

Edgar Filing: HUFFY CORP - Form 10-Q

HUFFY CORP  
Form 10-Q  
November 12, 2003

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For Quarter Ended September 27, 2003

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-5325

Huffy Corporation

(Exact name of registrant as specified in its charter)

Ohio

31-0326270

\_\_\_\_\_  
(State or other jurisdiction of incorporation or organization)

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

225 Byers Road, Miamisburg, Ohio 45342

\_\_\_\_\_  
(Address of principal executive offices) (Zip Code)

(937) 866-6251

\_\_\_\_\_  
(Registrant's telephone number, including area code)

No Change

\_\_\_\_\_  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes    X    No  
-----

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Edgar Filing: HUFFY CORP - Form 10-Q

Yes    X        No  
 -----        -----

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Outstanding Shares: 16,167,572 as of October 31, 2003  
 -----

PART I - FINANCIAL INFORMATION  
 -----

ITEM 1. FINANCIAL STATEMENTS:

HUFFY CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS  
 (Dollar Amounts in Thousands, Except Per Share Data)  
 (Unaudited)

	Three Months Ended		
	September 27, 2003	September 30, 2002	Septemb 20
	-----	-----	-----
Product sales	\$ 82,931	\$ 60,686	\$ 25
Services to retailers	23,812	22,342	6
	-----	-----	-----
Net sales	106,743	83,028	31
Product cost of sales	66,579	47,406	19
Services to retailers cost of sales	19,941	19,667	5
	-----	-----	-----
Cost of sales	86,520	67,073	25
	-----	-----	-----
Gross profit	20,223	15,955	6
Selling, general and administrative expenses	16,486	12,826	5
	-----	-----	-----
Operating income	3,737	3,129	
Other expense, net			
Interest expense	1,455	287	
Other (income) expense	(630)	419	
	-----	-----	-----
Earnings before income taxes and discontinued operations	2,912	2,423	
Income tax expense	583	754	
	-----	-----	-----
Earnings from continuing operations	2,329	1,669	
Discontinued operations:			
Income (loss) from discontinued			

Edgar Filing: HUFFY CORP - Form 10-Q

operations, net of income taxes	589	(723)	
Net earnings	\$ 2,918	\$ 946	\$
Earnings per common share:			
Basic:			
Weighted average number of common shares	15,677,536	11,871,429	15,12
Earnings from continuing operations	\$ 0.15	\$ 0.14	\$
Earnings (loss) from discontinued operations	0.04	(0.06)	
Net earnings per common share	\$ 0.19	\$ 0.08	\$
Diluted:			
Weighted average number of common shares	15,892,851	12,128,033	15,33
Earnings from continuing operations	\$ 0.15	\$ 0.14	\$
Earnings (loss) from discontinued operations	0.03	(0.06)	
Net earnings per common share	\$ 0.18	\$ 0.08	\$

See accompanying notes to condensed consolidated financial statements.

HUFFY CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Dollar Amounts In Thousands)  
(Unaudited)

	September 27, 2003	December 200
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 3,421	\$ 5,
Accounts and notes receivables, net	101,912	92,
Inventories, net	59,657	41,
Prepaid expenses and deferred income taxes	23,665	20,
Net assets held for sale	5,480	5,
Total current assets	194,135	166,
Property, plant and equipment, at cost	45,315	41,
Less: Accumulated depreciation and amortization	32,743	30,
Net property, plant and equipment	12,572	11,
Excess of cost over net assets acquired, net	29,200	26,
Intangible assets, net	47,645	48,
Other assets, net	32,227	29,

Edgar Filing: HUFFY CORP - Form 10-Q

Total assets	\$ 315,779	\$ 282,779
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
-----		
Current liabilities:		
Notes payable	\$ 68,840	\$ 54,840
Current installments of long-term obligations	5,108	5,108
Accounts payable	66,823	65,823
Accrued expenses and other current liabilities	30,031	37,031
	-----	-----
Total current liabilities	170,802	161,802
	-----	-----
Long-term obligations, less current installments	15,624	
Pension liabilities	29,454	31,454
Other long-term liabilities	15,920	16,920
	-----	-----
Total liabilities	231,800	210,200
	-----	-----
Shareholders' equity:		
Common stock	22,322	21,322
Additional paid-in capital	101,977	95,977
Retained earnings	78,013	73,013
Unearned stock compensation	(45)	
Accumulated other comprehensive loss	(28,415)	(28,415)
Treasury shares, at cost	(89,873)	(89,873)
	-----	-----
Total shareholders' equity	83,979	71,979
	-----	-----
Total liabilities and shareholders' equity	\$ 315,779	\$ 282,779
	=====	=====

See accompanying notes to condensed consolidated financial statements.

HUFFY CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Dollar Amounts In Thousands)  
(Unaudited)

		Nine Months E
		-----
		September 27, Sep
		2003
		-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings from continuing operations		\$ 2,790
Adjustments to reconcile net earnings from continuing operations to net cash		

## Edgar Filing: HUFFY CORP - Form 10-Q

used in operating activities:

Depreciation and amortization	3,602
Income (loss) from discontinued operations	1,547
Gain on sale of property, plant and equipment	4
Deferred income taxes	1,117
Changes in assets and liabilities:	
Accounts and notes receivable, net	(9,062)
Inventories	(17,810)
Prepaid expenses	(2,683)
Other assets	(3,686)
Accounts payable	1,304
Accrued expenses and other current liabilities	(7,028)
Other long-term liabilities	3,467
	-----
Net cash used in operating activities	(26,438)

=====

CASH FLOWS FROM INVESTING ACTIVITIES:

Capital expenditures	(4,534)
Acquisition of businesses, net of cash acquired	(1,360)
	-----
Net cash used in investing activities	(5,894)

=====

CASH FLOWS FROM FINANCING ACTIVITIES:

Net increase in notes payable	14,771
Repayment of debt assumed in the Gen-X acquisition	-
Preferred shares redeemed	-
Issuance of long-term debt	16,001
Repayments of long-term debt	(844)
Issuance of common shares	406
	-----
Net cash provided by financing activities	30,334

=====

Net change in cash and cash equivalents	(1,998)
Cash and cash equivalents:	
Beginning of the year	5,419
	-----
End of the period	\$ 3,421

=====

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

-----  
(IN THOUSANDS, EXCEPT FOR SHARE DATA)  
-----

(Unaudited)

NOTE 1. FINANCIAL STATEMENT PRESENTATION

BASIS OF PRESENTATION - The accompanying unaudited condensed consolidated

## Edgar Filing: HUFFY CORP - Form 10-Q

financial statements ("Financial Statements") include the accounts of the Company and all of its subsidiaries. All inter-company transactions and balances have been eliminated. The condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") including the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K as of and for the year ended December 31, 2002. Except as disclosed herein, there has been no material change in the information disclosed in the notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K as of and for the year ended December 31, 2002. In the opinion of management, the accompanying Financial Statements include all adjustments considered necessary to present fairly, when read in conjunction with the Company's Annual Report on Form 10-K as of and for the year ended December 31, 2002, the financial position as of September 27, 2003, and the results of operations and cash flows for the quarter and nine months ended September 27, 2003 and September 30, 2002. The results for these interim periods are not necessarily indicative of the results to be expected for the full year.

The results of operations and cash flows for the nine months ended September 30, 2002, do not include a full nine months of the results of Gen-X Sports, Inc., as the date of the acquisition was September 19, 2002. The McCalla Company was acquired on March 27, 2002, and is included in 2002 results of operations and cash flows from the date of acquisition.

