K2 INC
Form 10-Q
November 09, 2005

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT

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

For the quarterly period ended September 30, 2005

Commission File No. 1-4290

K2 INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-2077125**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**
5818 El Camino Real	
Carlsbad, California	**92008**
(Address of principal executive offices)	**(Zip Code)**

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

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

Not applicable

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

At October 23, 2005, there were 46,879,685 shares of Common Stock ($1.00 par value) outstanding.

PART 1 FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

CONSOLIDATED CONDENSED STATEMENTS OF INCOME (Unaudited)

(Thousands, except per share figures)

	Three Months Ended September 30		Nine Months Ended September 30	
	2005	2004	2005	2004
Net sales	$ 340,352	$ 333,460	$ 960,068	$ 861,811
Cost of products sold	215,225	214,274	632,364	578,627
Gross profit	125,127	119,186	327,704	283,184
Selling expenses	57,305	56,736	170,522	140,349
General and administrative expenses	35,809	34,877	106,812	83,295
Operating income	32,013	27,573	50,370	59,540
Interest expense	7,519	7,299	22,057	13,811
Other income, net	(583)	(426)	(2,421)	(604)
Income before income taxes	25,077	20,700	30,734	46,333
Provision for income taxes	8,337	7,502	10,217	16,217
Net income	$ 16,740	$ 13,198	$ 20,517	$ 30,116
Basic earnings per share:				
Net income	$ 0.36	$ 0.28	$ 0.44	$ 0.78
Diluted earnings per share:				
Net income	$ 0.32	$ 0.26	$ 0.42	$ 0.69
Basic shares outstanding	46,326	46,472	46,240	38,753
Diluted shares outstanding	55,190	55,148	55,224	47,503

See notes to consolidated condensed financial statements.

CONSOLIDATED CONDENSED BALANCE SHEETS

(Thousands, except number of shares)

	September 30 2005	December 31 2004
	(unaudited)	
Assets		
Current Assets		
Cash and cash equivalents	$ 17,458	$ 25,633
Accounts receivable, less allowances for doubtful accounts of $15,810 (2005) and $14,895 (2004)	343,188	369,914
Inventories, net	372,803	325,125
Deferred income taxes	13,550	29,709
Prepaid expenses and other current assets	26,311	22,775
Total current assets	773,310	773,156
Property, plant and equipment	287,793	272,959
Less allowance for depreciation and amortization	147,690	131,995
	140,103	140,964
Other Assets		
Goodwill	341,148	349,760
Tradenames	145,829	137,329
Other intangible assets, net	20,550	21,276
Deferred income taxes	7,507	7,506
Other	24,166	26,374
Total Assets	$ 1,452,613	$ 1,456,365
Liabilities and Shareholders Equity		
Current Liabilities		
Bank loans	$ 30,174	$ 31,490
Accounts payable	84,102	103,158
Income taxes payable	25,938	28,386
Accrued payroll and related	46,537	50,589
Other accruals	98,977	100,478
Current portion of long-term debt	27,670	35,074
Total current liabilities	313,398	349,175
Long-term pension liabilities	16,854	16,854
Long-term debt	281,174	250,812
Deferred income taxes	50,746	58,123
Convertible debentures	98,886	98,535
Shareholders Equity		
Preferred Stock, $1 par value, authorized 12,500,000 shares, none issued		
Common Stock, $1 par value, authorized 110,000,000 shares, issued shares - 47,642,825 in 2005 and 47,543,108 in 2004	47,643	47,543
Additional paid-in capital	503,230	502,322
Retained earnings	167,075	146,558
Treasury shares at cost, 750,167 shares in 2005 and 747,234 in 2004	(9,154)	(9,107)
Accumulated other comprehensive loss	(17,239)	(4,450)

Total Shareholders Equity	691,555	682,866
Total Liabilities and Shareholders Equity	$ 1,452,613	$ 1,456,365

See notes to consolidated condensed financial statements

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

(Thousands)

	Nine Months Ended September 30	
	2005	**2004**
Operating Activities		
Net Income	$ 20,517	$ 30,116
Adjustments to reconcile net income from operations to net cash provided by operating activities:		
Depreciation and amortization	26,900	19,879
Deferred taxes	8,731	13,343
Changes in current assets and current liabilities	(50,075)	(46,066)
Net cash provided by operating activities	6,073	17,272
Investing Activities		
Property, plant & equipment expenditures	(29,086)	(24,242)
Disposals of property, plant & equipment	4,769	381
Purchase of business, net of cash acquired	(17,184)	(113,467)
Other items, net	4,785	(1,474)
Net cash used in investing activities	(36,716)	(138,802)
Financing Activities		
Issuance of senior notes		200,000
Borrowings under long-term debt	783,500	479,015
Payments of long-term debt	(760,191)	(615,069)
Net decrease in short-term bank loans	(1,316)	(15,956)
Net proceeds from equity issuance		93,740
Debt issuance costs		(8,353)
Exercise of stock options	475	4,093
Net cash provided by financing activities	22,468	137,470
Net (decrease) increase in cash and cash equivalents	(8,175)	15,940
Cash and cash equivalents at beginning of year	25,633	21,256
Cash and cash equivalents at end of period	$ 17,458	$ 37,196

K2 adjusted the Property, plant & equipment expenditures and Other items, net amounts for the nine months ended September 30, 2005 by approximately $2.7 million, which were set forth in K2 s earnings release filed with the SEC on its Current Report on Form 8-K on October 19, 2005.

See notes to consolidated condensed financial statements.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

September 30, 2005

NOTE 1 Basis of Presentation

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005.

The consolidated condensed balance sheet at December 31, 2004 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

K2 reports its financial statements using a 13 week quarter ending on the last Sunday of March, June, September and December. For purposes of the consolidated financial statements, the end of each quarter is stated as of March 31, June 30, September 30 and December 31, respectively.

The interim financial statements should be read in connection with the financial statements in K2 Inc. s (K2 s) Annual Report on Form 10-K for the year ended December 31, 2004.

Certain prior year amounts have been reclassified to conform to the current year presentation.

NOTE 2 Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (Revised) *Share-Based Payment.* SFAS No. 123 (Revised) requires that companies recognize compensation expense equal to the fair value of stock options or other share based payments. The impact on K2 s net income will include the remaining amortization of the fair value of existing options currently disclosed as pro forma expense in Note 3 and is contingent upon the number of future options granted, the selected transition method and the selection of either the Black-Scholes or the binominal lattice model for valuing options.

