PHOENIX FOOTWEAR GROUP INC
Form 10-Q
August 12, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended June 28, 2008

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: 001-31309

Phoenix Footwear Group, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware *(State or Other Jurisdiction of* *Incorporation or Organization)*	**15-0327010** *(I.R.S. Employer* *Identification No.)*
5840 El Camino Real, Suite 106 **Carlsbad, California** *(Address of Principal Executive Offices)*	**92008** *(Zip Code)*

(760) 602-9688

(Registrant s Telephone Number, Including Area Code)

None

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

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

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

Class	Outstanding at July 22, 2008
Common Stock, $.01 par value per share	8,382,762 shares

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PHOENIX FOOTWEAR GROUP, INC.

QUARTERLY REPORT ON FORM 10-Q

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Part I Financial Information

Item 1. ***Condensed Consolidated Financial Statements and Notes to Financial Statements***

PHOENIX FOOTWEAR GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

JUNE 28, 2008 AND DECEMBER 29, 2007

(In thousands, except for share data)

	(Unaudited) June 28, 2008	December 29, 2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,085	$ 2,355
Restricted cash	3,000	
Accounts receivable (less allowances of $1,239 and $1,999 in 2008 and 2007, respectively)	13,888	14,323
Inventories (less provision of $1,623 and $2,321 in 2008 and 2007, respectively)	17,679	19,874
Notes receivable		13,303
Other current assets	1,619	1,661
Income tax receivable	542	2,657
Total current assets	37,813	54,173
PROPERTY, PLANT AND EQUIPMENT, net	2,258	1,996
OTHER ASSETS:		
Goodwill	5,850	5,850
Unamortizable intangibles	340	340
Intangible assets, net	4,963	5,268
Other assets, net	113	50
Total other assets	11,266	11,508
TOTAL ASSETS	$ 51,337	$ 67,677
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Notes payable, current	$ 11,071	$ 22,666
Accounts payable	6,372	7,032
Accrued expenses	3,090	3,833
Other current liabilities	1,090	1,467
Income taxes payable	10	444
Total current liabilities	21,633	35,442
OTHER LIABILITIES:		
Other long-term liabilities	835	1,127
Deferred income tax liability	21	21
Total other liabilities	856	1,148

Total liabilities	22,489	36,590
Commitments and contingencies (Note 8)		
STOCKHOLDERS EQUITY:		
Common stock, $0.01 par value 50,000,000 shares authorized; 8,383,000 and 8,383,000 shares issued and outstanding in 2008 and 2007, respectively	84	84
Additional paid-in-capital	46,072	46,161
Accumulated deficit	(14,819)	(12,380)
Accumulated other comprehensive earnings	154	168
	31,491	34,033
Less: Treasury stock at cost, 217,000 and 338,000 shares in 2008 and 2007, respectively	(2,643)	(2,946)
Total stockholders equity	28,848	31,087
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 51,337	$ 67,677

The accompanying notes are an integral part of these condensed consolidated financial statements.

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PHOENIX FOOTWEAR GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE EARNINGS (LOSS)

(Unaudited)

(In thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Net sales	$ 17,924	$ 19,815	$ 39,922	$ 41,143
Cost of goods sold	11,811	13,146	25,918	26,140
Gross profit	6,113	6,669	14,004	15,003
Operating expenses:				
Selling, general and administrative expense	8,223	8,081	16,763	17,185
Other (income) expense, net	(750)		(1,500)	2
Total operating expenses	7,473	8,081	15,263	17,187
Operating loss	(1,360)	(1,412)	(1,259)	(2,184)
Interest expense, net	859	319	1,223	666
Loss before income taxes and discontinued operations	(2,219)	(1,731)	(2,482)	(2,850)
Income tax provision (benefit)	21	(685)	38	(824)
Loss before discontinued operations	(2,240)	(1,046)	(2,520)	(2,026)
Earnings from discontinued operations, net of tax (Note 3)	81	117	81	1,511
Net loss	$ (2,159)	$ (929)	$ (2,439)	$ (515)
NET LOSS PER SHARE (Note 7)				
Basic:				
Continuing Operations	$ (.27)	$ (.13)	$ (.31)	$ (.25)
Discontinued Operations	.01	.01	.01	.19
Net loss	$ (.26)	$ (.12)	$ (.30)	$ (.06)
Diluted:				
Continuing Operations	$ (.27)	$ (.13)	$ (.31)	$ (.25)
Discontinued Operations	.01	.01	.01	.19
Net loss	$ (.26)	$ (.12)	$ (.30)	$ (.06)
Weighted average shares outstanding used to calculate per share information:				
Basic	8,166,191	8,044,871	8,120,863	8,016,207
Diluted	8,166,191	8,044,871	8,120,863	8,016,207
Net loss	$ (2,159)	$ (929)	$ (2,439)	$ (515)
Other comprehensive earnings (loss), net of tax:				