USE OF ESTIMATES - The preparation of the condensed consolidated financial statements requires management of the Company to make a number of estimates and assumptions related to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

FREIGHT- The Company classifies outbound freight expense to customers as an adjustment to product sales revenue on the accompanying consolidated statements of earnings. For the three months ended September 27, 2003 and September 30, 2002, freight expense was \$1,525 and \$656, respectively. For the nine months ended September 27, 2003 and September 30, 2002, freight expense was \$2,970 and \$1,635, respectively.

### NOTE 2. INVENTORIES

The components of inventories are as follows:

	SEPTEMBER 27, 2003	DECEMBER 2002
	-----	-----
Finished goods	\$53,478	
Work-in-progress	145	
Raw materials and supplies	6,034	
	-----	-----
	\$59,657	
	=====	=====

## Edgar Filing: HUFFY CORP - Form 10-Q

### NOTE 3. ACQUISITIONS

On September 19, 2002, the Company acquired all of the stock of Gen-X Sports Inc. and Gen-X Sports, Inc. and their subsidiaries in exchange for \$19,001 in cash and the issuance of 4,161,241 shares of Huffy Corporation's common shares to the stockholders of both Gen-X companies. The \$7.687 per share value of the common shares issued was determined based upon the average market price of Huffy Corporation's common shares over the two day period before and after the terms of the acquisition were agreed to and announced. Per the terms of the agreement, 193,466 additional common shares were issued to the Gen-X shareholders on or about the first annual anniversary date. Gen-X did not meet certain financial performance objectives in 2002, which would have resulted in the issuance of up to 645,161 additional common shares. In addition, the acquired Gen-X companies, immediately upon acquisition, redeemed \$4,970 of preferred stock at face value and refinanced their existing bank debt. Included in the assets acquired were trademarks, patents and licensing agreements recorded at their fair values of \$45,814, \$1,301 and \$940, respectively, as well as goodwill in the amount of \$14,643. The fair values for these assets, excluding goodwill, were determined by an independent third-party appraiser. Gen-X is a designer, marketer and distributor of branded sports equipment, including action sports products, winter sports products and golf products, and is a purchaser and reseller of excess sporting goods and athletic footwear inventories and special opportunity purchases.

The table below presents unaudited pro forma condensed combining statements of operations from the Company and Gen-X Sports, Inc. for the three and nine months ended September 30, 2002. The unaudited pro forma condensed combining statements of operations are presented as if the Gen-X Sports Inc. and Gen-X Sports, Inc. merger had occurred on January 1, 2002.

Huffy Corporation, Gen-X Sports Inc. and Gen-X Sports, Inc.  
Summary Unaudited Pro Forma Condensed Combining Statement of Operations  
(Dollar amounts in thousands, except per share data)

	PRO FORMA SEPTEMBER 30, 2002		
	THREE MONTHS ENDED		NINE
	HUFFY CORPORATION	PRO FORMA COMBINED	HUFFY CORPORATI
Net sales	\$ 106,743	\$ 111,338	\$ 318,8
Earnings from continuing operations	2,329	1,352	2,7
Per common share			
Basic	\$ 0.15	\$ 0.09	\$ 0.
Diluted	\$ 0.15	\$ 0.09	\$ 0.
Shares used in calculation of earnings per share			
Basic	15,677,536	14,658,923	15,123,7
Diluted	15,892,851	14,915,527	15,339,0

During the first nine months of 2003, goodwill was increased \$2,539 for the issuance of hold-back shares as well as additional legal costs and other professional fees associated with the acquisition. Gen-X patents and trademarks increased during the first nine months of 2003 by \$30 for costs associated with securing new patents and trademarks.

## Edgar Filing: HUFFY CORP - Form 10-Q

On March 27, 2002, the Company acquired 100% of the common stock of McCalla Company and its subsidiaries. The aggregate purchase price was \$5,400 and was paid in cash. Of the total purchase consideration, \$4,876 was allocated to goodwill and \$300 to a covenant not to compete. In the third quarter of 2002, goodwill was increased by \$87 for additional fees associated with the acquisition. During the fourth quarter of 2002, goodwill was increased \$1,645 to record a contingent purchase price payment owed at December 31, 2002 to the former owners of McCalla Company. The \$1,645 contingent purchase price payment was paid to the sellers in April 2003 and was treated as contingent purchase price in accordance with EITF 95-8, "Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination."

### NOTE 4. GOODWILL AND INTANGIBLE ASSETS

The Company has the following intangible assets as of September 27, 2003 and December 31, 2002:

	SEPTEMBER 27, 2003		DEC 31, 2002
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	GROSS CARRYIN AMOUNT
Assets subject to amortization:			
Gen-X patents	\$ 1,301	\$ 180	\$ 1,2
Gen-X license agreements	940	440	9
McCalla covenant not to compete	300	90	3
	-----	-----	-----
Total assets subject to amortization:	\$ 2,541	\$ 710	\$ 2,5
Assets not subject to amortization:			
Trademarks at Gen-X	\$ 45,814	\$ -	\$ 45,8
Goodwill recorded in connection with the Gen-X acquisition	14,643	-	12,1
Goodwill in the Hufffy Bicycle business unit	8,824	2,380	8,8
Goodwill in Hufffy Sports business unit	1,973	569	1,9
Goodwill recorded in connection with the McCalla acquisition	6,519	-	6,5
Goodwill in Hufffy Service First business unit	478	288	4
	-----	-----	-----
Total assets not subject to amortization	\$ 78,251	\$ 3,237	\$ 75,7

Prior to the adoption of SFAS No. 142, the Company amortized the excess of cost over net assets acquired on a straight-line basis over fifteen to forty years.

Changes in the carrying value of intangible assets for the nine months ended September 27, 2003, are as follows:

DECEMBER 31,



Edgar Filing: HUFFY CORP - Form 10-Q

	2002 GROSS CARRYING AMOUNT	ADDITIONS	ADJUSTMENTS
	-----	-----	-----
Assets subject to amortization:			
Gen-X patents	\$ 1,285	\$ 16	\$ -
Gen-X license agreements	940	8	(8)
McCalla covenant not to compete	300	-	-
	-----	-----	-----
Total assets subject to amortization:	\$ 2,525	\$ 24	\$ (8)
	=====	=====	=====
Assets not subject to amortization:			
Trademarks at Gen-X	\$ 45,800	\$ 6	\$ 8
Goodwill recorded in connection with the Gen-X acquisition	12,104	2,539	-
Goodwill in the Hufffy Bicycle business unit	8,824	-	-
Goodwill in Hufffy Sports business unit	1,973	-	-
Goodwill recorded in connection with the McCalla acquisition	6,521	-	(2)
Goodwill in Hufffy Service First business unit	478	-	-
	-----	-----	-----
Total assets not subject to amortization	\$ 75,700	\$ 2,545	\$ 6
	=====	=====	=====

The Company's reporting units are tested annually during the fourth quarter for impairment.

