn out provisions as specified in the asset purchase agreement. This transaction will be accounted for under the purchase method of accounting, accordingly the purchased assets and liabilities will be recorded at their estimated fair values at the date of acquisition. The purchase price allocation is expected to result in an excess of cost over net tangible assets acquired. The allocation of the purchase price will be completed during the 2003 fourth quarter. The results of the operations of K2 Snowshoes will be included in the consolidated financial statements of K2 beginning on the date of acquisition.

On October 22, 2003, K2 announced the signing of a definitive merger agreement with Brass Eagle Inc. (Brass Eagle) in which Brass Eagle would become a wholly-owned subsidiary of K2. Brass Eagle is the worldwide leader in the manufacturing, marketing, and distribution of paintball products, including markers, loaders, masks, paintballs and accessories under several brand names including Brass Eagle, Viewloader and JT. Each outstanding share of Brass Eagle common stock will be exchanged for 0.6036 shares of K2 common stock, which is expected to result in the issuance of approximately 4.5 million shares of K2 common stock. Based on the closing price of K2's stock for the 30 trading days ending October 20, 2003, the value of the transaction is \$77.8 million, for Brass Eagle shareholders, plus merger costs and assumed liabilities by K2. This transaction will be accounted for under the purchase method of accounting, accordingly the purchased assets and liabilities assumed will be recorded at their estimated fair values at the date of acquisition. The purchase price allocation is expected to result in an excess of cost over net tangible assets acquired. The allocation of the purchase price will be completed during the 2003 fourth quarter. The results of the operations of Brass Eagle will be included in the consolidated financial statements of K2 beginning on the date of acquisition. The proposed transaction is subject to regulatory review and other customary conditions, and is expected to be completed by the end of 2003.

ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations

Comparative Third Quarter Results of Operations

Net sales of K2 for the three months ended September 30, 2003 were \$168.0 million as compared with \$149.8 million in the year-earlier period. Net income for the third quarter of 2003 was \$3.4 million, or \$.12 per diluted share, as compared with \$3.9 million, or \$.21 per diluted share, in the third quarter of 2002.

Net Sales. In the sporting goods segment, net sales totaled \$134.1 million in the 2003 third quarter as compared with \$115.4 million in the prior year's third quarter. The overall improvement resulted from the addition of Rawlings sales of \$20.2 in the 2003 third quarter (as the result of the acquisition of Rawlings at the end of the 2003 first quarter), and from increased sales of skis and Ride snowboards.

In the other recreational products segment, net sales increased to \$14.7 million as compared to \$8.5 million in the prior year's quarter due to increased sales of skateboard shoes of \$6.6 million, reflecting strong sell through of the Adio shoe brand and an expanded retail distribution network.

Net sales of the two businesses in the industrial products group were \$19.1 million for the 2003 third quarter as compared with \$25.9 million in the prior year's quarter. The sales decrease was attributable to the sale of the composite utility and decorative light pole product lines on May 27, 2003. Excluding the impact of the sale, net sales grew due to higher shipments of Shakespeare cutting line and monofilament products of \$1.7 million. For additional discussion on the sale of the composite utility and decorative light pole product lines, see Note 4 of Notes to Consolidated Condensed Financial Statements.

Gross profit. Gross profit for the third quarter of 2003 increased 15.6% to \$54.9 million, or 32.7% of net sales, as compared with \$47.5 million, or 31.7% of net sales, in the prior year quarter. The improvement in gross profit dollars for the quarter was attributable to the increase in third quarter sales volume and an increase in gross profit as a percentage of net sales. The improvement in gross profit percentage was due to fewer close-out sales in the current year's quarter as compared to the prior year, continued product cost reductions associated with the China manufacturing facility and an increase in the sales of higher-margin products.

