GART SPORTS CO
Form 10-Q
September 17, 2002

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934

For the Quarterly Period Ended: August 3, 2002

Commission File Number: 000-23515

GART SPORTS COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**84-1242802**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1050 West Hampden Avenue, Englewood, Colorado 80110
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (303) 200-5050

Indicate by check mark whether the registrant 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 shorter period that the registrant was required to file such reports). Yes ý No o

Indicate by check mark whether the registrant has been subject to such filing requirements for the past 90 days. Yes ý No o

As of September 10, 2002, there were outstanding 12,191,336 shares of the registrant's common stock, $.01 par value, and the aggregate market value of the shares (based upon the closing price on that date of the shares on the NASDAQ National Market) held by non-affiliates was approximately $171,674,000.

GART SPORTS COMPANY
QUARTERLY PERIOD ENDED AUGUST 3, 2002
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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GART SPORTS COMPANY

AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands, Except Share and Per Share Amounts)

	August 3, 2002	February 2, 2002
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,293	$ 11,536
Accounts receivable, net of allowance for doubtful accounts of $1,164 and $1,116	10,912	11,831
Inventories	349,310	326,543
Prepaid expenses and other assets	11,856	9,796
Deferred income taxes	14,925	12,471
Total current assets	401,296	372,177
Property and equipment, net	84,233	87,615
Favorable leases, net of accumulated amortization of $2,111 and $1,196	11,380	12,295
Deferred income taxes	10,677	14,015
Goodwill, net of accumulated amortization of $734	44,938	41,663
Other assets, net of accumulated amortization of $6,852 and $5,227	8,028	8,417

	August 3, 2002	February 2, 2002
Total assets	$ 560,552	$ 536,182
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 151,037	$ 171,888
Current portion of capital lease obligations	668	634
Accrued expenses and other current liabilities	55,163	57,161
Total current liabilities	206,868	229,683
Long-term debt	146,702	158,474
Capital lease obligations, less current portion	1,472	1,821
Deferred rent and other long-term liabilities	12,850	10,695
Total liabilities	367,892	400,673
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value. 3,000,000 shares authorized; none issued		
Common stock, $.01 par value. 22,000,000 shares authorized; 13,415,894 and 11,340,341 shares issued and 12,344,540 and 10,728,986 shares outstanding	134	113
Additional paid-in capital	156,863	99,355
Unamortized restricted stock compensation	(2,322)	(2,743)
Accumulated other comprehensive loss	(805)	(448)
Retained earnings	53,679	44,755
	207,549	141,032
Treasury stock, 1,071,354 and 611,355 common shares, at cost	(14,889)	(5,523)
Total stockholders' equity	192,660	135,509
Total liabilities and stockholders' equity	$ 560,552	$ 536,182

See accompanying notes to consolidated financial statements.

GART SPORTS COMPANY

AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, Dollars in Thousands, Except Share and Per Share Amounts)

	Thirteen weeks ended		Twenty-six weeks ended	
	August 3, 2002	August 4, 2001	August 3, 2002	August 4, 2001
Net sales	$ 261,705	$ 237,938	$ 506,682	$ 400,580

	Thirteen weeks ended		Twenty-six weeks ended	
Cost of goods sold, buying, distribution and occupancy	193,646	178,616	377,169	301,932
Gross profit	68,059	59,322	129,513	98,648
Operating expenses	55,510	50,550	110,277	86,667
Merger integration costs		3,477		3,477
Operating income	12,549	5,295	19,236	8,504
Non operating income (expense):				
Interest expense, net	(2,432)	(2,656)	(5,116)	(4,932)
Other income	231	467	439	526
Income before income taxes	10,348	3,106	14,559	4,098
Income tax expense	(4,014)	(1,211)	(5,635)	(1,598)
Net income	$ 6,334	$ 1,895	$ 8,924	$ 2,500
Earnings per share:				
Basic	$ 0.52	$ 0.20	$ 0.77	$ 0.30
Diluted	$ 0.48	$ 0.18	$ 0.72	$ 0.27
Weighted average shares of common stock outstanding:				
Basic	12,282,536	9,529,185	11,562,880	8,447,488
Diluted	13,128,400	10,268,375	12,459,681	9,102,633

See accompanying notes to consolidated financial statements.

GART SPORTS COMPANY

AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited, Dollars in Thousands)

	Common stock	Additional paid-in capital	Unamortized restricted stock compensation	Accumulated other comprehensive loss	Retained earnings	Comprehensive income	Treasury stock	Total Stockholders' equity
BALANCES AT FEBRUARY 2, 2002	$ 113	$ 99,355	$ (2,743)	$ (448)	$ 44,755		$ (5,523)	$ 135,509
Net income					8,924	$ 8,924		8,924
Unrealized loss on equity securities, net of tax				(127)		(127)		(127)
Unrealized loss on interest rate swap, net of				(230)		(230)		(230)

	Common stock	Additional paid-in capital	Unamortized restricted stock compensation	Accumulated other comprehensive loss	Retained earnings	Comprehensive income	Treasury stock	Total Stockholders' equity
tax								
Comprehensive income						$ 8,567		
Issuance of common stock		25						25
Exercise of stock options	3	5,356						5,359
Proceeds from stock offering	18	52,127						52,145
Purchase of treasury stock							(9,366)	(9,366)
Amortization of restricted stock			421					421
BALANCES AT AUGUST 3, 2002	$ 134	$ 156,863	$ (2,322)	$ (805)	$ 53,679		$ (14,889)	$ 192,660

See accompanying notes to consolidated financial statements.