On April 14, 2005, the SEC adopted a new rule that amended the compliance dates of SFAS No. 123 (Revised) to require implementation no later than the beginning of the first fiscal year beginning after June 15, 2005 (the year beginning January 1, 2006 for K2). Early adoption of SFAS No. 123 (Revised) is permissible. K2 is in the process of evaluating the use of certain option-pricing models as well as the assumptions to be used in such models. When such evaluation is complete, K2 will

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 2 Recent Accounting Pronouncements (Continued)

determine the transition method to use, the timing of adoption and the impact any change in valuation models might have.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*. SFAS No. 154 replaces Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. SFAS No. 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle unless it is impracticable to do so. SFAS No. 154 also provides that a change in method of depreciating or amortizing long-lived non-financial assets be accounted for as a change in estimate effected by a change in accounting principle and that correction of errors in previously issued financial statements should be termed a restatement. SFAS No. 154 is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. Early adoption of this standard is permitted for accounting changes and corrections of errors made in fiscal years beginning after June 1, 2005. K2 believes that implementing SFAS No. 154 should not have a material impact on its financial position and results of operations.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 3 Stock Based Compensation

K2 currently applies the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation,* which allows entities to continue to apply the provisions of 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 September 30		Nine Months Ended September 30	
	2005	2004	2005	2004
	(Thousands, except per share data, percentage data and expected life)			
Net income as reported	$ 16,740	$ 13,198	$ 20,517	$ 30,116
Less: Total stock-based compensation expense determined under fair value based method for all awards, net of taxes	224	529	9,754	1,616
Net income, adjusted	$ 16,516	$ 12,669	$ 10,763	$ 28,500
Earnings per share:				
Basic - as reported	$ 0.36	$ 0.28	$ 0.44	$ 0.78
Basic - pro forma	$ 0.36	$ 0.27	$ 0.23	$ 0.74
Diluted - as reported	$ 0.32	$ 0.26	$ 0.42	$ 0.69
Diluted - pro forma	$ 0.32	$ 0.25	$ 0.25	$ 0.66
Risk free interest rate	2.63%	3.55%	3.60%	3.55%
Expected life of options	5 years	5 years	5 years	5 years
Expected volatility	50.4%	43.3%	40.9%	43.3%
Expected dividend yield				

The pro forma amounts may not be representative of future disclosures since the estimated fair value of stock options is amortized to expense over the vesting period and additional options may be granted in future years.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 3 Stock Based Compensation (Continued)

On May 17, 2005, the Compensation Committee of the Board of Directors of K2 approved the acceleration of vesting of certain unvested and out-of-the-money stock options previously awarded to employees and officers under the K2 stock option plans. An option was considered out-of-the-money if the stated exercise price was greater than $11.94 per share, the closing price of K2 s common stock on May 17, 2005, which was the last trading day before approval of the acceleration. Outstanding unvested options that had an exercise price equal to or less than $11.94 on May 17, 2005, will continue to vest under the terms of the original option agreements. As a result of this action, options to purchase approximately 2.1 million shares of K2 s common stock that would otherwise have vested over the next three years became fully vested. The options have a range of exercise prices of $12.51 to $14.30 and a weighted average exercise price of $13.14. Options held by non-employee directors were not affected. In addition, the Compensation Committee imposed a holding period that will require that all affected executive officers of the Company not sell shares acquired through the exercise of an accelerated option (other than shares needed to cover the exercise price and satisfying withholding taxes) prior to the earlier of the date on which exercise would have been permitted under the options original vesting terms or, if earlier, the executive officer s last day of employment.

The decision to accelerate the vesting of these options was made to reduce future compensation expense that is expected to be recorded in conjunction with K2 s adoption of SFAS No. 123 (Revised). The incremental expense associated with the acceleration of the options is included in the pro forma disclosures above for the nine months ended September 30, 2005.

NOTE 4 Inventories

The components of inventories consisted of the following:

(Unaudited)

	September 30 2005	December 31 2004
	(Thousands)	
Finished goods	$ 282,452	$ 237,162
Work in process	17,897	15,389
Raw materials	72,454	72,574
	$ 372,803	$ 325,125

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

Note 5 Acquisitions

During the 2005 second quarter, K2 completed the acquisition of substantially all of the assets of Hodgman, Inc., a business engaged in the design, selling and distribution of hunting and fishing waders, and JRC Products Limited, a business engaged in the design, selling and distribution of fishing tackle products. The purchase price for these assets was paid in cash. The results of the operations of these two companies were included in the consolidated financial statements of K2 beginning with the date of the applicable acquisition.

Those two transactions completed during the 2005 second quarter were accounted for under the purchase method of accounting, and accordingly the purchased assets and liabilities were recorded at their estimated fair values at the date of the acquisition. The combined purchase price allocation for the two acquisitions resulted in an excess of the purchase price over net tangible assets acquired of approximately $7.0 million.

The excess amounts of the two transactions were allocated to intangible assets with finite and indefinite lives including: customer relationships and patents of $0.1 million with an average life of 2.0 years; tradenames with an indefinite life not subject to amortization of $2.9 million; and goodwill not subject to amortization of $4.0 million.

At September 30, 2005, there was approximately $8.7 million of cash and 536,536 shares of K2 common stock held in escrow or due for payment relating to certain acquisitions. The cash and shares will be released from escrow during 2005 through 2008 subject to final agreement between K2 and the selling parties. The cash and shares in escrow as well as future cash payments due have been reflected in the purchase price of the related acquisitions. Shares held in escrow are reflected in the calculation of diluted earnings per share for the periods presented.

During 2004, K2 completed nine acquisitions, including the acquisitions of Fotoball USA, Inc. (later renamed K2 Licensed Products, Inc.) on January 23, 2004, Ex Officio on May 12, 2004, Marmot on June 30, 2004 and Völkl and Marker on July 7, 2004 as well as five smaller acquisitions.

The unaudited consolidated condensed statements of income for the three months ended September 30, 2005 and 2004 and the nine months ended September 30, 2005 include the operating results of each of the businesses acquired in 2004, however the 2004 nine month results include less than a full nine months of results of K2 Licensed Products, which was acquired by K2 on January 23, 2004, Worr Game Products and IPI, both of which were acquired by K2 on April 19, 2004, Ex Officio, which was acquired by K2 on May 12, 2004, Marmot, which was acquired by K2 on June 30, 2004 and Völkl and Marker, both of which were acquired on July 7, 2004.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

Note 5 Acquisitions (Continued)

The following summarized unaudited pro forma information of K2 assumes the acquisitions of Marmot and Völkl and Marker had occurred as of January 1, 2004, the earliest date for which information is presented below. This pro forma information does not purport to be indicative of what would have occurred had the acquisitions been made as of those dates, or of results which may occur in the future. Pro forma results of operations of K2 s other acquisitions completed during 2004 and 2005 have not been presented because the effects of these additional acquisitions were not material on either an individual basis or aggregate basis to K2 s consolidated results of operations.