Costs and Expenses. Selling expenses for the 2003 third quarter were \$29.5 million, or 17.6% of net sales, as compared with \$23.3 million, or 15.6% of net sales, in the prior year's third quarter. General and administrative expenses for the 2003 third quarter were \$17.6 million, or 10.5% of net sales, as compared with \$16.0 million, or 10.7% of net sales, in the prior year's third quarter. The increase in selling and general and administrative expenses in dollars and as a percentage of net sales for the 2003 third quarter was attributable to the Rawlings acquisition at the end of the 2003 first quarter resulting in increased selling expenses and general and administrative of \$6.5 and \$2.4 million, respectively.

Operating Income. Operating income for the third quarter was \$7.8 million, or 4.6% of net sales, as compared to operating income of \$8.1 million, or 5.4% of net sales, in the year ago third quarter. The decline in operating income dollars was due to the higher selling, general and administrative expenses as the result of the acquisition of Rawlings at the end of the 2003 first quarter, partially offset by increases in sales volume and an improvement in the gross profit percentage as compared to the prior year.

Interest Expense. Interest expense increased \$0.3 million to \$2.6 million in the third quarter of 2003 as compared to \$2.3 million in the year-earlier period. The increase in interest expense for the 2003 quarter was primarily attributable to higher average borrowing levels during the period resulting from K2's refinancing of \$64 million of Rawlings short and long-term debt in conjunction with the acquisition in the 2003 first quarter, partially offset by lower average interest rates on borrowings.

Comparative Nine-Month Results of Operations

Net sales for the nine months ended September 30, 2003 were \$524.8 million as compared with \$454.5 million in the year-earlier period. Net income for the first nine months of 2003 was \$9.3 million or \$.38 per diluted share, as compared with \$11.5 million, or \$.64 per diluted share, in the first nine months of 2002.

Net Sales. In the sporting goods segment, net sales for the 2003 first nine months were \$409.2 million, an increase from \$343.0 million in the 2002 period. The overall improvement resulted from the addition of Rawlings in the 2003 second and third quarters (as the result of the acquisition of Rawlings at the end of the 2003 first quarter) of \$56.5 million and higher sales of in-line skates of \$7.9 million, Stearns outdoor products of \$3.2 million and snowboard products of \$0.7 million, due to strong first half demand in the European in-line skate market, higher demand for rain gear and children's flotation devices and from the popularity of the Ride snowboard line.

In the other recreational products segment, net sales for the 2003 nine months increased to \$35.3 million as compared to \$26.9 million in the prior year's quarter due to increased sales of skateboard shoes of \$9.6 million, reflecting strong sell through of the Adio shoe brand and an expanded retail distribution network.

Net sales of the industrial products group were \$80.2 million for the first nine months as compared with \$84.6 million in the prior year's period. The sales decrease was attributable to the composite utility and decorative light pole product line on May 27, 2003. Excluding the impact of the sale, net sales grew due to higher shipments of Shakespeare cutting line and monofilament products of \$6.4 million. For additional discussion on the sale of the composite utility and decorative light pole product lines, see Note 4 of Notes to Consolidated Condensed Financial Statements.

Gross profit. Gross profit for the first nine months of 2003 was \$162.2 million, or 30.9% of net sales, as compared with \$134.9 million, or 29.7% of net sales, in the prior year period. The improvement in gross profit dollars for the period was attributable to the increase in sales volume and the improvement in gross profit as a percentage of net sales. The improvement in gross profit percentage was due to fewer close-out sales in the current year's nine months as compared to the prior year, continued product cost reductions associated with the China manufacturing facility and an increase in the sales of higher margin products.

Costs and Expenses. Selling expenses for the first nine months of 2003 were \$83.1 million or 15.8% of net sales, as compared with \$65.2 million, or 14.3% of net sales, in the prior year. General and administrative expenses for the 2003 nine months were \$52.5 million, or 10.0% of net sales as compared with \$44.9 million or 9.9% of net sales, in the prior year. The increase in selling expenses was attributable to the Rawlings acquisition at the end of the 2003 first quarter, increased volume-related expenses for the period and an additional investment in advertising and marketing. The increase in general and administrative expenses for the 2003 nine months was also attributable to the inclusion of the Rawlings expenses and the impact of stronger foreign currencies on translated expenses as compared to 2002.