Foreign currency translation adjustments, net of income taxes of $0 and $0 and $0 and $0 for the three and six months ended June 28, 2008 and June 30, 2007, respectively	30	138	(14)	153
Comprehensive loss	$ (2,129)	$ (791)	$ (2,453)	$ (362)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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PHOENIX FOOTWEAR GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended June 28, 2008	Six Months Ended June 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Loss	$ (2,439)	$ (515)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Earnings from discontinued operations	(81)	(1,511)
Depreciation and amortization	574	747
Net provision for losses on accounts receivable	(760)	(95)
Deferred income taxes		(652)
Allocation of shares in defined contribution plan	86	267
Share-based compensation	8	62
Debt issuance cost amortization	767	284
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	1,195	749
Inventories, net	2,195	(1,313)
Other current assets	(626)	(373)
Other non-current assets	(4)	
Income taxes receivable	2,115	(363)
Increase (decrease) in:		
Accounts payable	(660)	(1,520)
Accrued expenses	(708)	1,726
Other long-term liabilities	(865)	(272)
Income taxes payable	(434)	122
Net cash provided by (used in) operating activities from continuing operations	363	(2,657)
Net cash provided by operating activities from discontinued operations	81	5,983
Net cash provided by operating activities	444	3,326
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of equipment	(530)	(211)
Change in restricted cash	(3,000)	
Proceeds from sale of discontinued operations	13,500	
Net cash provided by (used in) investing activities from continuing operations	9,970	(211)
Net cash used in investing activities from discontinued operations		(104)
Net cash provided by (used in) investing activities	9,970	(315)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes payable and line of credit	18,120	6,350
Repayments of notes payable and line of credit	(29,715)	(9,150)
Debt issuance costs	(89)	
Net cash used in financing activities	(11,684)	(2,800)

NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		(1,270)		211
CASH AND CASH EQUIVALENTS Beginning of period		2,355		752
CASH AND CASH EQUIVALENTS End of period	$	1,085	$	963
SUPPLEMENTAL CASH FLOW INFORMATION				
Cash paid during the period for:				
Interest	$	611	$	1,963
Income taxes	$	502	$	102

The accompanying notes are an integral part of these condensed consolidated financial statements.

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PHOENIX FOOTWEAR GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Phoenix Footwear Group, Inc. (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America 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 notes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments which are of a normal recurring nature that are necessary for the fair presentation have been included in the accompanying financial statements. These financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission for the fiscal year ended December 29, 2007. Amounts related to disclosures of December 29, 2007 balances within these interim statements were derived from the aforementioned 10-K. The results of operations for the three and six months ended June 28, 2008, or for any other interim period, are not necessarily indicative of the results that may be expected for the full year.

Going Concern

The consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As of December 29, 2007, the Company was not in compliance with the financial covenants under its credit agreement. The Company did not request a waiver for the respective default as it was in the process of replacing the existing facility with a new lender. In June 2008, the Company entered into a Credit and Security Agreement with Wells Fargo Bank, N.A. (Wells Fargo) for a three year revolving line of credit and letters of credit collateralized by all of the Company s assets and those of its subsidiaries. Under the facility, the Company can borrow up to $17.0 million (subject to a borrowing base which includes eligible receivables and eligible inventory), which, subject to the satisfaction of certain conditions, may be increased to $20.0 million. The credit facility also includes a $7.5 million letter of credit sub facility. The Company believes the financial covenants in its new facility better reflect the Company s balance sheet improvements over the past fiscal year and current financial condition. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

Principles of Consolidation

The consolidated financial statements consist of Phoenix Footwear Group, Inc. and its wholly-owned subsidiaries, Penobscot Shoe Company (Penobscot), H.S. Trask & Co. (H.S. Trask), Chambers Belt Company (Chambers), PXG Canada, Inc. and Phoenix Delaware Acquisition Company d/b/a Tommy Bahama Footwear (Tommy Bahama). All intercompany accounts and transactions have been eliminated in consolidation.