NOTE 5. SUPPLEMENTAL CASH FLOW INFORMATION

	NINE MONTHS ENDED	
	-----	-----
	SEPTEMBER 27, 2003	SEPTEMBER 30, 2002
	-----	-----
Cash paid (received) during the period for:		
Interest	\$ 5,648	\$ -
Taxes	1,115	-
	-----	-----
Details of acquisitions:		
Fair value of assets	\$ -	\$ 136,000
Liabilities	-	80,000
	-----	-----
Net assets acquired	-	55,000
Less: common shares issued	-	31,000
Less: preferred shares redeemed	-	4,000
	-----	-----
Cash paid for Gen-X common shares	-	19,000

Edgar Filing: HUFFY CORP - Form 10-Q

Cash paid for McCalla acquisition	-	5,
Less: cash acquired	-	
Net cash paid for McCalla acquisition	-	4,
Net cash paid for acquisitions	\$ -	\$ 23,
=====		
Non-cash transactions:		
Issuance of common stock to pension plan	\$ 6,309	\$
Issuance of hold-back shares	1,164	
=====		

NOTE 6. ACCUMULATED OTHER COMPREHENSIVE LOSS

Components of accumulated other comprehensive loss consist of the following:

	September 27, 2003	December 31
	-----	-----
Foreign currency translation adjustment	\$ (883)	\$ (
Unrealized loss on derivative financial instruments	(102)	(
Minimum pension liability	(27,430)	(27,
	-----	-----
	\$ (28,415)	\$ (28,
	=====	=====

Components of comprehensive income (loss) consist of the following for the nine months ended:

	September 27, 2003	September 3
	-----	-----
Net earnings	\$ 4,337	\$ 2,
Other comprehensive income (loss):		
Minimum pension liability, net of income tax benefit of \$11,185	-	(20,
Unrealized gain on derivative financial instruments	106	
Foreign currency translation adjustment	30	
	-----	-----
Comprehensive income (loss)	\$ 4,473	\$ (17,
	=====	=====

NOTE 7. STOCK OPTION PLANS

The Company applies the principles of APB Opinion No. 25 and related interpretations in accounting for its stock-based compensation plans.

## Edgar Filing: HUFFY CORP - Form 10-Q

Accordingly, no compensation cost has been recognized for its fixed stock option plans and its stock purchase plan except for options issued below fair market value. The compensation cost (benefit) that has been charged against earnings for options issued below fair market value and options issued to replace canceled options, was \$(53) and \$(39) (after tax \$(33) and \$(24)) for the three month periods ended September 27, 2003 and September 30, 2002, respectively and \$103 and \$136 (after tax \$64 and \$84) for the nine month period ended September 27, 2003 and September 30, 2002 respectively. Had compensation cost for the Company's stock-based compensation plans been determined using the fair value method of accounting for stock compensation, the Company's net earnings and earnings per share would have been reduced to the pro forma amounts indicated below:

	Three Months Ended		
	SEPTEMBER 27, 2003	SEPTEMBER 30, 2002	SEPT
Net earnings as reported	\$ 2,918	\$ 946	
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effect	(263)	(186)	
Pro forma net earnings	2,655	760	
Diluted net earnings per common share:			
As reported	\$ 0.18	\$ 0.08	
Pro forma	0.17	0.06	

The Company records compensation cost for awards with pro rata vesting ratably over the vesting period.

### NOTE 8. GUARANTEES, COMMITMENTS AND CONTINGENCIES

#### CLAIMS AND ALLOWANCES

The Company maintains a reserve for product liability based upon expected settlement charges for pending claims and an estimate of unreported claims derived from experience, volume and product sales mix. Product liability expense is recorded in cost of sales on the accompanying condensed consolidated statements of earnings. The Company's policy is to fully reserve for warranty claims that have been or may be incurred on all products that have been shipped. The reserves are calculated based on claims that have been submitted but not settled. The calculation also considers anticipated claims based upon historical performance. Some major retailers have chosen to manage the warranty process in exchange for a claims allowance based on sales volume. The portion of the reserve related to retailer claims allowances is netted against accounts receivable while the balance of the reserve is classified as an accrued liability on the balance sheet. Additions to the reserve are treated as a deduction from net sales if they relate to a negotiated claim allowance and as selling, general and administrative costs if they relate to a general warranty expense.

The following is a roll-forward of the Company's claims and allowance activity for 2003:

RETAILER CLAIMS ALLOWANCES	GENERAL WARRANTY	TOTAL
-------------------------------	---------------------	-------

## Edgar Filing: HUFFY CORP - Form 10-Q

	-----	-----	-----
Balance December 31, 2002	\$ 802	\$ 143	\$ 945
Additions to reserves	75	314	389
Settled claims	(514)	(393)	(907)
	-----	-----	-----
Balance September 27, 2003	\$ 363	\$ 64	\$ 427
	=====	=====	=====

The Company remains potentially responsible for product liability claims related to the Gerry Baby Products Company for which the Company sold the assets on April 27, 1997. Until July of 2002 when it expired, the Company maintained a claims made based insurance policy covering product liability expense associated with products manufactured while it owned Gerry Baby Products. When this policy expired, the Company purchased new insurance that provides occurrence based coverage on each claim that exceeds \$5,000 in value.

### ENVIRONMENTAL EXPENDITURES

Environmental expenditures that relate to current operations are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated.

The Company, along with others, has been designated as a potentially responsible party (PRP) by the U.S. Environmental Protection Agency (the "EPA") with respect to claims involving the discharge of hazardous substances into the environment in the Baldwin Park operable unit of the San Gabriel Valley Superfund site. The Company, along with other PRPs, the Main San Gabriel Basin Watermaster (Watermaster), the San Gabriel Water Quality Authority (WQA), and numerous local water districts (Water Districts), have worked with the EPA on a mutually satisfactory remedial plan, with the end result being a joint water supply/clean up Project Agreement which settles four different lawsuits filed by the WQA and the Water Districts. The Project Agreement was signed on March 28, 2002 and was approved by the court and became effective May 9, 2002. In developing its estimate of environmental remediation costs, the Company considers, among other things, currently available technological solutions, alternative cleanup methods, and risk-based assessments of the contamination and, as applicable, an estimation of its proportionate share of remediation costs. The Company may also make use of external consultants and consider, when available, estimates by other PRPs and governmental agencies and information regarding the financial viability of other PRPs. Based upon information currently available, the Company believes it is unlikely that it will incur substantial previously unanticipated costs as a result of failure by other PRPs to satisfy their responsibilities for remediation costs.

The Company has recorded environmental accruals that, based upon the information available, are adequate to satisfy remediation requirements known at this time. The total accrual for estimated environmental remediation costs related to the Superfund site and other potential environmental liabilities was \$4,482 (\$6,032 before discounting) at September 27, 2003. Of that amount, the Company has a deposit of \$3,538 that is held in escrow under the terms of the settlement agreement. Amounts in escrow will be used to fund future costs and will serve as a long-term performance assurance pending the completion of remediation. Management expects that the expenditures relating to costs currently accrued will be made over a period of fourteen years.

The environmental escrow accounts are classified as current prepaid assets on

## Edgar Filing: HUFFY CORP - Form 10-Q

the accompanying condensed consolidated balance sheets if the funds are expected to be expended within the next 12 months and as long-term other assets for those funds, which are expected to be expended beyond 12 months. The current escrow balance at September 27, 2003 was \$879 and the long-term escrow balance at September 27, 2003 was \$2,659. The environmental accrual is similarly classified on the accompanying condensed consolidated balance sheet with \$879 shown in accrued liabilities and \$3,603 shown in other long-term liabilities as of September 27, 2003.