Pro Forma Information (Unaudited)

(Thousands, except per share amounts)

	Nine Months Ended September 30	
	2005	**2004**
Net sales	$ 960,068	$ 919,861
Operating income	50,370	44,107
Net income	20,517	18,144
Diluted earnings per share	$ 0.42	$ 0.40

Pursuant to the acquisitions made by K2 during 2005, 2004 and 2003, K2 approved restructuring and exit plans related to the closure of certain facilities of the acquired companies. In accordance with Emerging Issues Task Force (EITF) 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination,* K2 established reserves for employee severance, employee relocation costs and lease termination costs totaling approximately $0.6 million, $11.0 million and $5.1 million, during 2005, 2004 and 2003, respectively. These reserves were recognized as assumed liabilities of the acquired companies. The reserves established were not individually significant to any of K2 s acquisitions during 2005, 2004 or 2003.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

Note 5 Acquisitions (Continued)

The following table summarizes the activity in 2004 and 2005:

	Employee Severance	Employee Relocation	Subtotal	Lease Termination Costs	Total
			(Thousands)		
Balance at December 31, 2003	$ 2,411	$ 816	$ 3,227	$ 1,203	$ 4,430
Reserves established in conjunction with acquisitions	6,968	40	7,008	4,034	11,042
Adjustments to reserve estimates (reflected as an adjustment of the cost of the acquired companies)	(974)		(974)		(974)
Utilized in 2004:	(1,415)	(488)	(1,903)	(40)	(1,943)
Balance at December 31, 2004	6,990	368	7,358	5,197	12,555
Reserves established in conjunction with acquisitions	205		205	418	623
Adjustments to reserve estimates (reflected as an adjustment of the cost of the acquired companies)	(994)		(994)	(1,273)	(2,267)
Utilized in 2005:	(2,629)	(143)	(2,772)	(1,242)	(4,014)
Balance at September 30, 2005	$ 3,572	$ 225	$ 3,797	$ 3,100	$ 6,897

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

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 6 Intangible Assets and Goodwill

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

	Weighted Average Useful Life	September 30, 2005 Gross Amount	Accumulated Amortization	Net Book Value	December 31, 2004 Gross Amount	Accumulated Amortization	Net Book Value
				(Thousands)			
Intangibles subject to amortization:							
Patents	7.9 years	$ 15,756	$ 4,355	$ 11,401	$ 14,142	$ 3,161	$ 10,981
Customer contracts/relationships	8.2 years	8,215	2,409	5,806	8,139	1,488	6,651
Licensing agreements	7.4 years	2,795	1,234	1,561	2,795	868	1,927
Trademarks	7.1 years	955	241	714	955	128	827
Non-compete agreements	4.1 years	1,572	553	1,019	1,347	212	1,135
Order backlog and other	0.2 years	1,560	1,511	49	1,040	1,285	(245)
		30,853	10,303	20,550	28,418	7,142	21,276
Intangibles not subject to amortization: (by segment)							
Tradename							
Marine and Outdoor		3,252		3,252	352		352
Team sports		39,287		39,287	33,687		33,687
Action sports		81,690		81,690	81,690		81,690
Apparel and Footwear		21,600		21,600	21,600		21,600
Goodwill							
Marine and Outdoor		26,553		26,553	22,853		22,853
Team sports		80,220		80,220	88,722		88,722
Action sports		152,474		152,474	156,211		156,211
Apparel and Footwear		81,901		81,901	81,974		81,974
		486,977		486,977	487,089		487,089
Total intangibles and goodwill		$ 517,830	$ 10,303	$ 507,527	$ 515,507	$ 7,142	$ 508,365

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 6 Intangible Assets and Goodwill (Continued)

The table below shows the activity in intangibles subject to and not subject to amortization for the nine months ended September 30, 2005, including the purchase price allocations completed by K2 during 2005 relating to the acquisitions completed by K2 in the 2005 second quarter and 2004 fourth quarter, respectively. The final purchase price allocations were based on independent third party valuations.

	December 31, 2004 Net Book Value	Purchase Price Allocations (a)	Other Activity (b)	Amortization	September 30, 2005 Net Book Value
			(Thousands)		
Intangibles subject to amortization:					
Patents	$ 10,981	$ 453	$ 1,161	$ (1,194)	$ 11,401
Customer contracts/relationships	6,651	76		(921)	5,806
Licensing agreements	1,927			(366)	1,561
Trademarks	827			(113)	714
Non-compete agreements	1,135	225		(341)	1,019
Order backlog and other	(245)	520		(226)	49
	21,276	1,274	1,161	(3,161)	20,550
Intangibles not subject to amortization: (by segment)					
Tradename					
Marine and Outdoor	352	2,900			3,252
Team Sports	33,687	5,600			39,287
Action Sports	81,690				81,690
Apparel and Footwear	21,600				21,600
Goodwill					
Marine and Outdoor	22,853	3,878	(178)		26,553
Team Sports	88,722	(6,497)	(2,005)		80,220
Action Sports	156,211		(3,737)		152,474
Apparel and Footwear	81,974		(73)		81,901
	487,089	5,881	(5,993)		486,977
Total intangibles and goodwill	$ 508,365	$ 7,155	$ (4,832)	$ (3,161)	$ 507,527

(a) Amounts in this column represent the allocation of purchase price to intangibles in accordance with Statement of Financial Accounting Standards (SFAS) No. 141 Business Combinations and adjustments to the preliminary purchase price allocations upon finalization of the allocations to the SFAS No. 141 analysis.

(b) Amounts in this column represent either additions to intangibles not related to purchased intangibles or a reduction in the reserves established upon acquisition in accordance with SFAS No. 141.

Amortization expense for intangibles subject to amortization was approximately $3.2 million for the nine months ended September 30, 2005. Amortization expense of purchased intangible assets subject to amortization is estimated to be approximately $3.9 million during fiscal year ending 2005, $3.6 million during 2006, $3.4 million during 2007, $3.2 million during 2008 and $2.0 million during 2009.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 6 Intangible Assets and Goodwill (Continued)

Based on the results of the annual impairment tests, K2 had determined that no impairment of goodwill or intangible assets with indefinite lives existed as of December 31, 2004. Due to the recent softness in consumer demand for paintball products within its Action Sports segment, K2 performed an interim test of impairment for the indefinite lived asset associated with the Brass Eagle trademark. K2 s analysis indicated that the fair value exceeds the carrying value and, therefore, no impairment existed at September 30, 2005. In performing the interim test, K2 assumed a sales growth rate of 5%; an income tax rate of 35% and a discount factor of 12%. In the event consumer demand continues to remain soft for paintball products, K2 may be required to record an impairment charge in future periods related to indefinite and finite-lived intangibles within the Action Sports segment. There were no additional indicators of possible impairment present during the nine months ended September 30, 2005. However, future indicators or impairment tests of goodwill and intangible assets with finite and indefinite lives could result in a charge to earnings. K2 will continue to evaluate goodwill and intangible assets with indefinite lives on an annual basis or whenever events and changes in circumstances indicate that there may be a potential impairment.

