SPORT HALEY INC
Form 10-Q
February 12, 2007

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2006

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

Commission File No. 0-51715

SPORT-HALEY, INC.
(Exact name of small business issuer as specified in its charter)

COLORADO	**84-1111669**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4600 E. 48th Avenue, Denver, Colorado 80216
(Address of principal executive offices)

(303) 320-8800
(Issuer s telephone number including area code)

Indicate by check mark whether the registrant (1) 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 o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

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

Class	Outstanding at February 9, 2007
Common Stock, no par value	2,770,252

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SPORT-HALEY, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2006 (Unaudited)	June 30, 2006 (***)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,361,000	$ 8,492,000
Accounts receivable, net of allowances of $371,000 and $446,000, respectively	2,659,000	3,950,000
Inventories	5,037,000	4,775,000
Prepaid expenses and other	314,000	194,000
Total current assets	15,371,000	17,411,000
Property and equipment, net	485,000	613,000
Goodwill	270,000	
Other assets	3,000	3,000
Total Assets	$ 16,129,000	$ 18,027,000
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 907,000	$ 1,836,000
Accrued royalties payable	152,000	386,000
Accrued commissions payable	193,000	211,000
Accrued payroll	336,000	386,000
Other	144,000	137,000
Total current liabilities	1,732,000	2,956,000
Long-Term Liabilities:		
Loan payable to affiliate		34,000
Total long-term liabilities		34,000
Commitments and Contingencies (Notes 3 and 4)		
Total Liabilities	1,732,000	2,990,000
Minority Interest		22,000
Shareholders equity:		
Preferred stock, no par value; 1,500,000 shares authorized; none issued and outstanding		
Common stock, no par value; 15,000,000 shares authorized; 2,770,252 issued and outstanding	10,813,000	10,813,000
Additional paid-in capital	1,621,000	1,621,000
Retained earnings	1,963,000	2,581,000
Total shareholders equity	14,397,000	15,015,000
Total Liabilities and Shareholders Equity	$ 16,129,000	$ 18,027,000

*** Taken from the audited balance sheet at that date.

See accompanying notes to these condensed consolidated financial statements.

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SPORT-HALEY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended December 31,		Six Months Ended December 31,	
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)
Net sales	$ 4,190,000	$ 4,429,000	$ 8,863,000	$ 8,440,000
Cost of goods sold	2,562,000	2,663,000	5,684,000	5,304,000
Impairments	73,000	129,000	122,000	194,000
Total cost of goods sold	2,635,000	2,792,000	5,806,000	5,498,000
Gross profit	1,555,000	1,637,000	3,057,000	2,942,000
Other Operating Costs:				
Selling, general and administrative expenses	1,691,000	1,438,000	3,412,000	3,162,000
Royalty expense	152,000	175,000	362,000	338,000
Total other operating costs	1,843,000	1,613,000	3,774,000	3,500,000
Income (loss) from operations	(288,000)	24,000	(717,000)	(558,000)
Other income, net	84,000	77,000	162,000	130,000
Income (loss) before minority interest in subsidiary net income and provision for income taxes	(204,000)	101,000	(555,000)	(428,000)
Minority interest in subsidiary net income			(46,000)	
Provision for income taxes	(17,000)	(2,000)	(17,000)	(1,000)
Net income (loss)	$ (221,000)	$ 99,000	$ (618,000)	$ (429,000)
Basic earnings (loss) per common share	$ (0.08)	$ 0.04	$ (0.22)	$ (0.16)
Diluted earnings (loss) per common share	$ (0.08)	$ 0.03	$ (0.22)	$ (0.16)
Basic weighted average shares outstanding	2,770,000	2,770,000	2,770,000	2,728,000
Diluted weighted average shares outstanding	2,770,000	2,968,000	2,770,000	2,728,000

See accompanying notes to these condensed consolidated financial statements.

SPORT-HALEY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended December 31, 2006 (Unaudited)	2005 (Unaudited)
Cash flows from operating activities:		
Net loss	$ (618,000)	$ (429,000)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation and amortization	147,000	170,000
Impairments and write-downs	122,000	194,000
Allowance for doubtful accounts	60,000	75,000
Common stock options		31,000
Loss on sale of fixed assets		12,000
Minority interest	49,000	
Cash provided (used) due to changes in assets and liabilities:		
Accounts receivable	1,231,000	1,697,000
Inventories	(384,000)	(1,151,000)
Other assets	(120,000)	(140,000)
Accounts payable	(929,000)	123,000
Accrued commissions and other expenses	(295,000)	(276,000)
Net cash provided (used) by operating activities	(737,000)	306,000
Cash flows from investing activities:		
Proceeds from sales of fixed assets		16,000
Purchase of fixed assets	(19,000)	(9,000)
Purchase of minority interest	(375,000)	
Net cash provided (used) by investing activities	(394,000)	7,000
Cash flows from financing activities:		
Net proceeds from issuance of common stock		353,000
Net cash provided by financing activities		353,000
Net increase (decrease) in cash and cash equivalents	(1,131,000)	666,000
Cash and cash equivalents, beginning	8,492,000	7,721,000
Cash and cash equivalents, ending	$ 7,361,000	$ 8,387,000
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$ 17,000	$ 2,000