### LITIGATION

The Company along with numerous California water companies and other potentially responsible parties ("PRPs") for the Baldwin Park Operable Unit of the San Gabriel Valley Superfund have been named in fourteen civil lawsuits which allege bodily injury and property damage claims related to the contaminated groundwater in the Azusa, California area (collectively, the "San Gabriel Cases").

The San Gabriel Cases had been stayed for a variety of reasons, including a number of demurrers and writs taken in the Appellate Division, relating primarily to the California Public Utilities Commission ("PUC") investigation described below. The resulting Appellate Division decisions were reviewed by the California Supreme Court, which ruled in February 2003. The cases have been reactivated as a result of the California Supreme Court's decision, with the trial level Coordination Judge holding a number of Status Conferences on all of the cases, at which conferences issues pertaining to the three master complaints (two of which include the Company as a defendant), demurrers to such master complaints, case management orders and initial written discovery and hears to resolve the PUC-related issues remanded by the California Supreme Court were discussed. As noted by the matters being discussed with the Court, the toxic tort cases are in their initial stages. Thus, it is impossible to currently predict the outcome of any of the actions.

The Company, along with the other PRPs for the Baldwin Park Operable Unit of the San Gabriel Valley Superfund Site (the "BPOU"), was also named in four civil lawsuits filed by water purveyors. The water purveyor lawsuits alleged CERCLA, property damage, nuisance, trespass and other claims related to the contaminated groundwater in the BPOU (collectively, the "Water Entity Cases"). The Company was named as a direct defendant by the water purveyor in two of these cases, and was added as a third party defendant in the two others by Aerojet General Corporation, which, in those cases, was the only PRP sued by the water purveyors. Each of the Water Entity Cases have been settled through the entry of the Project Agreement. According to the

terms of the Project Agreement, the Water Entity Cases have been dismissed without prejudice. The Third Party complaints filed by Aerojet in connection with the Water Entity Cases have also been dismissed without prejudice subject to Aerojet filing a new suit in the event a final allocation agreement cannot be worked out.

On March 12, 1998, the PUC commenced an investigation in response to the allegations in the toxic tort actions that "drinking water delivered by the water utilities caused death and personal injury to customers." The PUC's inquiry addressed two broad issues central to these allegations: 1) "whether current water quality regulation adequately protects the public health;" and 2) "whether respondent utilities are (and for the past 25 years have been) complying with existing drinking water regulation." On November 2, 2000, the PUC issued its Final Opinion and Order Resolving Substantive Water Quality Issues. Significantly, the Order finds, in pertinent part, that: 1) "existing maximum contaminant level ("MCLs") and action level ("ALs") established by the DHS are adequate to protect the public health;" 2) "there is a significant margin of safety when MCLs are calculated so that the detection of carcinogenic

## Edgar Filing: HUFFY CORP - Form 10-Q

contaminants above MCLs that were reported in this investigation are unlikely to pose a health risk;" 3) based upon its comprehensive review of 25 years of utility compliance records, that for all periods when MCLs and ALs for specific chemicals were in effect, the PUC regulated water companies complied with DHS testing requirements and advisories, and the water served by the water utilities was not harmful or dangerous to health; and 4) with regard to the period before the adoption by DHS of MCLs and ALs, a further limited investigation by the PUC Water Division will be conducted.

Based upon information presently available, such future costs are not expected to have a material adverse effect on the Company's financial condition, liquidity, or its ongoing results of operations. However, such costs could be material to results of operations in a future period.

As previously reported, Huffey Corporation divested its Washington Inventory Service subsidiary in November 2000. Subsequently, in late 2001 and mid 2002, two class action suits were filed in California seeking damages for alleged violations of labor practices. As a previous owner, Huffey was potentially obligated to indemnify the subsidiary purchaser for some portion of any liability it or such subsidiary had in the first case and had potential liability in the latter case, both limited to the periods it owned the subsidiary. After protracted negotiations and on advice of counsel, a settlement was negotiated and preliminarily approved on January 28, 2003 by the Superior Court of California, County of Los Angeles. A charge to discontinued operations of \$7,914 or \$0.43 per common share was taken in the fourth quarter of 2002 to record the Company's estimated obligation related to this matter. The settlement was given final court approval, pending compliance with the terms of the Class Settlement Agreement, and a Judgment of Dismissal was issued on April 7, 2003. The Claims Administrator will issue its report as to claims made and on the amount of payments to be made in the fourth quarter, 2003, not to exceed \$5,200 for the Company. The Company contributed \$5,121 into a court appointed escrow account for the future payment of claims. In the third quarter of 2003, the Company revised its estimate of claims which resulted in income from discontinued operations for the quarter ended in September 27, 2003, of \$950 before tax, and \$589 after tax.

### NOTE 9. LINES OF CREDIT AND LONG-TERM OBLIGATIONS

In September 2002, the Company entered into an Amended and Restated Loan and Security Agreement with Congress Financial Corporation (Central), which has subsequently been amended. The interest rate under the revolving credit facility varies, based upon excess availability, from the prime rate to prime rate plus .25%, or London Interbank Offering Rate (LIBOR) plus 1.75% to LIBOR plus 2.75%. On March 14, 2003, the Company entered into a \$15,000 subordinated term note with Ableco Finance LLC. The new note is secured by a lien on the Company's trademarks and trade names and a subordinated position on all other assets pledged under the Company's revolving credit facility. The loan matures on the earlier of the maturity of the Company's revolving credit facility or five years. Financial covenants in the loan require the Company to maintain minimum EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization), and a fixed charge coverage ratio. In conjunction with the new term loan, the Company amended its credit facility with its existing lender to incorporate the new borrowing into the agreement. Financial covenants identical to the term loan were added to the revolving credit facility. In addition, changes were made in the revolving credit facility's existing Net Worth covenant, which raised the minimum net worth requirement to \$60,000 and increases the minimum net worth requirement to \$62,500 on January 1, 2004. The revolving credit facility is secured by all assets of the Company and its affiliates and will expire on December 31, 2004, with a 12-month renewal option. As of September 27, 2003, the Company was in compliance with these covenants.

## Edgar Filing: HUFFY CORP - Form 10-Q

From time to time, the Company has requested and received additional short-term borrowing authority under its revolving credit facility with Congress Financial to cover seasonal working capital requirements. In July 2003, the Company amended its revolving credit facility to increase the maximum loan amount to \$105,000 and to increase

the revolving loan limit to \$90,000. As of September 27, 2003, the revolving credit facility had \$10,847 of borrowing capacity. Management believes that the available balance on the amended credit facility and internally generated cash flows will be sufficient to finance the Company's seasonal working capital and capital expenditure needs in the coming year. The Company considers on an ongoing basis alternative capital financing structures, including possible placements of equity securities and other hybrid financing instruments, as well as senior and subordinated debt arrangements.

Assets that are leased subject to capital leases include computer and office equipment with a cost of \$1,674 and accumulated depreciation of \$(491) at September 27, 2003.

### NOTE 10. SEGMENT DATA

Huffy classifies its business into two segments, sporting goods and services to retailers. The sporting goods segment includes Huffy companies which market wheeled recreational products, basketballs and other balls, golf clubs and accessories, snowboards and accessories, hockey equipment and apparel, snow skis and accessories, in-line skates, skateboards, other action sports accessories and the excess/opportunity inventory products. The sporting goods segment also includes Huffy companies which manufacture and market basketball backboards. The services to retailers segment includes Huffy companies which: assemble and repair bicycles, assemble grills, physical fitness equipment, and furniture; assemble and repair outdoor power equipment; and provide merchandising services to major retailers and for a number of well-known manufacturers and/or distributors serving the Home Center channel.