Operating Income. Operating income for the first nine months increased 7.3% to \$26.6 million, or 5.1% of net sales as compared with \$24.8 million, or 5.5% of net sales in the prior year. The increase in operating income reflects higher sales volume and an improvement in gross profit percentage, partially offset by higher selling and general and administrative expenses. The decline in operating income as a percentage of net sales was due to higher selling, general and administrative expenses as a percentage of net sales, partially offset by higher gross profits as a percentage of net sales.

Other Income, net. Other income, net for the 2003 first nine months was \$1.7 million as compared to \$0.1 million in the prior year. Other income for the 2003 first nine months included a \$1.5 million gain on the May 27, 2003 sale of the assets of the composite utility and decorative light pole product lines of its industrial products segment. For additional discussion, see Note 4 of Notes to Consolidated Condensed Financial Statements.

Interest Expense. Interest expense increased to \$7.2 million for the first nine months of 2003, as compared with \$7.1 million in the year-earlier period. The increase in interest expense for the 2003 period was primarily attributable to higher average borrowing levels during the period resulting from the Rawlings acquisition at the end of the 2003 first quarter, partially offset by lower average interest rates on borrowings.

Debt Extinguishment Costs. K2 expensed approximately \$2.0 million (\$1.3 million, or \$.05 per diluted share, after tax) in the 2003 first quarter of capitalized debt costs related to the repayment of the amounts outstanding under its existing debt facilities, and an additional \$4.7 million (\$3.1 million, or \$.11 per diluted share, after tax) make-whole premium related to the prepayment of K2's \$58.9 million of senior notes.

Liquidity and Sources of Capital

K2's operating activities provided \$49.6 million of cash in the 2003 first nine months as compared to net cash provided of \$15.7 million in the prior period. Included in the prior year's period was a repurchase of \$51.8 million of securitized receivables resulting from K2's replacement of a former asset securitization program. The former program accounted for the receivable transfers as sales of receivables and accordingly, received off-balance sheet treatment. When the program was replaced, K2 repurchased the receivables previously sold under the program. The improvement in cash provided by operations in 2003 was primarily attributable to higher collections of accounts receivable of \$29.3 million as K2 collected Rawlings seasonal accounts. Partially offsetting these improvements was smaller reduction in inventory during the 2003 period as compared to the 2002 period of \$42.5 million.

Net cash used in investing activities was \$10.1 million in the 2003 first nine months, as compared to cash used of \$8.4 million in the prior year. The \$1.7 million increase in cash used was due to higher capital expenditures of \$9.0 million and \$16.3 million in cash used for acquisitions, partially offset by \$20.1 million in cash proceeds received from the sale of the composite utility and decorative light pole product lines discussed in Note 4 of Notes to Consolidated Condensed Financial Statements. There were no material commitments for capital expenditures at September 30, 2003.

Net cash used in financing activities was \$36.1 million in the 2003 first nine months, as compared to cash used of \$11.3 million in the prior year. The increase in cash used was due to higher cash provided from operations which allowed for higher net repayments of debt in 2003 as compared to 2002.

K2's principal long-term borrowing facility is a \$205 million revolving credit facility (Credit Facility), secured by all of K2's assets in the United States, Canada and England. The Credit Facility has a \$75 million limit for the issuance of letters of credit. The Credit Facility expires on March 31, 2006. At September 30, 2003, there were \$25.1 million borrowings under the Credit Facility, \$26.1 million of outstanding letter of credit issuances and \$104.5 million of available borrowing capacity. At September 30, 2003, K2 also had outstanding a \$16.7 million term loan, payable in monthly equal principal payments through March 31, 2006, \$25.0 million of 7.25% convertible subordinated debentures due March 2010 and \$75.0 million of 5.00% convertible senior debentures due June 2010. At September 30, 2003, K2 had \$8.1 million outstanding under various foreign lending arrangements.