See accompanying notes to these condensed consolidated financial statements.

SPORT-HALEY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 **SIGNIFICANT ACCOUNTING POLICIES**

Principles of Consolidation Included in the December 31, 2006, consolidated financial statements are the accounts of Sport-Haley, Inc. (Sport Haley) and Reserve Apparel Group LLC (Reserve Apparel). Sport Haley and Reserve Apparel may collectively be referred to as the Company , we , us or our .

Nature of Operations Sport Haley, organized as a Colorado corporation in January 1991, designs, purchases or contracts for the manufacture of, markets and distributes women s and men s fashion golf apparel and outerwear under the SPORT HALEY® and Ben Hogan® labels. Our fashion golf apparel collections, known for their innovative designs, quality fabrics, generous fits and classic styles, are primarily marketed in the premium and mid-priced markets, through a network of independent sales representatives and distributors, to golf professional shops, country clubs, resorts and exclusive department stores within the United States and by certain distributors within various international markets. Ben Hogan® fashion golf apparel is distributed per the terms of a license agreement with Callaway Golf Company (Callaway).

Reserve Apparel, formed in November 2005, designs, purchases or contracts for the manufacture of, markets and distributes branded golf apparel and outerwear under the Top-Flite® label to mass retailers and other big-box type high sales volume retail stores. In accordance with its operating agreement, Sport Haley owned a 51% interest in Reserve Apparel and Explorer Gear USA, Inc. (Explorer Gear) owned a 49% interest. On September 21, 2006, Sport Haley entered into an agreement with Explorer Gear to purchase its 49% membership interest in Reserve Apparel for a lump sum payment of $375,000, since which time Reserve Apparel has been a wholly-owned subsidiary of Sport Haley. Top-Flite® branded golf apparel is distributed per the terms of a license agreement with Callaway.

Condensed Financial Statements The accompanying condensed consolidated balance sheets and interim condensed consolidated statements of operations and cash flows include all adjustments (consisting only of normal recurring items) necessary for their fair representation. The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities.

Certain information in footnote disclosures normally included in financial statements has been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission. The information included in this Form 10-Q should be read in conjunction with financial statements and notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations for the year ended June 30, 2006, included in the Company s filing on Form 10-K.

Reclassification Certain prior period amounts have been reclassified to conform to the December 31, 2006, presentation. Such reclassifications had no affect on net income (loss) in any of the periods presented.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Stock-Based Compensation - Our Stock Option Plan (the Plan) expired by its terms on February 28, 2003. Accordingly, no options have been granted since then. Option agreements that were issued in accordance with the Plan prior to February 28, 2003, generally remain in force until the earlier of their exercise, the expiration of certain time periods after the termination of a grantee s employment (or other relationship with the Company) or expiration by their terms.

At December 31, 2006, there were outstanding options to purchase 673,500 shares of our common stock at exercise prices ranging from $2.71 to $9.78 per share and expiration dates between February 2007 and January 2013. No options were exercised and 5,000 options expired during the six months ended December 31, 2006.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123(R) (SFAS 123R), *Share-Based Payment,* which is a revision of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation.* SFAS 123R is effective for annual periods beginning after July 1, 2005, supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* and amends Statement of Financial Accounting Standards No. 95, *Statement of Cash Flows.* SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the statement of operations based upon their fair values and rescinds the acceptance of pro forma disclosure. SFAS 123R permits two methods of adoption, a modified prospective method and a modified retrospective method. Under the modified prospective method, stock-based compensation cost is recognized, beginning with the effective date, based on the requirements of SFAS 123R for all share-based payments granted after the effective date and for all awards granted prior to the effective date that remain unvested on the effective date. The modified retrospective method includes the requirements of the modified prospective method and also permits restatement of prior periods based on amounts previously reported in pro forma disclosures pursuant to SFAS 123 for either all periods presented or for only prior interim periods of the year of adoption. We adopted the modified prospective method prescribed in SFAS 123R, effective July 1, 2005.