Accounting Period

The Company operates on a fiscal year consisting of a 52- or 53-week period ending the Saturday nearest to December 31. The second quarters consisted of the 13 weeks ended June 28, 2008 and June 30, 2007.

Reclassifications

Certain reclassifications have been made to the fiscal 2007 financial statements to conform to the classifications used in fiscal 2008. These classifications have no effect on the reported net loss.

2. INCOME TAXES

The Company accounts for income taxes under Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes* (SFAS No. 109). SFAS No. 109 is an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company s financial statements or tax returns. Income taxes are provided on the earnings in the consolidated financial statements. Tax credits are recognized as a reduction to income taxes in the year the credits are earned. The provision for income taxes is based on the current quarter activity of the various legal entities and jurisdictions in which the Company operates. As such, the effective tax rate may vary from the customary relationship between income tax expense/(benefit) and pre-tax accounting income/(loss). The Company s effective tax rate may vary from period to period depending on, among other factors, the geographic and business mix of taxable earnings and losses. The Company considers these factors and others, including its history of generating taxable earnings, in assessing its ability to realize deferred tax assets. The effective tax rate for the quarter ended June 28, 2008 was near 0% due to a valuation allowance being placed on the tax effect of the Company s net operating losses recorded during the period. The effective tax rate for the quarter ended June 30, 2007 was 40% due to an increased effect on the annual tax rate from permanent differences.

On December 31, 2006, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* (FIN No. 48). FIN No. 48 creates a single model to address the accounting for the uncertainty in income tax positions and prescribes a minimum recognition threshold a tax position must meet before recognition in the financial statements. The total amount of unrecognized tax benefits as of the date of adoption was $253,000, which includes $35,000 of interest and penalties. Of the total gross liability of $253,000, $8,000 related to uncertain tax positions taken in prior fiscal years resulting from net operating losses in such years, therefore the liability was presented as a reduction of the related deferred tax asset as of the date of adoption. At June 28, 2008 and December 29, 2007, the Company had approximately $181,000 and $178,000, respectively, of net unrecognized tax benefit positions that, if recognized, would affect the effective income tax rate. Due to statute expiration and possible settlement with state authorities, a decrease could occur with respect to this FIN No. 48 reserve of approximately $96,000 during fiscal year 2008.

The Company is subject to taxation in the U.S., Canada and various state tax jurisdictions. For federal tax purposes, the Company s 2004 through 2007 tax years remain open for examination by the tax authorities under the normal three year statute of limitations. Generally, for state tax purposes, the Company s 2003 through 2007 tax years remain open for examination by the tax authorities under a four year statute of limitations; however, certain states may keep their statute open for six to ten years. Generally, the Company s tax years from 2006 are subject to examination by Canadian tax authorities.

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The Company recognizes accrued interest and penalties related to unrecognized tax benefits as part of income tax expense. The liability for accrued interest and penalties as of June 28, 2008 and December 29, 2007, was $63,000 and $57,000, respectively. Interest is computed on the difference between the Company s uncertain tax benefit positions under FIN No. 48 and the amount deducted or expected to be deducted in the Company s tax returns.

The Company periodically assesses the likelihood that it will be able to recover its deferred tax assets. The Company considers all available evidence, both positive and negative, including historical levels of income and expectations and risks associated with estimates of future taxable income. As a result of this analysis of all available evidence, both positive and negative, management does not believe that it is more likely than not that the net deferred tax assets will be realized. Accordingly, the net deferred tax asset of $7.3 million at June 28, 2008 and December 29, 2007, has been fully offset by a valuation allowance.

3. DISCONTINUED OPERATIONS

On July 2, 2007, the Company sold all of the outstanding capital stock of its wholly-owned subsidiary, Royal Robbins, to Kellwood Company (Kellwood), a leading marketer of apparel and consumer soft goods headquartered in St. Louis, Missouri and, concurrently, PXG Canada sold certain assets and assigned certain obligations of PXG Canada that related solely to PXG Canada s business devoted to the purchasing, marketing, distribution and sale of Royal Robbins branded products to Canadian Recreation Products, Inc. (Canadian Recreation), a wholly-owned subsidiary of Kellwood.