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

NOTE 7 Warranties

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

The following activity related to product warranty liabilities:

(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
(Thousands)	**2005**	**2004**	**2005**	**2004**
Beginning Balance	$ 9,373	$ 6,465	$ 9,691	$ 5,526
Charged to costs and expenses	2,348	2,312	7,002	5,429

Increase to reserve resulting from acquisitions		2,008		2,333
Amounts charged to reserve	(2,368)	(2,033)	(7,340)	(4,536)
Ending Balance	$ 9,353	$ 8,752	$ 9,353	$ 8,752

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 8 Borrowings and Other Financial Instruments

At September 30, 2005, K2 s principal long-term borrowing facility was a five-year, $250.0 million revolving Credit Facility (Facility) expiring on July 1, 2009 with several banks and other financial institutions. The Facility is expandable to $350.0 million subject to certain conditions. The Facility has a $100.0 million limit for the issuance of letters of credit. Borrowings under the Facility are secured by all of K2 s assets in the United States, Canada and England. Actual borrowing availability under the Facility is based on K2 s trade receivable and inventory levels in the United States, Canada and England, subject to eligibility criteria and defined advance rates. Borrowings under the Facility are subject to an interest rate grid, but as of September 30, 2005 bear a rate equal to the prime rate, or a LIBOR interest rate plus 2.00%, and the Facility had an unused commitment fee of 0.375% per year. The Facility includes various covenants, including requirements that K2 maintain a minimum debt service coverage ratio, as well as limiting annual capital expenditures, indebtedness, dividends and certain investment activities.

On March 18, 2005, K2 obtained an amendment to its Facility allowing K2 to make up to $50.0 million in repurchases of K2 common stock provided that unused borrowing availability under the facility is at least $50.0 million after such repurchases.

On July 25, 2005, K2 also obtained an amendment to its Facility allowing K2 to issue up to $100.0 million in unsecured notes, subject to the approval of the administrative agent, provided the issuance is completed within 365 days and the net proceeds are used to repay borrowings outstanding under the Facility.

At September 30, 2005, borrowings of $88.6 million were outstanding under the Facility bearing an average interest rate of 5.73%. At September 30, 2005, there were also letters of credit outstanding under the Facility of $12.8 million (consisting of $10.8 million of standby letters of credit and $2.0 million of trade letters of credit expiring over the next 12 months). K2 has classified $25.0 million of seasonal borrowings outstanding under the Facility at September 30, 2005 as current. Pursuant to the terms of the Facility, an additional $144.8 million was available for borrowing at September 30, 2005.

At September 30, 2005, K2 also had $25.0 million of 7.25% convertible subordinated debentures (7.25% Debentures) due March 2010. The 7.25% Debentures are convertible into 2,097,315 shares of K2 common stock at a conversion price of $11.92 per share. Pursuant to the agreement for these debentures, the noteholders received warrants to purchase 243,260 and 524,329 additional shares of K2 s common stock at exercise prices of $13.14 and $11.92 per share, respectively, exercisable within the three and five year period ended February 14, 2006 and February 14, 2008, respectively (the Warrants). K2 assigned a total fair market value of $2.3 million to the Warrants.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 8 Borrowings and Other Financial Instruments (Continued)

At September 30, 2005, the aggregate unamortized fair market value of $1.1 million is reflected as a reduction of the face amount of the 7.25% Debentures on K2 s balance sheet which is being amortized to interest expense using the effective interest method through the exercise periods, thereby increasing the carrying value of the debentures.

At September 30, 2005, K2 also had $75.0 million of 5.00% convertible senior debentures (5% Debentures) due June 2010. The 5% Debentures are convertible into 5,706,458 shares of K2 common stock at a conversion price of $13.14 per share. The debentures are redeemable by K2 in whole or in part at K2 s option on or after June 15, 2008 at a redemption price of 101.429% beginning on June 15, 2008 and ending on June 14, 2009, and at 100.714% beginning on June 15, 2009 and ending on June 14, 2010.

At September 30, 2005, K2 also had $200.0 million of 7.375% senior, unsecured notes (Senior Notes) due July 1, 2014. The Senior Notes are redeemable by K2 in whole or in part at K2 s option at any time prior to July 1, 2009 at a price equal to 100% of the principal amount plus accrued and unpaid interest plus a make-whole premium as defined in the indenture. Thereafter, K2 may redeem all or a portion of the notes at the redemption prices set forth in the indenture. The Senior Notes include various incurrence covenants, including limitations on indebtedness, restricted payments and sales of assets.

At September 30, 2005, K2 also had $50.4 million outstanding under various foreign lending arrangements.

NOTE 9 Pension Plans

K2 sponsors several trusteed non-contributory defined benefit pension plans covering about 850 of its domestic employees. Benefits are generally based on years of service and the employee s highest average compensation for five consecutive years during the years of credited service. Contributions are intended to provide for benefits attributable to service to date and service expected to be provided in the future. K2 funds these plans in accordance with the Employee Retirement Income Security Act of 1974.

Effective August 31, 2004, the domestic pension plans (the plans) were amended to freeze the accrual of future benefits for almost all of the employees. This resulted in active participants no longer accruing benefits under the plans. Participants will remain eligible to receive benefits they have earned under the plans through August 31, 2004 when they retire. New employees will not be eligible to accrue any benefit under the plans. Only a small group of about 20 employees subject to a collective bargaining agreement will continue to accrue a benefit. The impact of this plan change on K2 s benefit costs is a one-time recognized curtailment loss of $0.4 million in the 2004 third

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 9 Pension Plans (Continued)

quarter. The impact on future benefit costs is the elimination of the service cost and an $8.0 million reduction of the projected benefit obligation for future pay increases. This plan change has further resulted in an estimated reduction in net periodic pension costs for the 2005 year of $2.8 million.

The components of net periodic pension cost consisted of the following:

	Three Months Ended September 30		Nine Months Ended September 30	
(Thousands)	2005	2004	2005	2004
Service cost	$ 25	$ 450	$ 75	$ 1,350
Interest cost	1,010	1,030	3,030	3,090
Expected return on assets	(1,034)	(910)	(3,102)	(2,730)
Amortization of:				
Prior service cost		15		45
Actuarial loss	162	135	486	405
Total net periodic benefit cost	$ 163	$ 720	$ 489	$ 2,160

The decline in the net periodic benefit cost for the three and nine months ended September 30, 2005 as compared to September 30, 2004 is due to K2 freezing its plans effective August 31, 2004. K2 s expected cash contribution to its plans in 2005 is $4.9 million. During the three and nine months ended September 30, 2005, K2 made contributions totaling approximately $3.1 million and $4.6 million, respectively, to the plans.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 10 Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

	Currency Translation Adjustments	Additional Minimum Pension Liability	Derivative Financial Instruments	Total
		(Thousands)		
Balance at December 31, 2004	$ 7,143	$ (10,525)	$ (1,068)	$ (4,450)
Currency translation adjustment	(13,591)			(13,591)
Reclassification adjustment for amounts recognized in cost of sales			492	492
Change in fair value of derivatives, net of $155 in taxes			310	310
Balance at September 30, 2005	$ (6,448)	$ (10,525)	$ (266)	$ (17,239)

Total comprehensive income was $15.7 million and $15.9 million for the three months ended September 30, 2005 and 2004, respectively. Total comprehensive income was $7.7 million and $33.2 million for the nine months ended September 30, 2005 and 2004, respectively. Total comprehensive income includes the net change in accumulated other comprehensive loss for the period.