Previously, we accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations and elected to apply the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. Under the intrinsic value method, compensation expense for stock options was recognized over the vesting period of the grant based on the excess, if any, of the market price of our common stock at the date of grant over the stock option exercise price. As governed by the Plan, stock options were generally granted at or near fair market value on the date of grant. The expected life was determined based upon the Plan s vesting period and exercise behavior of the employees.

Upon our adoption of the modified prospective method prescribed in SFAS 123R, effective July 1, 2005, we recorded $31,000 in stock-based compensation expense during the three months ended September 30, 2005, using the fair value method. We have not been required to record any additional stock-based compensation expense since September 30, 2005, as

SPORT-HALEY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

all employee-related options are now fully vested. Therefore, we have omitted the comparison of pro forma amounts of net income (loss) and net income (loss) per share applicable to common stock for the three months and six months ended December 31, 2006 and 2005, respectively.

Recent Pronouncements In June 2006, the Financial Accounting Standards Board issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes.* FIN 48 requires the use of a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in an income tax return and disclosures regarding uncertainties in income tax positions. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized upon adoption of FIN 48. We are required to adopt FIN 48 effective July 1, 2007. The cumulative effect of initial adoption of FIN 48, if any, will be recorded as an adjustment to beginning retained earnings in the year of adoption and will be presented separately. We are currently evaluating the impact that FIN 48 will have on our financial condition and the results of our operations.

We have reviewed all other recently issued, but not yet effective, accounting pronouncements and do not believe the future adoption of any such pronouncements may be expected to cause a material impact on our financial condition or the results of our operations.

NOTE 2 INVENTORIES

	December 31, 2006	**June 30, 2006**
Inventories consisted of the following:		
Component	$ 516,000	$ 366,000
Finished goods	4,521,000	4,409,000
	$ 5,037,000	$ 4,775,000

Included in finished goods inventories are allowances for inventory write-downs of $147,000 and $276,000 as of December 31, 2006, and June 30, 2006, respectively.

NOTE 3 LINE OF CREDIT AGREEMENT

We maintain a revolving line of credit agreement with a commercial bank. The revolving line of credit agreement, renewed by amendment through December 5, 2007, provides for a maximum loan amount of $3,000,000, collateralized by a certificate of deposit held at the commercial bank in the amount of $3,000,000, which earns a market rate of interest. Borrowings under the line of credit agreement accrue interest at the bank s prime rate. We generally maintain the line of credit to facilitate the issuance of letters of credit for inventory purchases from offshore suppliers and, if necessary, to fund any temporary working capital needs. At December 31, 2006, and June 30, 2006, respectively, we did not have any balances due on the line of credit.

SPORT-HALEY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 COMMITMENTS AND CONTINGENCIES

At December 31, 2006, and June 30, 2006, we had $2,356,000 and $509,000, respectively, in outstanding letters of credit that were issued to foreign suppliers in accordance with finished goods inventory purchase commitments. Outstanding letters of credit reduce the amount available for borrowing under the line of credit agreement.

NOTE 5 EARNINGS PER SHARE

Effective with the year ended June 30, 1998, we adopted the provisions of Statement of Financial Accounting Standards No. 128 (SFAS No. 128), *Earnings per Share*. SFAS No. 128 requires the presentation of basic and diluted earnings (loss) per common share. The following table provides a reconciliation of the numerator and denominator of basic and diluted earnings (loss) per common share:

	Three Months ended December 31, 2006		
	Net Income (Loss)	**Weighted Average Shares**	**Per Share**
Basic loss per share	$ (221,000)	2,770,000	$ (0.08)
Effect of dilutive securities options **[A]**			
Diluted loss per share	$ (221,000)	2,770,000	$ (0.08)

	Six Months ended December 31, 2006		
	Net Income (Loss)	**Weighted Average Shares**	**Per Share**
Basic loss per share	$ (618,000)	2,770,000	$ (0.22)
Effect of dilutive securities options **[A]**			
Diluted loss per share	$ (618,000)	2,770,000	$ (0.22)

	Three Months ended December 31, 2005		
	Net Income (Loss)	**Weighted Average Shares**	**Per Share**
Basic income per share	$ 99,000	2,770,000	$ 0.04
Effect of dilutive securities options		198,000	(0.01)
Diluted income per share	$ 99,000	2,968,000	$ 0.03

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Six Months ended December 31, 2005		
	Net Income (Loss)	Weighted Average Shares	Per Share
Basic loss per share	$ (429,000)	2,728,000	$ (0.16)
Effect of dilutive securities options **[A]**			
Diluted loss per share	$ (429,000)		