On December 29, 2007, the Company sold all of the outstanding capital stock of its wholly-owned subsidiary, Altama, to Tactical Holdings, Inc. (Tactical). At closing, the purchase price of $13.5 million was paid through the delivery of a promissory note and pledge security agreement. As a result of the closing date working capital review performed by Tactical, the Company recorded a reserve for a working capital adjustment of approximately $197,000 at December 29, 2007. Based on the results of the post-closing review, the closing date working capital adjustment was adjusted down by approximately $81,000, to $116,000. Subsequent to the final working capital adjustment, the sale resulted in a gain, net of tax of $519,000. In addition, Phoenix Footwear and Tactical entered into a $1.5 million Transition Services Agreement for which the Company provided ongoing administrative and other services through June 2008 to support new management with the operation of the Altama business. Payment in full on the note and the first payment of $750,000 under the Transition Services Agreement was made on February 29, 2008. Pursuant to the acquisition terms, $3.0 million of this payment was deposited into an 18 month interest bearing escrow account to secure our indemnification obligations to Tactical and is recorded as Restricted Cash as of June 28, 2008. An additional payment of $500,000 under the Transition Services Agreement was made on April 1, 2008 and the remaining payment of $250,000 was made on July 1, 2008. The sale of Altama generated a pre-tax loss of approximately $6.9 million. The tax benefit generated by the capital loss from the sale of Altama was used to offset the tax obligation generated by the capital gain from the sale of Royal Robbins. The tax benefit realized from the sale of Altama was approximately $7.4 million resulting in a net after tax gain on the sale of approximately $519,000.

The results of the Royal Robbins business, previously included in the footwear segment, and the results of the Altama business, previously included in the military boot segment, have been segregated from continuing operations and reported as discontinued operations in the Consolidated Statements of Operations for the three and six months ended June 30, 2007. In accordance with EITF 87-24, *Allocation of Interest to Discontinued Operations* (EITF 87-24), interest expense incurred on the debt that was required to be repaid as a result of each sale was allocated to discontinued operations for the periods presented and is included in cost of goods sold and operating expenses. During the three and six months ended June 28, 2008, interest expense allocated to discontinued operations was $0. During the three and six months ended June 30, 2007, interest expense allocated to discontinued operations was $1.2 million and $2.4 million, respectively.

The following table summarizes the results of the Royal Robbins and Altama businesses for the three and six months ended June 30, 2007:

	Three months ended June 30, 2007	Six months ended June 30, 2007
	(In thousands)	
Net sales	$ 11,726	$ 32,472
Cost of goods sold and operating expenses	11,736	30,635
(Loss) earnings before income taxes	(10)	1,837
Income tax (benefit) expense	(127)	326

Earnings from discontinued operations	$ 117	$ 1,511

4. INVENTORIES

The components of inventories as of June 28, 2008 and December 29, 2007, net of reserves, were:

	June 28, 2008	**December 29, 2007**
	(In thousands)	
Raw materials	$ 1,507	$ 1,945
Work in process	531	249
Finished goods	15,641	17,680
	$ 17,679	$ 19,874

5. GOODWILL AND INTANGIBLE ASSETS

The changes in the carrying amounts of goodwill and unamortizable intangible assets during the first two quarters of fiscal 2008 are as follows:

	Goodwill	**Unamortizable Intangibles**
	(In thousands)	
Balance at December 29, 2007	$ 5,850	$ 340
Balance at June 28, 2008	$ 5,850	$ 340

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The changes in the carrying amounts of amortizable intangible assets during the first two quarters of fiscal 2008 are as follows:

	Gross	Accumulated Amortization	Net
		(In thousands)	
Balance at December 29, 2007	$ 7,514	$ (2,246)	$ 5,268
Amortization expense		(305)	(305)
Balance at June 28, 2008	$ 7,514	$ (2,551)	$ 4,963

Changes in amortizable intangibles during the first two quarters of fiscal 2008 relate to the amortization of intangible assets during the quarter.