The following summarizes the outstanding borrowings and long-term contractual obligations of K2 at September 30, 2003 and the effects such obligations are expected to have on liquidity and cash flow in future periods.

| <u>Obligations</u> | <u>Total</u> | <u>1 year</u> | <u>1-3 years</u> | <u>4-5 years</u> | <u>5 years and beyond</u> |
|---|-------------------|------------------|------------------|------------------|-------------------------------|
| | | | (Thousands) | | |
| Long-term debt | \$ 41,746 | \$ 6,667 | \$ 35,079 | \$ | \$ |
| Convertible subordinated debentures | 97,951 | | | | 97,951 |
| Operating leases | 21,504 | 5,250 | 7,019 | 4,740 | 4,495 |
| Total contractual cash obligations | \$ 161,201 | \$ 11,917 | \$ 42,098 | \$ 4,740 | \$ 102,446 |

K2 believes that the credit availability under the Credit Facility, together with cash flow from operations, will be sufficient for K2's business needs through September 30, 2004. K2's ability to arrange debt financing from other sources, should such additional financing become necessary, could be limited by the fact that substantially all of K2's assets are the subject of security interests pursuant to existing indebtedness.

Subsequent Events

On October 17, 2003, K2 completed the acquisition of certain assets and the assumption of certain liabilities of WinterQuest LLC (WinterQuest), a privately held company founded in 1906, which is a marketer and manufacturer of snowshoes under the Tubbs and Atlas brands. For additional discussion, see Note 11 of Notes to Consolidated Condensed Financial Statements.

On October 22, 2003, K2 announced the signing of a definitive merger agreement with Brass Eagle Inc. (Brass Eagle) in which Brass Eagle would become a wholly-owned subsidiary of K2. Brass Eagle is a leader in the manufacturing, marketing, and distribution of paintball products, including markers, loaders, masks, paintballs and accessories under several brand names including Brass Eagle, Viewloader and JT. For additional discussion, see Note 11 of Notes to Consolidated Condensed Financial Statements.

liabilities by K2. This transaction will be accounted for under the purchase method of accounting, accordingly the purchased assets and liabilities assumed will be recorded at their estimated fair values at the date of acquisition. The purchase price allocation is expected to result in an excess of cost over net tangible assets acquired. The allocation of the purchase price will be completed during the 2003 fourth quarter. The results of the operations of Brass Eagle will be included in the consolidated financial statements of K2 beginning on the date of acquisition. The proposed transaction is subject to regulatory review and other customary conditions, and is expected to be completed by the end of 2003.

Sale of Operating Division

On May 27, 2003, K2 completed the sale of the assets of the composite utility and decorative light poles and other product lines (the Division) of its industrial products segment to GTG Temporary, LLC, a subsidiary of Genlyte Thomas Group LLC. The Division was sold for approximately \$20.1 million in cash and the assumption of certain liabilities by the buyer. The gain on sale of the Division of \$1.5 million (\$1.0 million, net of taxes) includes an estimate of the costs of disposal and amounts related to the retention of certain liabilities by K2.

Critical Accounting Policies

K2's discussion and analysis of its financial condition and results of operations are based upon K2's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires K2 to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities.

Discussed below are several significant accounting policies, which require the use of judgments and estimates that may materially affect the consolidated financial statements.

The estimates described below are reviewed from time to time and are subject to change if the circumstances so indicate. The effect of any such change is reflected in results of operations for the period in which the change is made. Establishment of the reserves affecting inventories and the allowance for doubtful accounts are among the most important.

Revenue Recognition

K2 recognizes revenue from product sales upon shipment to its customers, net of reserves for estimated returns. As a general matter, customers have no right of return, however returns do occur from time to time for a variety of reasons, including local business practices in one of the foreign countries in which K2 does business. Reserves for estimated returns are established based upon historical return rates and recorded as reductions of sales.

Warranty

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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.