Segment performance is measured on operating profit or loss (before interest, corporate expenses and income taxes). The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies in Note 1 of Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2002. Intercompany profit or loss is eliminated where applicable.

The information presented below is for the periods ended September 27, 2003 and September 30, 2002.

	Three Months Ended		
	September 27, 2003	September 30, 2002	Septemb 200
NET SALES TO UNAFFILIATED CUSTOMERS			
Sporting Goods	\$ 82,931	\$ 60,686	\$ 250
Services to Retailers	23,812	22,342	68
	-----	-----	-----
Total net sales	\$ 106,743	\$ 83,028	\$ 318
	=====	=====	=====

Edgar Filing: HUFFY CORP - Form 10-Q

EARNINGS BEFORE TAXES			
Sporting Goods	\$ 1,721	\$ 4,267	\$ 9
Services to Retailers	2,414	(223)	4
	-----	-----	-----
Total segment earnings before taxes	4,135	4,044	14
Corporate expenses, net	232	(1,334)	(6)
Net interest expense	(1,455)	(287)	(3)
	-----	-----	-----
Earnings before income taxes	\$ 2,912	\$ 2,423	\$ 3
	=====	=====	=====

ASSETS		
Sporting Goods		\$ 250
Services to Retailers		65
		-----
TOTAL ASSETS		\$ 315
		=====

NOTE 11. DISCONTINUED OPERATIONS

As previously reported, Huffy Corporation divested its Washington Inventory Service subsidiary in November 2000. Subsequently, in late 2001 and mid 2002, two class action suits were filed in California seeking damages for alleged violations of labor practices. As a previous owner, Huffy was potentially obligated to indemnify the subsidiary purchaser for some portion of any liability it or such subsidiary had in the first case and had potential liability in the latter case, both limited to the periods it owned the subsidiary. After protracted negotiations and on advice of counsel, a settlement was negotiated and preliminarily approved on January 28, 2003 by the Superior Court of California, County of Los Angeles. A charge to discontinued operations of \$7,914 or \$0.43 per common share was taken in the fourth quarter of 2002 to record the Company's estimated obligation related to this matter. The settlement was given final court approval, pending compliance with the terms of the Class Settlement Agreement, and a Judgment of Dismissal was issued on April 7, 2003. The Claims Administrator will issue its report as to claims made and on the amount of payments to be made in the fourth quarter 2003, not to exceed \$5,200 for the Company. The Company contributed \$5,121 into a court appointed escrow account for the future payment of claims. In the third quarter of 2003, the Company revised its estimate of claims which resulted in income from discontinued operations for the quarter ended September 27, 2003 of \$950 before tax, and \$589 after tax.

NOTE 12. RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2003, the Company adopted SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). SFAS 143 addresses the financial accounting and reporting for legal obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The adoption of SFAS 143 did not materially affect the Company's Financial Statements for the three months or nine months ended September 27, 2003. The



## Edgar Filing: HUFFY CORP - Form 10-Q

cumulative effect of implementing SFAS 143 has had an immaterial effect on the Company's financial statements taken as a whole.

The Company has adopted SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"). SFAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs associated with exit or disposal activities, and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." Costs addressed by SFAS 146 include costs to terminate a contract that is not a capital lease, costs of involuntary employee termination benefits pursuant to a one-time benefit arrangement, costs to consolidate facilities, and costs to relocate employees. SFAS 146 is effective for exit or disposal activities that were initiated after December 31, 2002. SFAS 146 changes the timing of expense recognition for certain costs the Company incurs while closing facilities or undertaking other exit or disposal activities; however, the timing difference is not typically significant in length. Adoption of SFAS 146 did not have a material impact on the Company's Financial Statements for the three months or nine months ended September 27, 2003.

The Company has adopted SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS 148"). SFAS 148 provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation as required by SFAS 123. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The Company's disclosure regarding the effects of stock-based compensation included in Note 7 is in compliance with SFAS 148.

The Company has adopted Financial Accounting Standards Board ("FASB") Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34" ("FIN 45"). FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. FIN 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions were applicable to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not have a material impact on the Company's Financial Statements for the three months or nine months ended September 27, 2003.

The Company has adopted SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity". The Statement requires issuers to classify as liabilities (or assets in some circumstance) three classes of freestanding financial instruments that embody obligations for the issuer. Generally, the Statement is effective for financial instruments entered into or modified after May 31, 2003 and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. Adoption did not

have an effect on the financial statements for the nine months ended September 27, 2003.

The Company adopted SFAS No. 149, "Amendment of Statement 133 on derivative Instruments and Hedging Activities", which amends and clarifies accounting for derivative instruments and hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS No. 149 provides guidance relating to decisions made (a) as part of the Derivatives Implementation Group process, (b) in connection with other FASB projects dealing

## Edgar Filing: HUFFY CORP - Form 10-Q

with financial instruments and (c) regarding implementation issues raised in the application of the definition of a derivative and the characteristics of a derivative that contains financing components. SFAS No. 149 is effective for contracts entered into or modified and for hedging relationships designated after June 28, 2003. The application of this Statement did not have a material impact on the company's consolidated financial statements.

### NOTE 13. NEW ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51" ("FIN 46"). FIN 46 addresses the consolidation of entities whose equity holders have either (a) not provided sufficient equity at risk to allow the entity to finance its own activities or (b) do not possess certain characteristics of a controlling financial interest. FIN 46 requires the consolidation of these entities, known as variable interest entities ("VIEs"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that is subject to a majority of the risk of loss from the VIE's activities, entitled to receive a majority of the VIE's residual returns, or both. FIN 46 applies immediately to variable interest in VIEs created or obtained after January 31, 2003. For variable interests in a VIE created before February 1, 2003, FIN 46 is applied to the VIE no later than the end of the first interim or annual reporting period ending after December 15, 2003 (the quarter ending December 31, 2003 for the Company). The Interpretation requires certain disclosures in financial statements issued after January 31, 2003, if it is reasonably possible that the Company will consolidate or disclose information about variable interest entities when the Interpretation becomes effective. The adoption of FIN 46 is not expected to have a material impact on it's financial position, results of operations or liquidity.

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

THREE AND NINE MONTHS ENDED SEPTEMBER 27, 2003  
 COMPARED TO THE  
 THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2002

-----  
 (Dollar Amounts in Thousands, Except Share Data)

	September 27, 2003	September 30, 2002	Change
	-----	-----	-----
Net sales	\$ 106,743	\$ 83,028	\$ 23,715
Gross profit	20,223	15,955	4,268
Percentage of revenues	18.9%	19.2%	
SG&A expenses	16,486	12,826	3,660
Percentage of revenues	15.4%	15.4%	

## Edgar Filing: HUFFY CORP - Form 10-Q

	NINE MONTHS ENDED		
	September 27, 2003	September 30, 2002	Change
Net sales	\$ 318,851	\$ 246,826	\$ 72,025
Gross profit	65,461	44,987	20,474
Percentage of revenues	20.5%	18.2%	
SG&A expenses	58,416	37,201	21,215
Percentage of revenues	18.3%	15.1%	

For the third quarter of 2003, Huffy Corporation ("Huffy" or "Company") had net earnings from continuing operations of \$2,329, or \$0.15 per common share compared to net earnings for the same period in 2002 of \$1,669, or \$0.14 per common share. For the nine months ended September 27, 2003 net earnings from continuing operations were \$2,790, or \$0.19 per common share, compared to \$3,568, or \$0.33 per common share, in the first nine months of 2002. Current year results include the earnings from Gen-X Sports Inc. acquired on September 19, 2002. The results and earnings of the McCalla companies for the period subsequent to the acquisition date of March 27, 2002, are also included in the three and nine months results.