Intangible assets consist of the following as of June 28, 2008 and December 29, 2007:

	Useful Life (Years)	June 28, 2008	December 29, 2007
		(In thousands)	
Unamortizable:			
Trademarks and tradenames		$ 340	$ 340
Amortizing:			
Customer lists	5-20	$ 5,464	$ 5,464
Covenant not to compete	2-5	2,025	2,025
Other	5	25	25
Less: Accumulated Amortization		(2,551)	(2,246)
Total		$ 4,963	$ 5,268

Amortizable intangible assets with definite lives are amortized using the straight-line method over periods ranging from 2 to 20 years. During the three and six months ended June 28, 2008, aggregate amortization expense was approximately $153,000 and $305,000, respectively. During the three and six months ended June 30, 2007, aggregate amortization expense was approximately $225,000 and $449,000, respectively.

Amortization expense related to intangible assets at June 28, 2008 in each of the next five fiscal years and beyond is expected to be incurred as follows:

	(In thousands)
Remainder of 2008	$ 299
2009	596
2010	461
2011	326
2012	258
Thereafter	3,023
Total	$ 4,963

6. ACCOUNTING FOR STOCK-BASED COMPENSATION

The Company has a 2001 Long-Term Incentive Plan. Under the 2001 Plan, awards in the form of stock options, stock appreciation rights or stock awards may be granted to employees and directors of the Company and persons who provide consulting or other services to the Company deemed by the Board of Directors to be of substantial value to the Company. The Plan is administered by the compensation committee of the Board of Directors.

The following table summarizes compensation costs related to the Company s stock option-based compensation plans:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands)			
Selling, general and administrative	$ 2	$ 27	$ 8	$ 62
Pre-tax stock-based compensation expense	2	27	8	62
Income tax benefit		(2)		(7)
Total stock-based compensation expense	$ 2	$ 25	$ 8	$ 55

The fair value of stock options at the date of grant was estimated using the Black-Scholes option pricing model. The expected life of employee stock options was determined using historical data of employee exercises and represents the period of time that stock options are expected to be outstanding. The risk free interest rate was based on the U.S. Treasury constant maturity for the expected life of the stock option. Expected volatility was based on the historical volatilities of the Company s common stock.

The Company recognizes stock-based compensation expense using the straight-line attribution method for stock options and is recognized at the time the expense is considered probable. The remaining unrecognized compensation cost related to unvested stock option awards at June 28, 2008 is $0. This amount does not include the cost of any additional options that may be granted in future periods nor any changes in the Company s forfeiture rate. In connection with the exercise of stock options, the Company did not realize income tax benefits during the three or six month periods ended June 28, 2008 and June 30, 2007 that have been credited to additional paid-in capital.

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Options outstanding and exercisable under these arrangements totaled 410,000 as of June 28, 2008, and 624,000 as of December 29, 2007. The Company did not grant stock option awards or modify any outstanding stock options during the three or six months ended June 28, 2008 or June 30, 2007.

The following table summarizes the stock option transactions during the first six months of fiscal 2008:

	Options	Weighted Average Exercise Price	Aggregate Intrinsic Value
	(In thousands, except exercise price)		
Options outstanding, December 29, 2007	644	$ 7.01	
Options granted			
Options exercised			
Options cancelled	(234)	$ 6.96	
Options outstanding, June 28, 2008	410	$ 7.03	$
Options exercisable, June 28, 2008	410	$ 7.03	$

The outstanding stock options as of June 28, 2008 have an exercise price ranging from $1.73-$13.33 per share and expire at various dates through June 2015.

SFAS No. 123R requires the Company to reflect income tax benefits resulting from tax deductions in excess of expense as a financing cash flow in its Consolidated Statement of Cash Flows rather than as an operating cash flow as in prior periods. Cash proceeds, tax benefits and intrinsic value of related total stock options exercised during the three and six month periods ended June 28, 2008 and June 30, 2007 were each $0.

All stock options are granted with an exercise price equal to the fair market value of the Company s common stock at the grant date. The fair value of each stock option is estimated on the date of the award using the Black-Scholes option pricing model. Stock options generally expire ten years from the date of grant with one-third becoming exercisable on each anniversary of the grant date.

In 2005, the Company began issuing Performance Based Stock Rights (Stock Rights) which cliff vest based on specifically defined performance criteria consisting primarily of revenue, income and shareholder value targets and expire generally within a three year period if the performance criteria have not been met. These performance-based stock rights have an exercise price of $0.00. The stock rights that could vest upon achievement of the performance targets at June 28, 2008 totaled 768,000 shares. The outstanding stock rights have an expected life of approximately 1.9 years. The Company will recognize compensation expense based on the fair value of the stock rights at the time vesting is considered probable. The Company deems stock rights to be equivalent to a stock option for the purpose of calculating dilutive shares. No expense has been recorded in connection with these rights as the Company does not consider it probable that the related performance criteria will be met.