Accounts Receivable and Allowances

K2 evaluates the collectibility of accounts receivable based on a combination of factors. In circumstances where there is knowledge of a specific customer's inability to meet its financial obligations, a specific reserve is recorded against amounts due to reduce the net recognized receivable to the amount that is reasonably believed to be collected. For all other customers, reserves are established based on historical bad debts, customer payment patterns and current economic conditions. The establishment of these reserves requires the use of judgment and assumptions regarding the potential for losses on receivable balances. If the financial condition of K2's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required resulting in an additional charge to expenses when made.

Inventories

Inventories are valued at the lower of cost or market value. Cost is substantially determined by the first-in, first-out (FIFO) method, including material, labor and factory overhead. K2 records adjustments to its inventory for estimated obsolescence or diminution in market value equal to the difference between the cost of inventory and the estimated market value, based on market conditions from time to time. These adjustments are estimates, which could vary significantly, either favorably or unfavorably, from actual experience if future economic conditions, levels of consumer demand, customer inventory levels or competitive conditions differ from expectations.

Long-Lived and Definite Lived Intangible Assets

Long-lived assets, including, among others, amortizable intangible assets (including the amortizable intangible assets acquired in the Rawlings acquisition completed in March 2003) and property, plant and equipment are reviewed periodically to determine if the carrying values are impaired. K2 evaluates the recoverability of the carrying amount of these long-lived and definite lived assets at least annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. An impairment of long-lived assets is assessed when the undiscounted expected future cash flows derived from an asset are less than its carrying amount. If the carrying value exceeds the estimate of future undiscounted cash flows, the impairment is calculated as the excess of the carrying value of the asset over the estimate of its fair value.

Indefinite Lived Intangible Assets

Effective January 1, 2002, K2 adopted new accounting standards on Business Combinations, and Goodwill and Other Intangible Assets. In accordance with these new standards, goodwill and intangible assets with indefinite lives are no longer amortized but instead are measured for impairment at least annually, or when events indicate that an impairment exists. As required by the new standards, the impairment tests for goodwill and other indefinite-lived intangible assets are assessed for impairment using fair value measurement techniques. Specifically, goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a K2 reporting unit with the net book value (or carrying amount), including goodwill. If the fair value of the reporting unit exceeds the carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit exceeds the fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. The impairment test for other intangible assets consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

Determining the fair value of a reporting unit under the first step of the goodwill impairment test and determining the fair value of individual assets and liabilities of a reporting unit under the second step of the goodwill impairment test is judgmental in nature and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the extent of such charge. K2's estimates of fair value utilized in goodwill and other indefinite-lived intangible asset tests may be based upon a number of factors, including assumptions about the projected future cash flows, discount rate, growth rate, determination of market comparables, technological change, economic conditions, or changes to K2's business operations. Such changes may result in impairment charges recorded in future periods.

Income Taxes

Income taxes are recorded using the liability method. K2 estimates actual current tax exposure together with temporary differences that result from differing treatment of items for tax and accounting purposes. These temporary differences result in deferred tax assets and liabilities. K2 then assesses the likelihood that deferred tax assets will be recovered from future taxable income and to the extent that recovery is unlikely, a valuation allowance must be established. A significant portion of K2's deferred tax assets relate to net operating loss carryforwards for both domestic and foreign purposes. The realization of these assets is based upon estimates of future taxable income. In those jurisdictions where the realization of these carryforwards is not likely, a valuation allowance has been established. If actual results are less favorable than those projected by management, additional income tax expense may be required.

Pensions

K2 sponsors several trustee noncontributory defined benefit pension plans covering most of its domestic employees. Pension costs and liabilities are actuarially calculated. These calculations are based on assumptions related to the discount rate, projected compensation increases and expected return on assets. K2 evaluates the assumptions used on a periodic basis and makes adjustments as necessary. As of December 31, 2002, K2's assumption related to the discount rate, projected compensation increases and expected return on assets was 6.75%, 4.00% and 8.75%, respectively. A variance in the discount rate, rate of compensation increase and expected return on plan assets could have a significant impact on the pension costs recorded.