### Net Sales

Net sales in the third quarter of 2003 were \$106,743, an increase of 28.6%, compared to net sales of \$83,028 for the same period in 2002. Revenue from services to retailers rose 6.6% from \$22,342 in the third quarter of 2002 to \$23,812 in the same period of 2003. Product sales rose 36.7% from \$60,686 in the third quarter of 2002 to \$82,931 in the same period of 2003. This sales gain was the result of the addition of Gen-X Sports to the Huffy portfolio. The core Huffy business, the businesses owned by Huffy prior to the Gen-X acquisition, suffered a decline in sales to Kmart of \$5,074, reflecting not only the bankruptcy related decrease in Kmart store count, but also a decline in sales caused by a poor economy and associated low consumer confidence, as well as this summer's unusual weather. Fortunately, much of this sales volume loss to Kmart was offset by market share gains with other customers in the sporting goods segment, and greater penetration in the home improvement market by the service segment. At this time, management does not believe that Kmart will have any further unfavorable impact on future sales volume or margin in the short term.

For the nine months ended September 27, 2003, consolidated net sales were \$318,851, an increase of 29.2% from \$246,826 in the same period last year. Revenue from services to retailers rose 10.2% from \$62,116 in the first nine months of 2002 to \$68,452 in the same period of 2003. The addition of the McCalla Companies accounted for the majority of the increase in services to retailers sales. Product sales rose 35.6% from \$184,710 in the first nine months of 2002 to \$250,399 in the same period of 2003. The core Huffy business, the businesses owned by Huffy prior to the Gen-X acquisition, suffered a decline in sales to Kmart of \$16,882, reflecting not only the bankruptcy related decrease in Kmart store count, but also a decline in sales caused by a poor economy and the associated low consumer confidence. Fortunately, much of this sales volume loss to Kmart was offset by market share gains with other customers in the sporting goods segment, and greater penetration in the home improvement market by the service segment.

### Gross Profit

Consolidated gross profit for the third quarter 2003 was \$20,223, or 18.9% of net sales as compared to \$15,955, or 19.2% of net sales reported for the same

## Edgar Filing: HUFFY CORP - Form 10-Q

period in 2002, reflecting a 26.8% improvement over the prior year gross margin when measured on a dollar basis. The primary reason for this very significant improvement was the addition of Gen-X Sports Inc. and the McCalla Company to the Huffy portfolio. In addition, 2003 margins were favorably impacted by an improved margin structure in the service segment, where year over year margins improved by 12.0 percentage points reflecting improved pricing and a more efficient field cost structure.

For the first nine months of 2003, gross profit was \$65,461, or 20.5% of net sales, compared to \$44,987, or 18.2% of net sales, in the same period in the prior year. Margins in the sporting goods segment improved primarily as a result of adding Gen-X to the Huffy portfolio. In the services to retailer segment, margins improved by 7.8 percentage points reflecting modest pricing improvements, coupled with improved year over year field efficiency, particularly in the first quarter.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses of \$16,486, for the three months ended September 27, 2003 were higher than the \$12,826 experienced during the same period in 2002. The primary reason for the increase in these expenses was the selling, general and administrative expenses added as a result of the acquisition of Gen-X Sports Inc. Administrative pension expense increased in 2003 by \$1,961 over 2002 expense due to poor 2002 stock market performance and declining interest rates. Insurance costs increased in 2003 by \$1,314 over the third quarter of 2002 due to the addition of Gen-X and a less favorable insurance market. Offsetting these increased expenses, during the third quarter of 2003, the Company recorded income of \$2,669 resulting from the recovery of expenses from prior periods.

Selling, general and administrative expenses for the first nine months of 2003 were \$58,416 versus \$37,201 in the first nine months of 2002. Increased pension expenses and the added selling, general and administrative expenses associated with the Gen-X and McCalla acquisitions were the primary reasons for the increase. Administrative pension expense increased in 2003 by \$2,895 over 2002 expense due to poor 2002 stock market performance and declining interest rates. Insurance costs increased in 2003 by \$1,621 over 2002 due to the addition of Gen-X and McCalla and a less favorable insurance market.

### Net Interest Expense

Net interest expense increased from \$287 for the third quarter of 2002 to \$1,455 in the current year. For the nine months ended September 27, 2003, net interest expense increased from \$908 in the first half of 2002 to \$3,847 in 2003. Borrowing costs to finance the acquisitions of Gen-X Sports Inc. and the McCalla Company as well as the increased working capital needs of these subsidiaries resulted in higher interest costs in 2003.

### Other (Income) Expense

At the end of the second quarter, the Company reported the loss of a contract from merchandising services in the home improvement segment. During the three months ended September 27, 2003, the Company recorded income of \$866 related to a termination payment under the terms of the contract.

### Discontinued Operations

As previously reported, Huffy Corporation divested its Washington Inventory Service subsidiary in November 2000. Subsequently, in late 2001 and mid 2002, two class action suits were filed in California seeking damages for alleged violations of labor practices. As a previous owner, Huffy was potentially obligated to indemnify the subsidiary purchaser for some portion of any

## Edgar Filing: HUFFY CORP - Form 10-Q

liability it or such subsidiary had in the first case and had potential liability in the latter case, both limited to the periods it owned the subsidiary. After protracted negotiations and on advice of counsel, a settlement was negotiated and preliminarily approved on January 28, 2003 by the Superior Court of California, County of Los Angeles. A charge to discontinued operations of \$7,914 or \$0.43 per common share was taken in the fourth quarter of 2002 to record the Company's estimated obligation related to this matter. The settlement was given final court approval, pending compliance with the terms of the Class Settlement Agreement, and a Judgment of Dismissal was issued on April 7, 2003. The Claims Administrator will issue its report as to claims made and on the amount of payments to be made in the fourth quarter, 2003, which is expected to approximate \$5,200 for the Company. The Company contributed \$5,121 into a court appointed escrow account for the future payment of claims. In the third quarter of 2003, the Company revised its estimate of claims which resulted in income from discontinued operations for the quarter ended September 27, 2003 of \$950 before tax, and \$589 after tax.

### ACQUISITIONS

On September 19, 2002, the Company acquired all of the stock of Gen-X Sports Inc. in exchange for \$19,001 in cash and the issuance of 4,161,241 shares of Huffy Corporation's common shares to the stockholders of both Gen-X companies. Per the terms of the agreement, 193,466 additional common shares were issued to the Gen-X shareholders on or about the first annual anniversary date. Gen-X did not meet certain financial performance objectives in 2002 that would have resulted in the issuance of up to 645,161 additional common shares. In addition, the acquired companies immediately upon acquisition redeemed \$4,970 of preferred stock and refinanced their existing bank debt. Included in the assets acquired are trademarks, patents and licensing agreements recorded at their fair values of \$45,814, \$1,301 and \$940, respectively, as well as goodwill in the amount of \$14,643. Gen-X is a designer, marketer and distributor of branded sports equipment, including action sports products, winter sports products and golf products, and is a purchaser and reseller of excess sporting goods and athletic footwear inventories and special opportunity purchases.