The Company did not recognize any compensation expense during the first six months of fiscal 2008 or fiscal 2007 related to these Stock Rights as none have vested.

The following table summarizes performance based stock rights issued as of June 28, 2008:

	Rights	Aggregate Intrinsic Value
	(In thousands)	
Stock Rights outstanding December 29, 2007	598	
Granted	195	
Exercised		
Cancelled	(25)	

Stock Rights outstanding June 28, 2008	768	$ 1,098

7. PER SHARE DATA

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the period. Diluted (loss) earnings per share is calculated by dividing net (loss) earnings and the effect of assumed conversions by the weighted average number of common and, when applicable, potential common shares outstanding during the period. A reconciliation of the numerators and denominators of basic and diluted (loss) earnings per share is presented below.

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands, except per share data)			
Basic net loss per share:				
Net loss	$ (2,159)	$ (929)	$ (2,439)	$ (515)
Weighted average common shares outstanding	8,166	8,045	8,121	8,016
Basic net loss per share	$ (.26)	$ (.12)	$ (.30)	$ (.06)
Diluted net loss per share:				
Net loss	$ (2,159)	$ (929)	$ (2,439)	$ (515)
Weighted average common shares outstanding	8,166	8,045	8,121	8,016
Effect of stock options and stock performance rights outstanding				
Weighted average common and potential common shares outstanding	8,166	8,045	8,121	8,016
Diluted net loss from continuing operations per share	$ (.26)	$ (.12)	$ (.30)	$ (.06)

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Options and performance stock rights, to purchase shares of common stock which totaled 1.6 million, and 1.8 million in fiscal 2008 and in fiscal 2007, respectively, were not included in the computation of diluted earnings per share as the effect would be anti-dilutive.

In addition to shares outstanding held by the public, the Company s defined contribution 401(k) savings plan held zero and approximately 121,000 shares as of June 28, 2008 and June 30, 2007, respectively, which were issued during 2001 in connection with the termination of the Company s defined benefit pension plan. These shares, while eligible to vote, were classified as treasury stock and therefore were not deemed outstanding for the purpose of determining per share earnings until the time that such shares were allocated to employee accounts. This allocation occurred over a seven-year period which commenced in 2002 and was completed in February 2008. During fiscal 2008 and fiscal 2007, approximately 121,000 shares were allocated each year to the defined contribution 401(k) savings plan.

In addition to the options and rights outstanding under the Plan, the Company granted options to two separate major stockholders in consideration for debt and debt guarantees. Options outstanding and exercisable under these arrangements totaled 398,000 as of June 28, 2008 and June 30, 2007. These options were granted July 17, 1997, September 1, 1999 and on various dates during 2001 and have an exercise price ranging from $1.75 to $2.38 per share and expire at various dates through June 2011.

In conjunction with the Company s secondary offering completed July 19, 2004, the Company issued 50,000 warrants with an exercise price of $15.00 to the managing underwriters. The warrants expire on July 18, 2009 and contain piggyback registration rights that expire seven years from the closing of the offering. These warrants were excluded from the computation of diluted earnings per share as the effect would be anti-dilutive.

8. COMMITMENTS AND CONTINGENCIES

On October 3, 2006, the Company notified the seller under the purchase agreement for the acquisition of Tommy Bahama Footwear that it was withholding payment of the $500,000 holdback that the Company maintained under the terms of the Agreement. The Company had previously notified the sellers that certain acquired assets did not conform to the representations and warranties contained in the purchase agreement. The sellers have demanded payment of the holdback amount. The $500,000 is currently recorded in other current liabilities.