Adjustments resulting from translating foreign functional currency financial statements into U.S. dollars are included in the foreign currency translation adjustment in the above table. The currency translation loss for the nine months ended September 30, 2005 is the result of the strengthening of the U.S. dollar against foreign currencies during the period, including the Euro, Japanese Yen and British Pound Sterling.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 11 Earnings Per Share Data

Basic earnings per share (EPS) is determined by dividing net income or loss by the weighted average number of shares outstanding during the period. Diluted EPS reflects the potential dilutive effects of stock options, restricted stock, shares held in escrow and warrants, using the treasury stock method, and of the debentures using the if converted method. The table below provides a reconciliation from basic shares to fully diluted shares for the respective periods.

Options to purchase 4,403,109 and 4,596,928 shares of common stock were outstanding at September 30, 2005 and 2004, respectively. At September 30, 2005, there were also 192,000 unvested and 38,000 vested restricted stock awards outstanding and 536,536 shares held in escrow relating to certain acquisitions. At September 30, 2005 and 2004, 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 months ended September 30, 2005 and 2004, approximately 2,024,000 and 448,000 stock options, respectively, were excluded since their inclusion would have been antidilutive. For the three months ended September 30, 2005, approximately 162,000 warrants were also excluded as their inclusion would have been antidilutive. For the three months ended September 30, 2005 and 2004, 539,874 and 179,975 shares of K2 common stock held in escrow, respectively, were included in the calculation of diluted earnings per share.

For the nine months ended September 30, 2005 and 2004, approximately 1,621,000 and 428,000 stock options, respectively, were excluded since their inclusion would have been antidilutive. For the three months ended September 30, 2005, 108,000 warrants were also excluded as their inclusion would have been antidilutive. For the nine months ended September 30, 2005 and 2004, 590,794 and 139,396 shares of K2 common stock held in escrow, respectively, were included in the calculation of diluted earnings per share.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 11 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 EPS as well as the calculation of diluted EPS for the periods presented:

	Three Months Ended September 30		Nine Months Ended September 30	
	2005	2004	2005	2004
	(Thousands, except per share amounts)			
Determination of diluted number of shares:				
Average common shares outstanding	46,326	46,472	46,240	38,753
Assumed conversion of dilutive stock options, restricted stock awards, warrants and shares in escrow	1,061	873	1,181	947
Assumed conversion of subordinated debentures	7,803	7,803	7,803	7,803
Diluted average common shares outstanding	55,190	55,148	55,224	47,503
Calculation of diluted earnings per share:				
Net income	$ 16,740	$ 13,198	$ 20,517	$ 30,116
Add: interest component on assumed conversion of subordinated debentures, net of taxes	928	887	2,785	2,712
Net income, adjusted	$ 17,668	$ 14,085	$ 23,302	$ 32,828
Diluted earnings per share (a)	$ 0.32	$ 0.26	$ 0.42	$ 0.69

(a) Diluted earnings per share is calculated by dividing net income, adjusted, by diluted

NOTE 12 Segment Information

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

The Marine and Outdoor segment includes *Shakespeare* fishing tackle and monofilament products as well as *Stearns* outdoor products. The Team Sports segment includes baseball and softball products and *K2 Licensed Products*. The Action Sports segment includes skis, snowboards, snowshoes, in-line skates and paintball products. The Apparel and Footwear segment includes *Marmot* and *Ex Officio* products as well as skateboard shoes and related apparel.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 12 Segment Information (Continued)

The segment information for the 2004 period has been restated to reflect these reclassifications.

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

	Net Sales to Unaffiliated Customers		Intersegment Sales		Operating Profit (Loss)	
	2005	2004	2005	2004	2005	2004
			(Millions)			
Marine and Outdoor	$ 79.1	$ 68.2	$ 44.4	$ 38.7	$ 8.5	$ 6.7
Team Sports	45.8	40.1			(4.9)	(5.2)
Action Sports	163.2	180.1	3.4	2.9	25.0	23.2
Apparel and Footwear	52.3	45.1	1.1	0.5	6.4	6.1
Total segment data	$ 340.4	$ 333.5	$ 48.9	$ 42.1	35.0	30.8
Corporate expenses, net					(2.4)	(2.8)
Interest expense					(7.5)	(7.3)
Income before provision for income taxes					$ 25.1	$ 20.7

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

	Net Sales to Unaffiliated Customers		Intersegment Sales		Operating Profit (Loss)	
	2005	2004 (a)	2005	2004 (a)	2005	2004 (a)
			(Millions)			
Marine and Outdoor	$ 321.9	$ 274.8	$ 114.3	$ 88.0	$ 44.7	$ 38.4
Team Sports	206.7	195.9			5.7	5.1
Action Sports	308.7	324.3	8.4	2.9	1.8	17.6
Apparel and Footwear	122.8	66.8	2.1	0.9	10.3	8.2

Total segment data	$ 960.1	$ 861.8	$ 124.8	$ 91.8	62.5	69.3
Corporate expenses, net					(9.7)	(9.2)
Interest expense					(22.1)	(13.8)
Income before provision for income taxes					$ 30.7	$ 46.3

(a) Results for the nine months ended September 30, 2004 include less than a full nine months of results of K2 Licensed Products, which was acquired by K2 on January 23, 2004, Worr Game Products and IPI, both of which were acquired by K2 on April 19, 2004, Ex Officio, which was acquired by K2 on May 12, 2004, Marmot, which was acquired by K2 on June 30, 2004 and Völkl and Marker, both of which were acquired on July 7, 2004.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 13 Contingencies

Certain of K2 s products are used in relatively high risk recreational settings and from time to time K2 is named as a defendant in lawsuits asserting product liability claims relating to its sporting goods products. To date, none of these lawsuits has had a material adverse effect on K2, and K2 does not expect any lawsuit now pending to have such an effect. K2 maintains product liability, general liability and excess liability insurance coverage. No assurances can be given such that insurance will continue to be available at an acceptable cost to K2 or such coverage will be sufficient to cover one or more large claims, or that the insurers will not successfully disclaim coverage as to a pending or future claim.

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 PRP s 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, 2005 and December 31, 2004, K2 had recorded an estimated liability of approximately $800,000 for environmental liabilities. The estimate is 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 these matters cannot be predicted with certainty, however, and taking into consideration reserves provided, management does not believe these matters will have a material adverse effect on K2 s financial statements.

In January 2004, Rawlings was sued by a licensee in the U.S. District Court for the District of Maine in connection with a license agreement pursuant to which the licensee was granted an exclusive license to use certain Rawlings trademarks for the manufacture and sale of team and personal sporting-equipment bags this lawsuit was later transferred to the U.S. District Court for the Eastern District of Missouri. In February 2004, Rawlings gave the licensee notice that it was terminating the license agreement and sued the licensee in the Missouri District Court, in which Rawlings alleged, among other things, that the licensee breached the license agreement by failing to use its best efforts . This license agreement was in place prior to the March 26, 2003 acquisition of Rawlings by K2. Accordingly, during 2004, K2 established liabilities totaling $3.5 million for the estimated probable settlement or verdict on the matter.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 13 Contingencies (Continued)

On April 29, 2005, a jury awarded the licensee (1) $4.1 million for a claim of lost profits for the next ten years on sales of equipment bags, plus the value of inventory of such bags (the 10-Year Lost Profits Verdict), (2) $2.1 million for lost profits of equipment bags beginning ten years from the date of the breach of the agreement through forever (the Speculative Profits Verdict) and (3) $2.5 million for K2 s alleged tortious interference with the licensee s business expectations (the Tortious Interference Verdict) between Rawlings and the licensee. The Missouri District Court ruled that the licensee was not permitted to bring certain claims to the jury. Following trial, the licensee filed a motion to recover approximately $0.6 million in attorney s fees and costs this motion is currently pending. Following the verdict, K2 established in the second quarter 2005 an additional $1.2 million in liabilities for a total of approximately $4.7 million in liabilities related to this litigation, including estimated legal fees and costs of licensee s attorneys.