For the 2002 year, difficult market conditions resulted in negative asset returns on the pension assets for the 2002 year. These negative returns will result in an increase in 2003 pension expense of approximately \$1.5 million as compared to the 2002 year. The reduction in the discount rate assumption at the end of 2002 is estimated to result in an additional increase to 2003 pension expense of approximately \$0.5 million as compared to the 2002 year. Finally, because of the declines in the pension asset values, K2 estimates a required cash contribution of approximately \$3.0 million to the pension plans in 2004.

Based on the negative asset returns realized during 2002, the accumulated benefit obligation of the pension plans exceeded the fair value of the plan assets by \$13.1 million at December 31, 2002. These asset shortfalls resulted in K2 recording a non-cash charge to Other Comprehensive Income, a component of K2's shareholder's equity, of \$7.5 million (\$4.9 million, net of taxes) during 2002. Based on this amount recorded, K2 had \$12.6 million of net long-term pension liabilities as of September 30, 2003 and December 31, 2002, consisting of \$13.1 million in asset shortfalls and an intangible asset for the unrecognized prior service cost of \$0.5 million.

Stock-Based Compensation and Other Equity Instruments

K2 accounts for employee and directors' stock option grants using the intrinsic method. Generally, the exercise price of K2's employee stock options equals or exceeds the market price of the underlying stock on the date of grant and no compensation expense is recognized. If the option price is less than the market value at the date of grant, K2 records compensation expense over the vesting period of the option. For further discussion, see Note 2 of Notes to Consolidated Condensed Financial Statements.

Foreign Currency Translation

The functional currency for most foreign operations is the local currency. The financial statements of foreign subsidiaries have been translated into United States dollars. Asset and liability accounts have been translated using the exchange rate in effect at the balance sheet date. Revenue and expense accounts have been translated using the average exchange rate for the year. The gains and losses associated with the translation of the financial statements resulting from the changes in exchange rates from year to year have been reported in the other comprehensive income or loss account in shareholders' equity. To the extent assets and liabilities of the foreign operations are realized or the foreign operations pay back intercompany debt, amounts previously reported in other comprehensive income or loss account would be included in net income or loss in the period in which the transaction occurs. Transaction gains or losses, other than those related to intercompany accounts and investments deemed to be of a long-term nature, are included in net income or loss in the period in which they occur.

Statement Regarding Forward-Looking Disclosure

This Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which represent K2's expectations concerning future events, many of which are beyond the control of K2, including, but not limited to, the following: statements regarding future sales and earnings, marketing efforts and trends concerning products sold by K2, foreign exchange rate fluctuations, debt reduction, conditions impacting the pension obligations, inventory levels at retail, product acceptance and demand, growth efforts, cost savings and economies of scale, dependence on foreign manufacturing, margin enhancement efforts, product development efforts, success of new product introductions future acquisitions and dispositions and overall market trends which involve substantial risks and uncertainties. K2 cautions these statements are further qualified by important factors that could cause actual results to differ materially from those in the forward-looking statements, including, but not limited to, weather, economic conditions, the financial condition of K2's customers, unfavorable political developments, rapid changes in marketing strategies, product design, styles and tastes, competitive pricing and the impact of foreign exchange on product costs, and other risks described in K2's Annual Report on Form 10-K for the year ended December 31, 2002, in the Annual Report on Form 10-K for the year ended August 31, 2002 of Rawlings Sporting Goods Company, Inc. (other than the risks entitled "Credit Agreement Restrictions" and "Consideration of Strategic Alternatives"), and the section entitled "Risk Factors and Trends Affecting the Combined Company" in the Registration Statement on Form S-4 filed with the Securities Exchange Commission on February 25, 2003. Additionally, a resurgence of the severe acute respiratory syndrome (SARS) virus in southern China and Hong Kong could impact K2's ability to manufacture and source products. Most of K2's factories, as well as those with which K2 contracts, are located in southern China and K2's Asian offices are located in Hong Kong. Any significant interruption in K2's ability to send personnel to those areas to inspect and develop product or samples, or a high absenteeism rate at the factories or at K2's offices, could have an adverse effect on K2's ability to finalize, manufacture and ship its products.