On March 27, 2002, Huffy Service First acquired the stock of McCalla Company and its subsidiaries, Creative Retail Services, Inc. and Creative Retail Services (Canada) Inc. ("McCalla") for \$5,400, less \$500 net cash acquired, subject to certain post-closing adjustments. A contingent purchase price payment was recorded for the McCalla acquisition of \$1,645 in the fourth quarter of 2002 and paid in April 2003. Of the total purchase price, \$6,519 was recorded as goodwill and \$300 was recorded as a covenant-not-to-compete. McCalla provides merchandising, including cycle and periodic product resets, stocking and sales training for a number of well-known manufacturers serving Home Depot, including, among others, Duracell, and Spectrum Brands.

### LIQUIDITY AND CAPITAL RESOURCES

On March 14, 2003, the Company entered into a \$15,000 subordinated term note with Ableco Finance LLC. The new note is secured by a lien on the Company's trademarks and trade names and a subordinated position on all other assets pledged under the Company's revolving credit facility. The loan matures on the earlier of the maturity of the Company's revolving credit facility or five years. Financial covenants in the loan require the Company to maintain a minimum EBITDA, (Earnings Before Interest, Taxes, Depreciation and Amortization) and a fixed charge coverage ratio.

In conjunction with the new term loan, the Company amended its credit facility with its existing lender to incorporate the new borrowing into the agreement. Financial covenants identical to the term loan were added to the revolving credit facility. In addition, changes were made in the revolving credit

## Edgar Filing: HUFFY CORP - Form 10-Q

facility's existing Net Worth covenant, which raised the minimum net worth requirement to \$60,000 and increases the minimum net worth requirement to \$62,500 on January 1, 2004. The revolving credit facility is secured by all assets of the Company and its affiliates and will expire on December 31, 2004, with a 12 month renewal option. As of September 27, 2003, the Company was in compliance with these covenants.

From time to time, the Company has requested and received additional short-term borrowing authority under its revolving credit facility with Congress Financial to cover seasonal working capital needs. In July 2003, the Company amended its revolving credit facility to increase the maximum loan amount to \$105,000 and to increase the revolving loan limit to \$90,000. As of September 27, 2003, the Company had \$10,847 of borrowing capacity on its revolving credit facility.

At September 27, 2003, inventory was valued at \$59,657 up from \$41,847 at December 31, 2002. This increase is primarily the result of remaining seasonal inventory build up for winter sporting goods products. Accounts payable at September 27, 2003 are \$66,823 as compared to \$65,519 at the end of 2002. This increase reflects the timing and mix of purchases, as well as the purchase terms in place. Accrued expenses and other current liabilities are \$30,031 at September 27, 2003 versus \$37,059 at December 31, 2002. This decrease is due primarily to the Company's payment into escrow of the anticipated claims related to the Washington Inventory Services litigation, as well as a reduction in the estimated liability associated with this litigation.

As of September 27, 2003, the Company has the following contractual obligations and outstanding borrowings that are expected to impact future liquidity and cash flows:

Contractual Obligations	Total	Less than 1 year	1-3 years
Long-term debt	\$ 15,000	\$ -	\$ 15,000
Capital leases	1,085	500	585
Operating leases	12,310	3,708	5,367
Purchase obligations	3,865	1,037	896
Total contractual obligations	\$ 32,260	\$ 5,245	\$ 21,848
	=====	=====	=====

The Company's revolving credit facility is classified as a current liability in the accompanying condensed consolidated balance sheets.

The Company expects cash and cash equivalents, cash flow from operations and its revolving credit facility to be sufficient to finance seasonal working capital needs and capital expenditures throughout the coming year. The Company considers on an ongoing basis alternative capital financing structures, including possible placements of equity securities and other hybrid financing instruments, as well as senior and subordinated debt arrangements.

IMPACT OF ACCOUNTING STANDARDS NOT YET ADOPTED

## Edgar Filing: HUFFY CORP - Form 10-Q

See Note 13 to the accompanying notes to Condensed Consolidated Financial Statements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to short-term interest rate risks and foreign currency exchange rate risks. In the normal course of business these risks are managed through a variety of strategies, including the use of a derivative financial instrument to hedge our underlying exposures. The Company does not use derivative instruments for trading purposes.

#### Interest Rate Risks

Interest rate risk arises primarily from variable rate borrowings in the United States and Canada. The Company has entered into an interest rate swap, which is recognized on the balance sheet at fair value. The Company has determined that the swap is effective; therefore, changes in the fair value of the swap are recorded on a quarterly basis as an adjustment to accumulated other comprehensive loss. The swap expires on April 4, 2004.

At September 27, 2003, a hypothetical 100 basis point increase in short-term interest rates would result in a reduction of \$214 in earnings before income taxes.

#### Foreign Currency Exchange Risk

All subsidiaries of the Company, except for Creative Retail Services (Canada) Inc., use the U.S. dollar as their functional currency. A small portion of the Company's sales, receivables, purchases and expenses are denominated in Euros, Australian dollars and the Canadian dollar. The Company also maintains bank accounts in Euros, Australian dollars and the Canadian dollar to facilitate international operations. At this time, the Company's exposure to currency exchange risk is not considered material.

### ITEM 4. CONTROLS AND PROCEDURES

Quarterly evaluation of the Company's disclosure controls and internal controls

As of September 27, 2003, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), an evaluation of the effectiveness of the Company's disclosure controls and procedures was performed.

#### Disclosure controls and internal controls

Disclosure controls are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 (Exchange Act), such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's (SEC) rules and forms. Disclosure controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding the required disclosure. Internal controls are procedures which are designed with the objective of providing reasonable assurance that (1) our transactions are properly authorized; (2) our assets are safeguarded against unauthorized or improper use; and (3) our transactions are properly recorded and reported, all to permit the preparation of our financial statements in conformity with generally accepted accounting principles.

## Edgar Filing: HUFFY CORP - Form 10-Q

### Limitations on the effectiveness of controls

The Company's management, including the CEO and CFO, does not expect that our disclosure controls or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some person, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

### Scope of the controls evaluation

The CEO/CFO evaluation of our disclosure controls and our internal controls included a review of the controls' objectives and design, the controls' implementation by the Company and the effect of the controls on the information generated for use in this Quarterly Report on Form 10-Q. In the course of the controls evaluation, we sought to identify data errors, controls problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, were being undertaken. This type of evaluation will be done on a quarterly basis so that the conclusions concerning controls effectiveness can be reported in our Quarterly Reports on Form 10-Q and Annual Report on Form 10-K. Our internal controls are also evaluated on an ongoing basis by Internal Audit, by other personnel in our Finance organization and by our independent auditors in connection with their audit and review activities. The overall goals of these various evaluation activities are to monitor our disclosure controls and our internal controls and to make modifications as necessary; our intent in this regard is that the disclosure controls and internal controls will be maintained as dynamic systems that change (including with improvements and corrections) as conditions warrant.