On May 19, 2005, K2 and Rawlings, as the case may be, have filed a motion for new trial with respect to the 10-Year Lost Profits Verdict and a motion for judgment notwithstanding the verdict with respect to the Speculative Profits Verdict and the Tortious Interference Verdict. On July 27, 2005, the Missouri District (1) denied Rawlings motion for a new trial in respect of the $4.1 million 10-Year Lost Profits Verdict, (2) granted Rawlings motion for judgment notwithstanding the verdict with respect to the $2.1 million Speculative Profits Verdict and (3) denied K2 s motion for judgment notwithstanding the verdict for the $2.5 million Tortious Interference Verdict. The only matter that remains open for the Missouri District Court is the licensee s motion for approximately $0.6 million for its attorneys fees and costs. Accordingly, there is currently a judgment against K2 and Rawlings for approximately $6.8 million.

K2 intends to vigorously prosecute an appeal. K2 believes, in part based on advice and estimates from outside counsel as follows: that certain portions of the Missouri District Court s decision are not supported by facts or law; that there are meritorious arguments to be raised during the appeals process because of, among other things, a lack of evidence to support certain aspects of the verdict; and that K2 s aggregate exposure including attorney s fees and costs of license is approximately $4.7 million. In connection with its appeal, K2 will be required by Missouri law to post bond in the amount of approximately $6.8 million. In the event that K2 and Rawlings are unsuccessful in their appeal and the amount of the judgment, including the fees and costs of attorneys for the licensee, is greater than $4.7 million, or the outcome of a total liability greater than $4.7 million becomes probable and estimable, K2 will be required to record an expense in the period in which the matter is finalized. However, this expense could be higher if the appeals court rules in favor of the licensee for certain claims on which it is expected that licensee will appeal. The appeal process is expected to take one to two years.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 13 Contingencies (Continued)

In connection with K2 s acquisition of substantially all of the assets of Miken Composites, LLC, a business engaged in the design, selling and distribution of composite softball bats and softball-related products and accessories in the fourth quarter 2004, K2 assumed the post-litigation damages related to a patent lawsuit in the U.S. District Court for the District of Minnesota. In this patent lawsuit, *Miken Composites, L.L.C. v. Wilson Sporting Goods Co*., Miken commenced an action in April 2002 seeking a declaration that a line of softball bats manufactured by Miken does not infringe a particular patent owned by Wilson. In response, Wilson counterclaimed seeking to enjoin Miken from continuing to manufacture certain bats and seeks damages for all past alleged infringements of its patent.

In July 2004, the Minnesota Court issued an order interpreting certain of Wilson s claims concerning its patent, and this interpretation appears to be favorable to K2 and Miken. And, based on this favorable ruling, Miken moved for summary judgment, on which the Minnesota Court still has not ruled. Then, on March 17, 2005, the Minnesota District Court entered an order to stay the patent case pending resolution of a related appeal in federal court of *Wilson Sporting Goods Co. v. Hillerich & Bradsby Co.* This case involves similar patent issues as those in *Miken Composites, L.L.C. v. Wilson Sporting Goods Co*.

Each of K2 and Miken has denied all material allegations and asserted various affirmative defenses in respect of Wilson s counterclaims. The resolution of this matter will depend primarily upon contested facts, and cannot be accurately predicted. Although each of K2 and Miken believes that it has significant defenses to Wilson s counterclaims, in the event that K2 and Miken are unsuccessful in the declaratory judgment and counterclaim actions, K2 will be required to record an expense in the period when the loss resulting from the resolution of the matter is probable and estimable. The litigation process for this case, including any appeals, is estimated to be an additional two to three years.

K2 is involved in lawsuits, claims, investigations and proceedings, including those identified above, consisting of product liability, patent, commercial, employment and environmental matters, which arise in the ordinary course of business. In accordance with SFAS No. 5, *Accounting for Contingencies*, K2 makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. K2 believes that it has adequate provisions for such matters. K2 reviews these provisions at least quarterly and adjusts these provisions to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular legal matter. Litigation is inherently unpredictable. However, K2 believes that it has valid defenses with respect to legal matters pending against it. Nevertheless, it is possible that cash flows or results of operations could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 14 Supplemental Guarantor Information

Obligations to pay principal and interest on K2 s Senior Notes are guaranteed fully and unconditionally by K2 s existing and future wholly-owned U.S. subsidiaries. Separate financial statements of the guarantors are not provided, as subsidiary guarantors are 100% owned by K2 and guarantees are full, unconditional, and joint and several. The non-guarantor subsidiaries are K2 s consolidated non-U.S. subsidiaries. Supplemental condensed consolidating financial information of the K2 s guarantors is presented below.

Condensed Consolidating Statements of Income (Unaudited)

(Thousands)

	Three Months Ended September 30, 2005				
	K2 Inc.	**Guarantor Subsidiaries**	**Non-guarantor Subsidiaries**	**Eliminating Entries**	**Consolidated K2 Inc.**
Net sales	$ 11	$ 239,258	$ 149,985	$ (48,902)	$ 340,352
Cost of products sold	628	157,974	106,193	(49,570)	215,225
Gross profit	(617)	81,284	43,792	668	125,127
Selling expenses	(976)	41,183	17,098		57,305
General and administrative expenses	9,677	17,984	8,148		35,809
Operating income (loss)	(9,318)	22,117	18,546	668	32,013
Income in consolidated subsidiaries	32,843			(32,843)	
Other expense (income), net	2	(796)	211		(583)
Interest expense (income)	6,783	(525)	1,261		7,519
Income (loss) before income taxes	16,740	23,438	17,074	(32,175)	25,077
Income taxes (benefit)		4,669	3,668		8,337
Net income (loss)	$ 16,740	$ 18,769	$ 13,406	$ (32,175)	$ 16,740

	Three Months Ended September 30, 2004				
	K2 Inc.	**Guarantor Subsidiaries**	**Non-guarantor Subsidiaries**	**Eliminating Entries**	**Consolidated K2 Inc.**
Net sales	$	$ 211,392	$ 164,179	$ (42,111)	$ 333,460

Cost of products sold		138,863	116,634	(41,223)	214,274
Gross profit		72,529	47,545	(888)	119,186
Selling expenses	581	36,818	19,392	(55)	56,736
General and administrative expenses	6,578	19,527	9,128	(356)	34,877
Operating income (loss)	(7,159)	16,184	19,025	(477)	27,573
Income in consolidated subsidiaries	26,280			(26,280)	
Other expense (income), net		(1,162)	433	303	(426)
Interest expense	5,923	59	1,310	7	7,299
Income (loss) before income taxes	13,198	17,287	17,282	(27,067)	20,700
Income taxes (benefit)		4,726	2,776		7,502
Net income (loss)	$ 13,198	$ 12,561	$ 14,506	$ (27,067)	$ 13,198