ITEM 3 Quantitative and Qualitative Disclosures of Market Risk

Fluctuations in foreign currency exchange rates can affect K2's earnings and cash flows. K2 manages its exposures to changes in foreign currency exchange rates on certain firm purchase commitments and anticipated, but not yet committed purchases, by entering into some foreign currency forward contracts. K2's risk management objective is to reduce its exposure to the effects of changes in exchange rates on the cost of products sold over quarterly time horizons. Foreign currency exchange rate movements also affect K2's competitive position, as exchange rate changes may affect business practices and/or pricing strategies of non-U.S. based competitors and may affect the profitability and pricing strategies of K2 as well. K2's foreign currency risk policies entail entering into foreign currency derivative instruments only to manage risk of currency fluctuations over a given period of time, not for speculative investments.

Considering both the anticipated cash flows from firm purchase commitments and anticipated purchases for the next quarter and the foreign currency derivative instruments in place at year end, a hypothetical 10% weakening of the U.S. dollar relative to other currencies would not materially adversely affect expected fourth quarter 2003 earnings or cash flows. This analysis is dependent on actual purchases during the next quarter occurring within 90% of budgeted forecasts. The effect of the hypothetical change in exchange rates ignores the effect this movement may have on other variables including competitive risk. If it were possible to quantify this competitive impact, the results could well be different than the sensitivity effects shown above. In addition, it is unlikely currencies would uniformly strengthen or weaken relative to the U.S. dollar. In reality, some currencies may weaken while others may strengthen.

ITEM 4 Controls and Procedures

An evaluation was conducted under the supervision and with the participation of K2's management, including K2's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operation of K2's disclosure controls and procedures as of September 30, 2003, pursuant to Exchange Act Rule 13a-15. Based on that evaluation, K2's CEO and CFO concluded that K2's disclosure controls and procedures were effective as of such date to ensure that information required to be disclosed in the reports that K2 files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Such officers also confirm that there was no change in K2's internal control over financial reporting during the quarter ended September 30, 2003 that has materially affected, or is reasonably likely to materially affect, K2's internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 5 OTHER INFORMATION

ITEM 6 EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

10.1 Form of Indemnification Agreement dated August 7, 2003 entered into with each member of the Company's Board of Directors and executive officers.

10.2 In October 2003, the Company entered into a Reimbursement Agreement with Mr. Richard J. Heckmann, Chairman and Chief Executive Officer, for the reimbursement of expenses incurred by Mr. Heckmann in the operation of his private plane when used for K2 business. The Reimbursement is effective for expenses incurred by Mr. Heckmann for K2 business purposes as Mr. Heckmann had incurred significant expenses since December 2002 and an agreement in principle was reached in September 2003. A copy of the agreement is attached hereto as an exhibit.

31.1 Certification of Chief Executive Officer Pursuant Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.

32 Certification of the Chief Executive Officer and Chief Financial Officer under rule 13a-14(b) of the Securities and Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.

(b) Reports on Form 8-K filed in the third quarter ended September 30, 2003.

Report on Form 8-K dated July 21, 2003, furnished by the Company, containing the Company's press release dated July 21, 2003 announcing the Company's 2003 second quarter results.

Report on Form 8-K dated July 22, 2003, furnished by the Company, under Item 9, Regulation FD Disclosure, certain statements made by the Company in connection with the Company's 2003 second quarter conference call and filing of its earnings release dated July 21, 2003.

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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.

K2 INC.
(registrant)

Date: November 14, 2003

s/ JOHN J. RANGEL

John J. Rangel
Senior Vice President and
Chief Financial Officer