Among other matters, we sought in our evaluation to determine whether there were any "significant deficiencies" or "material weaknesses" in the Company's internal controls, or whether the Company had identified any acts of fraud involving personnel who have a significant role in the Company's internal controls. This information was important both for the controls evaluation generally and because items 5 and 6 in Section 302 Certifications of the CEO and CFO require that the CEO and CFO disclose that information to our Board's Audit Committee and to our independent auditors and to report on related matters in this section of the Quarterly Report on Form 10-Q. In the professional auditing literature, "significant deficiencies" are referred to as "reportable conditions"; these are control issues that could have a significant adverse effect on the ability to record, process, summarize and report

financial data in the financial statements. A "material weakness" is defined in the auditing literature as a particularly serious reportable condition where the internal control does not reduce to a relatively low level the risk that



## Edgar Filing: HUFFY CORP - Form 10-Q

misstatements caused by error or fraud may occur in amounts that would be material in relation to the financial statements and not be detected within a timely period by employees in the normal course of performing their assigned functions. We also sought to deal with other control matters in the controls evaluation, and in each case if a problem was identified, we considered what revision, improvement and/or correction to make in accord with our on-going procedures.

In accordance with SEC requirements, the CEO and CFO note that, since the date of the controls evaluation to the date of this Quarterly Report, there have been no significant changes in internal controls or in other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses during the quarter ended September 27, 2003.

### Conclusions

Based upon the controls evaluation, our CEO and CFO have concluded that, subject to the limitations noted above, our disclosure controls are effective to ensure that material information relating to Hufffy and its consolidated subsidiaries is made known to management, including the CEO and CFO, particularly during the period when our periodic reports are being prepared, and that our internal controls are effective to provide reasonable assurance that our financial statements are fairly presented in conformity with generally accepted accounting principles.

The discussion in this quarterly report contains forward-looking statements and is qualified by the cautionary statements in the Company's report on Form 10-K, dated February 20, 2003.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

- A. The Company along with numerous California water companies and other potentially responsible parties ("PRPs") for the Baldwin Park Operable Unit of the San Gabriel Valley Superfund (see Note 15 to the Company's December 31, 2002 Annual Report on Form 10-K regarding the Superfund in which a tentative remediation settlement has been reached) have been named in fourteen civil lawsuits which allege bodily injury and property damage claims related to the contaminated groundwater in the Azusa, California area (collectively, the "San Gabriel Cases").

The cases had been stayed for a variety of reasons, including a number of demurrers and writs taken in the Appellate Division, relating primarily to the California Public Utilities Commission ("PUC") investigation described below. The resulting Appellate Division decisions were reviewed by the California Supreme Court, which ruled in February 2003. The cases have been reactivated as a result of the California Supreme Court's decision, with the trial level Coordination Judge holding a number of Status Conferences on all of the cases, at which conferences issues pertaining to the three master complaints (two of which will include the Company as a defendant), demurrers to such master complaints, case management orders, initial written discovery and a hearing to resolve the PUC-related issue remanded by the California Supreme Court were discussed. As noted by the matters being

## Edgar Filing: HUFFY CORP - Form 10-Q

discussed with the Court, the toxic tort cases are in their initial stages. Thus, it is impossible to currently predict the outcome of any of the actions.

The Company, along with the other PRPs for the Baldwin Park Operable Unit of the San Gabriel Valley Superfund Site (the "BPOU"), has also been named in four civil lawsuits filed by water purveyors. The water purveyor lawsuits allege CERCLA, property damage, nuisance, trespass and other claims related to the contaminated groundwater in the BPOU (collectively, the "Water Entity Cases"). The Company was named as a direct defendant by the water purveyor in two of these cases, and was added as a third party defendant in the two others by Aerojet General Corporation, which, in those cases, was the only PRP sued by the water purveyors. Each of the Water Entity Cases have been settled through the entry of the Project Agreement. According to the terms of the Project Agreement, the Water Entity Cases have been dismissed without prejudice.

On March 12, 1998, the PUC commenced an investigation in response to the allegations in the toxic tort actions that "drinking water delivered by the water utilities caused death and personal injury to customers." The PUC's inquiry addressed two broad issues central to these allegations: 1) "whether current water quality regulation adequately protects the public health;" and 2) "whether respondent utilities are (and for the past 25 years have been) complying with existing drinking water regulation." On November 2, 2000, the PUC issued its Final Opinion and Order Resolving Substantive Water Quality Issues. Significantly, the Order finds, in pertinent part, that: 1) "existing maximum contaminant level ("MCLs") and action level ("ALs") established by the DHS are adequate to protect the public health;" 2) "there is a significant margin of safety when MCLs are calculated so that the detection of carcinogenic contaminants above MCLs that were reported in this investigation are unlikely to pose a health risk;" 3) based upon its comprehensive review of 25 years of utility compliance records, that for all periods when MCLs and ALs for specific chemicals were in effect, the PUC regulated water companies complied with DHS testing requirements and advisories, and the water served by the water utilities was not harmful or dangerous to health; and 4) with regard to the period before the adoption by DHS of MCLs and ALs, a further limited investigation by the PUC Water Division will be conducted.

Based upon information presently available, such future costs are not expected to have a material adverse effect on the Company's financial condition, liquidity, or its ongoing results of operations. However, such costs could be material to results of operations in a future period.

- B. As previously reported, Huffly Corporation divested its Washington Inventory Service subsidiary in November 2000. Subsequently, in late 2001 and mid 2002, two class action suits were filed in California seeking damages for alleged violations of labor practices. As a previous owner, Huffly was potentially obligated to indemnify the subsidiary purchaser for some portion of any liability it or such subsidiary had in the first case and had potential liability in the latter case, both limited to the periods it owned the subsidiary. After protracted negotiations and on advice of counsel, a settlement was negotiated and preliminarily approved on January 28, 2003 by the Superior Court of California, County of Los Angeles. A charge to discontinued operations of \$7,914 or \$0.43 per common share was taken in the fourth quarter of 2002 to record the Company's estimated obligation related to this matter. The settlement was given

Edgar Filing: HUFFY CORP - Form 10-Q

final court approval, pending compliance with the terms of the Class Settlement Agreement, and a Judgment of Dismissal was issued on April 7, 2003. The Claims Administrator is expected to issue its report as to claims made and on the amount of payments to be made in the fourth quarter, 2003, not to exceed \$5,200 for the Company. The Company contributed \$5,121 into a court appointed escrow account for the future payment of claims. In the third quarter of 2003, the Company revised its estimate of claims which resulted in income from discontinued operations for the quarter ended in September 27, 2003, of \$950 before tax, and \$589 after tax.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- a. Exhibits - The exhibits, as shown in the "Index of Exhibits" attached hereto are applicable to be filed as a part of this report.
- b. The Company filed a report on form 8-K dated October 15, 2003 with the Securities and Exchange Commission regarding an earnings release announcing the financial results for the fiscal period ended September 27, 2003.

Please see the Company's meaningful cautionary statements regarding forward looking statements contained in the Company's report on Form 10-K filed with the Securities and Exchange Commission on February 20, 2003 which is hereby incorporated herein by reference.

SIGNATURES

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

HUFFY CORPORATION, Registrant

November 12, 2003	/s/ Timothy G. Howard
-----	-----
Date	Timothy G. Howard Vice President - Corporate Controller (Principal Accounting Officer)

INDEX OF EXHIBITS

Exhibit No.	Item
-----	-----
(2)	Not applicable

Edgar Filing: HUFFY CORP - Form 10-Q

- (3) Not applicable
- (4) Specimen Stock Certificate of Huffy Corporation
- (11) Not applicable
- (15) Not applicable
- (18) Not applicable
- (19) Not applicable
- (22) Not applicable
- (23) Not applicable
- (24) Not applicable
- (31) Section 302 Certification
- (32) Section 906 Certification