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 14 Supplemental Guarantor Information (Continued)

Condensed Consolidating Statements of Income (Unaudited) - Continued

(Thousands)

	Nine Months Ended September 30, 2005				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Net sales	$ 11	$ 731,917	$ 352,982	$ (124,842)	$ 960,068
Cost of products sold	628	492,093	262,132	(122,489)	632,364
Gross profit	(617)	239,824	90,850	(2,353)	327,704
Selling expenses	121	120,697	49,704		170,522
General and administrative expenses	24,798	58,684	23,330		106,812
Operating income (loss)	(25,536)	60,443	17,816	(2,353)	50,370
Income in consolidated subsidiaries	64,458			(64,458)	
Other income, net	(819)	(1,473)	(129)		(2,421)
Interest expense (income)	19,224	(323)	3,156		22,057
Income (loss) before income taxes	20,517	62,239	14,789	(66,811)	30,734
Income taxes		5,722	4,495		10,217
Net income (loss)	$ 20,517	$ 56,517	$ 10,294	$ (66,811)	$ 20,517

	Nine Months Ended September 30, 2004				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Net sales	$	$ 640,638	$ 313,011	$ (91,838)	$ 861,811
Cost of products sold		435,047	234,541	(90,961)	578,627
Gross profit		205,591	78,470	(877)	283,184
Selling expenses	1,184	101,965	37,344	(144)	140,349
General and administrative expenses	16,977	52,294	16,747	(2,723)	83,295
Operating income (loss)	(18,161)	51,332	24,379	1,990	59,540

Income in consolidated subsidiaries	60,487			(60,487)	
Other expense (income), net		(3,764)	117	3,043	(604)
Interest expense	12,210	142	1,453	6	13,811
Income (loss) before income taxes	30,116	54,954	22,809	(61,546)	46,333
Income taxes (benefit)		10,217	6,000		16,217
Net income (loss)	$ 30,116	$ 44,737	$ 16,809	$ (61,546)	$ 30,116

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 14 Supplemental Guarantor Information (Continued)

Condensed Consolidating Balance Sheets (Unaudited)

(Thousands)

	As of September 30, 2005				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Assets					
Current Assets					
Cash and cash equivalents	$ 5,077	$ 1,573	$ 10,808	$	$ 17,458
Accounts receivable, net	78,047	238,018	179,478	(152,355)	343,188
Inventories, net	175	250,341	127,718	(5,431)	372,803
Deferred income taxes	23,006		(9,456)		13,550
Prepaid expenses and other current assets	841	6,888	18,582		26,311
Total current assets	107,146	496,820	327,130	(157,786)	773,310
Property, plant and equipment	13,129	159,397	115,267		287,793
Less allowance for depreciation and amortization	1,272	101,250	45,168		147,690
	11,857	58,147	70,099		140,103
Intangible assets, net	426,958	14,908	65,661		507,527
Deferred income taxes	7,507				7,507
Investment in subsidiaries	881,248			(881,248)	
Other	18,968	(32)	5,105	125	24,166
Total Assets	$ 1,453,684	$ 569,843	$ 467,995	$ (1,038,909)	$ 1,452,613
Liabilities and Shareholders Equity					
Current Liabilities					
Bank loans	$	$	$ 30,174	$	$ 30,174
Accounts payable	1,975	90,306	86,410	(94,589)	84,102
Accrued liabilities	60,465	63,980	45,374	1,633	171,452
Current portion of long-term debt	25,000		2,670		27,670
Total current liabilities	87,440	154,286	164,628	(92,956)	313,398
Long-term pension liabilities	16,854				16,854
Long-term debt	263,596		17,578		281,174
Deferred income taxes	50,746				50,746
Advances (to) from affiliates. net	244,607	(242,634)	62,732	(64,705)	
Convertible subordinated debentures	98,886				98,886

Interdivisional equity		658,191	223,057	(881,248)	
Shareholders Equity	691,555				691,555
Total Liabilities and Shareholders Equity	$ 1,453,684	$ 569,843	$ 467,995	$ (1,038,909)	$ 1,452,613

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 14 Supplemental Guarantor Information (Continued)

Condensed Consolidating Balance Sheets

(Thousands)

	As of December 31, 2004				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Assets					
Current Assets					
Cash and cash equivalents	$ 3,167	$ 5,098	$ 17,368	$	$ 25,633
Accounts receivable, net	54,123	240,539	176,633	(101,381)	369,914
Inventories, net	1,479	214,336	115,337	(6,027)	325,125
Deferred income taxes	27,970	14	1,725		29,709
Prepaid expenses and other current assets	716	5,582	16,477		22,775
Total current assets	87,455	465,569	327,540	(107,408)	773,156
Property, plant and equipment	8,548	153,883	110,528		272,959
Less allowance for depreciation and amortization	638	93,939	37,418		131,995
	7,910	59,944	73,110		140,964
Investment in affiliates	560,820			(560,820)	
Intangible assets, net	484,109	13,431	5,825	5,000	508,365
Deferred income taxes	7,506				7,506
Other	20,707	2,702	2,965		26,374
Total Assets	$ 1,168,507	$ 541,646	$ 409,440	$ (663,228)	$ 1,456,365
Liabilities and Shareholders Equity					
Current Liabilities					
Bank loans	$	$	$ 31,490	$	$ 31,490
Accounts payable	3,054	95,462	84,369	(79,727)	103,158
Accrued liabilities	59,993	58,520	60,940		179,453
Current portion of long-term debt	30,455	421	4,198		35,074
Total current liabilities	93,502	154,403	180,997	(79,727)	349,175
Long-term pension liabilities	16,854				16,854
Long-term debt	229,736	1,624	19,452		250,812
Deferred income taxes	52,048	6,075			58,123
Advances (to) from affiliates, net	(5,034)	(32,645)	60,360	(22,681)	
Convertible subordinated debentures	98,535				98,535

Interdivisional equity		412,189	148,631	(560,820)	
Shareholders Equity	682,866				682,866
Total Liabilities and Shareholders Equity	$ 1,168,507	$ 541,646	$ 409,440	$ (663,228)	$ 1,456,365

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 14 Supplemental Guarantor Information (Continued)

Condensed Consolidating Statements of Cash Flows (Unaudited)

(Thousands)