On September 10, 2007, the Company notified the American Red Cross that it was discontinuing participation under the license agreement between the parties. The Company had entered into the license agreement with American Red Cross in April 2006 to use the Red Cross Emblem in connection with the sales and marketing of footwear. In September 2007, the Company learned of certain litigation, in which the Company has not been named as a party, challenging the power and authority of the American Red Cross to license commercial use of the Red Cross Emblem. As a result of the claims alleged in that litigation, the Company made a decision to discontinue its participation under the license agreement. In response to the Company s notice, the American Red Cross has demanded payment of the remaining minimum royalty payments which it claims under the license agreement of $362,500, plus interest. Although the Company continues to deny its liability for breach under the agreement, and intends to vigorously defend against any claims initiated, management cannot predict the outcome of the dispute, and, therefore the Company has accrued the remaining minimum royalty payments of $362,500 remaining under the license agreement as of June 28, 2008.

In the normal course of business, the Company is subject to legal proceedings, lawsuits and other claims. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. Consequently, the ultimate aggregate amount of monetary liability or financial impact with respect to these matters at June 28, 2008, cannot be ascertained. While these matters could affect the Company s operating results for any one quarter when resolved in future periods and while there can be no assurance with respect thereto, management believes, with the advice of outside legal counsel, that after final disposition, any monetary liability or financial impact to the Company from these matters would not be material to the Company s consolidated financial condition, results of operations or cash flows.

9. DEBT

In June 2008, the Company entered into a Credit and Security Agreement with Wells Fargo Bank, N.A. (Wells Fargo) for a three year revolving line of credit and letters of credit collateralized by all of the Company s assets and those of its subsidiaries. Under the facility, the Company can borrow up to $17.0 million (subject to a borrowing base which includes eligible receivables and eligible inventory), which, subject to the satisfaction of certain conditions, may be increased to $20.0 million. The credit facility also includes a $7.5 million letter of credit sub facility. The borrowings under the revolving line of credit bear interest at prime rate minus .25% or the applicable 30, 90, 180-day LIBOR plus 2.4%, subject to certain minimums, and .25% downward adjustment if a required net income amount is earned by the Company for fiscal 2008. At June 28, 2008, the available borrowing capacity under the revolving line of credit, net of outstanding letters of credit was $1.0 million.

The agreement includes various financial and other covenants with which the Company has to comply in order to maintain borrowing availability and avoid penalties, including an annual capital expenditure limitation and a minimum quarterly net income requirement. Other covenants include, but are not limited to, covenants limiting or restricting the Company s ability to incur indebtedness, incur liens, enter into mergers or consolidations, dispose of assets, make investments, pay dividends, enter into transactions with affiliates, or prepay certain indebtedness. The credit and security agreement also contains customary events of default including, but not limited to, payment defaults, covenant defaults, cross-defaults to other indebtedness, material judgment defaults, inaccuracy of representations and warranties, bankruptcy and insolvency events, defects in Wells Fargo security interest, change in control events, material adverse change and certain officers being convicted of felonies. The occurrence of an event of default will increase the interest rate by 3.0% over the rate otherwise applicable and could result in the acceleration of all obligations of the Company to Wells Fargo with respect to indebtedness, whether under the Credit and Security Agreement or otherwise. As of June 28, 2008, the Company was in compliance with all material terms of the new credit facility. All payments on accounts receivable go directly to the lender as a reduction of the debt.

Concurrently with the execution of the Credit and Security Agreement, the Company made an initial borrowing thereunder in the amount of $11.2 million, which was used to pay in full the outstanding balances owed to the Company s then lender, Manufacturers & Traders Trust Company (M&T). The Company also terminated the underlying credit agreement, notes, security agreements and related instruments and documents, but left in force a Letter of Credit Reimbursement Agreement between M&T and the Company. In connection with the pay off of the M&T facility, the Company cash collateralized on a dollar-for-dollar basis four letters of credit previously issued by M&T The Company pledged the cash collateral account to M&T pursuant to a Pledge Account Agreement which the Company entered into with M&T. As of June 28, 2008 there remains one Letter of Credit outstanding with M&T totaling $3.1 million which is supported through a back-to-back Letter of Credit issued by Wells Fargo.

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Debt as of June 28, 2008 and December 29, 2007 consisted of the following:

	June 28, 2008	December 29, 2007
	(In thousands)	
Credit and Security Agreement with Wells Fargo; collateralized by all of the Company s assets; interest payable monthly and bears a rate of Prime minus .25% (effective rate of 4.75% at June 28, 2008)	11,071	
Revolving line of credit with M&T; secured by accounts receivable, inventory and equipment; interest payable monthly and bears a rate of Prime plus 3.5% (effective rate of 8.0% at December 29, 2007)		22,666(1)