	Nine Months Ended September 30, 2005				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Operating Activities					
Net income (loss)	$ (50,631)	$ 61,710	$ 11,791	$ (2,353)	$ 20,517
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Gain on sale of operating division		100			100
Depreciation and amortization	5,665	9,805	11,430		26,900
Deferred taxes	3,661	(6,111)	11,181		8,731
Changes in current assets and current liabilities	(23,352)	(32,551)	(31,421)	37,149	(50,175)
Net cash provided by (used in) operating activities	(64,657)	32,953	2,981	34,796	6,073
Investing Activities					
Property, plant & equipment expenditures	(2,036)	(14,873)	(12,177)		(29,086)
Disposals of property, plant & equipment	88	4,369	312		4,769
Purchase of businesses, net of cash acquired	(17,184)				(17,184)
Other items, net	127,255	186,060	4,670	(313,200)	4,785
Net cash provided by (used in) investing activities	108,123	175,556	(7,195)	(313,200)	(36,716)
Financing Activities					
Borrowings (payments) under long-term debt, net	28,756	(2,045)	(3,402)		23,309
Net decrease in short-term bank loans			(1,316)		(1,316)
Proceeds received from exercise of stock options	475				475
Net cash provided by (used in) financing activities	29,231	(2,045)	(4,718)		22,468
(Increase) decrease in investment in subsidiaries	(320,428)			320,428	
Advances (to) from affiliates	249,641	(209,989)	2,372	(42,024)	
Net increase (decrease) in cash and cash equivalents	1,910	(3,525)	(6,560)		(8,175)
Cash and cash equivalents at beginning of year	3,167	5,098	17,368		25,633
Cash and cash equivalents at end of period	$ 5,077	$ 1,573	$ 10,808	$	$ 17,458

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

September 30, 2005

NOTE 14 Supplemental Guarantor Information (Continued)

Condensed Consolidating Statements of Cash Flows (Unaudited)

(Thousands)

	Nine Months Ended September 30, 2004				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Operating Activities					
Net income (loss)	$ (21,164)	$ 52,600	$ (261)	$ (1,059)	$ 30,116
Adjustments to reconcile net income (loss) to net cash provided by operating activities:					
Depreciation and amortization	4,283	11,131	4,465		19,879
Deferred taxes	2,132	(1,672)	1,929	10,954	13,343
Changes in current assets and current liabilities	773	(47,981)	(40,946)	42,088	(46,066)
Net cash provided by operating activities	(13,976)	14,078	(34,813)	51,983	17,272
Investing Activities					
Property, plant & equipment expenditures	(890)	(9,195)	(15,641)	1,484	(24,242)
Disposals of property, plant & equipment		1,753	112	(1,484)	381
Purchase of businesses, net of cash acquired	(113,467)				(113,467)
Other items, net	28,677	9,418	18,306	(57,875)	(1,474)
Net cash provided by (used in) investing activities	(85,680)	1,976	2,777	(57,875)	(138,802)
Financing Activities					
Issuance of senior notes	200,000				200,000
Borrowings (payments) under long-term debt, net	(97,749)	(910)	(37,408)	13	(136,054)
Net decrease in short-term bank loans			(16,041)	85	(15,956)
Net proceeds from equity issuance	93,740				93,740
Debt issuance costs	(8,353)				(8,353)
Proceeds received from exercise of stock options	4,093				4,093
Net cash provided by (used in) financing activities	191,731	(910)	(53,449)	98	137,470
(Increase) decrease in investment in subsidiaries	(76,938)	8		76,930	
Advances (to) from affiliates	(2,017)	(15,078)	82,462	(65,367)	
Net increase (decrease) in cash and cash equivalents	13,120	74	(3,023)	5,769	15,940
Cash and cash equivalents at beginning of year	2,681	2,371	16,204		21,256
Cash and cash equivalents at end of period	$ 15,801	$ 2,445	$ 13,181	$ 5,769	$ 37,196

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

Certain statements in Management s Discussion and Analysis are forward-looking as defined in the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations that are subject to risks and uncertainties. Actual results may differ materially from expectations as of the date of this filing because of the factors discussed below under the *Statement Regarding Forward-Looking Disclosure* section and elsewhere in this quarterly report on Form 10-Q.

K2 Inc. (K2) is a premier, branded consumer products company with a portfolio of leading brands including *Shakespeare*, *Pflueger* and *Stearns* in the Marine and Outdoor segment; *Rawlings*, *Worth* and *K2 Licensed Products* in the Team Sports segment; *K2*, *Völkl*, *Marker*, *Ride* and *Brass Eagle* in the Action Sports segment; and *Adio*, *Marmot* and *Ex Officio* in the Apparel and Footwear segment. K2 s diversified mix of products is used primarily in team and individual sports activities such as fishing, watersports activities, baseball, softball, alpine skiing, snowboarding and in-line skating.

Matters Affecting Comparability

Operating Segments. As a result of a number of acquisitions in 2003 and 2004, K2 reclassified its business into the following four segments based on similar product types, distribution channels and management s perspective in evaluating K2 s various lines of business: Marine and Outdoor, Team Sports, Action Sports and Apparel and Footwear. The Marine and Outdoor segment includes *Shakespeare* fishing tackle and monofilament products as well as *Stearns* outdoor products. The Team Sports segment includes baseball and softball products and *K2 Licensed Products*. The Action Sports segment includes skis, bindings, snowboards, snowshoes, in-line skates and paintball products. The Apparel and Footwear segment includes skateboard shoes and apparel, technical apparel and equipment and outdoor and adventure travel apparel. All periods presented have been recasted to reflect these changes in the segments.

The Marine and Outdoor segment represented $321.9 million, or 33.5%, of K2 s 2005 nine months consolidated net sales; the Action Sports segment represented $308.7 million, or 32.2% of 2005 nine months consolidated net sales; the Team Sports segment had net sales of $206.7 million, or 21.5% of 2005 nine months consolidated net sales; and the Apparel and Footwear segment had net sales of $122.8 million, or 12.8% of 2005 nine months consolidated net sales.

Acquisitions. The consolidated condensed statements of income for the three months ended September 30, 2005 and 2004 and the nine months ended September 30, 2005 include the operating results of each of the businesses acquired in 2004, however the 2004 nine month results include less than a full nine months of results of K2 Licensed Products, which was acquired by K2 on January 23, 2004, Worr Game Products and IPI, both of which were acquired by K2 on April 19, 2004, Ex Officio, which was acquired by K2 on May 12, 2004, Marmot, which was acquired by K2 on June 30, 2004 and Völkl and Marker, both of which were acquired on July 7, 2004. Net sales from acquisitions completed by K2 on or subsequent to September 30, 2004 accounted for $10.9 million and $23.7 million of net sales for the three and nine months ended September 30, 2005, respectively. Net sales for the period from January 1, 2005 through the earlier of the one year anniversary date of acquisition or September 30, 2005 for acquisitions completed by K2 in 2004 and 2005 which either did not have operations in 2004 or which did not have a full nine months of operations in 2004 accounted for $97.8 million of net sales for the nine months ended September 30, 2005. For further discussion of K2 s acquisition activities see Note 5 of the Notes to Consolidated Condensed Financial Statements.

Consolidated Results of Operations

The following table sets forth certain ratios and relationships calculated from the Consolidated Condensed Statements of Income for the quarter and nine months ended September 30:

	Three Months Ended September 30				Nine Months Ended September 30		
			Increase /(Decrease)				Increase /(Decrease)
	2005	2004	$	%	2005	2004	
(In millions, except per share data)							