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GART SPORTS COMPANY

AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, Dollars in Thousands)

	Twenty-six weeks ended	
	August 3, 2002	**August 4, 2001**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 8,924	$ 2,500
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	11,616	8,889
Deferred income taxes	5,635	(41)
Loss on disposition of assets	125	1,598
Increase in deferred rent	1,406	849
Deferred compensation	25	69
Changes in operating assets and liabilities:		
Accounts receivable, net	919	(2,008)
Inventories	(22,767)	(12,624)
Prepaid expenses and other assets	(2,263)	(1,028)
Other assets	(85)	(2,413)
Accounts payable	(20,963)	13,805
Accrued expenses and other current liabilities	(1,568)	(7,287)

	Twenty-six weeks ended	
Net cash provided by (used in) operating activities	(18,996)	2,309
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(11,585)	(12,027)
Proceeds from sale of property and equipment		7,834
Receipts (payment) of notes receivable	24	(211)
Acquisition of Oshman's, net of cash acquired		(46,848)
Net cash used in investing activities	(11,561)	(51,252)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term debt	172,234	184,114
Principal payments on long-term debt	(184,006)	(124,929)
Principal payments on capital lease obligations	(315)	(144)
Proceeds from stock offering, net of offering costs	52,145	
Purchase of treasury stock	(9,366)	
Proceeds from the sale of common stock under option plans	2,622	1,667
Net cash provided by financing activities	33,314	60,708
Increase in cash and cash equivalents	2,757	11,765
Cash and cash equivalents at beginning of period	11,536	8,107
Cash and cash equivalents at end of period	$ 14,293	$ 19,872
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest, net	$ 4,093	$ 4,593
Cash paid during the period for income taxes	$ 18	$

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements do not include all information and footnotes necessary for the annual presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America, and should be read in conjunction with the 2001 Annual Report on Form 10-K. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the statement of financial position and the results of operations for the interim periods have been included. The results for the thirteen and twenty-six week periods ended August 3, 2002 are not necessarily indicative of the results to be expected for the full year.

Reclassifications

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

2. ACQUISITION

On June 7, 2001, Gart Sports Company completed its acquisition of Oshman's Sporting Goods, Inc. ("Oshman's"). The consideration consisted of approximately 3.4 million shares of Gart Sports Company common stock valued at approximately $37.8 million and approximately $50.2 million in cash. Oshman's operates as a wholly owned subsidiary of the Company. At the time of the acquisition, Oshman's operated 58 sporting goods specialty stores, including 43 SuperSports USA stores and 15 traditional stores. The acquisition was accounted for under the purchase method of accounting, and accordingly, the statement of operations includes the results of Oshman's since the date of the acquisition.

The total cost of the acquisition has been allocated to the tangible and intangible assets acquired and liabilities assumed based on their respective fair values. The Company's initial recording of the purchase price has been adjusted to give effect to the market value of the Company stock at the time of the announcement of the merger and for changes in estimates made at the time of the initial recording. In compliance with Financial Accounting Standards Board ("FASB") Statement No. 142, the Company no longer amortizes goodwill. The final adjusted allocation of the purchase price is as follows:

Inventory	$	67,336
Other current assets		19,415
Property and equipment, net		22,833
Favorable leases and other long term assets, excluding goodwill		13,364
Goodwill		45,672
Current liabilities		(67,232)
Long term debt		(12,128)
Other long term liabilities		(1,236)
Book value of net assets acquired, including intangibles	$	88,024

The following unaudited pro forma combined financial information presents the combined consolidated results of operations of Gart Sports Company and Oshman's as if the acquisition had occurred as of the beginning of fiscal 2001, after giving effect to certain adjustments, including amortization of favorable leases and goodwill, interest expense, depreciation expense, and related income tax effects. No adjustments have been made to the pro forma statement of operations to

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conform accounting policies and practices or to recognize anticipated cost savings and synergies. The pro forma combined consolidated financial information does not necessarily reflect the results of operations that would have occurred had Gart Sports Company and Oshman's constituted a single entity during such periods.

	Thirteen weeks ended August 4, 2001	Twenty-six weeks ended August 4, 2001
	(Unaudited, in thousands except per share amounts)	
Net Sales	264,757	502,053
Net Income (loss)	569(1)	(3,858)(1)(2)
Basic earnings (loss) per share	0.06(1)	(0.46)(1)(2)
Diluted earnings per share	0.06(1)	

(1)

Includes $3.5 million, before taxes, of integration costs, due to the acquisition of Oshman's.

(2)

Includes $5.2 million, before taxes, of severance expense accrued by Oshman's as part of the acqusition.

3. NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations consummated after June 30, 2001 and establishes criteria for recognizing intangible assets separately from goodwill.

SFAS No. 142 requires that upon adoption, amortization of goodwill and intangible assets deemed to have indefinite lives will cease and instead, the carrying value of goodwill and these intangibles will be evaluated for impairment on an annual basis. In addition, a transitional impairment test is required as of the date of adoption. Other intangible assets will continue to be amortized over their useful lives and periodically reviewed for impairment. The Company adopted SFAS No. 142 for the period commencing February 3, 2002, the beginning of its fiscal 2002. The Company completed its initial impairment analysis of its existing goodwill in the first quarter of fiscal 2002, and determined that no impairment was indicated.

The adoption of SFAS No. 142 did not have a material impact on the Company's consolidated financial position, results of operations, or cash flows in regard to the impairment provisions of the statement while the application of the non-amortization provisions of the statement will result in the cessation of amortization of approximately $1.1 million per year.

Net income and earnings per share for the thirteen and twenty-six weeks ended August 4, 2001 adjusted to exclude amortization expense (net of income taxes) is as follows (in thousands, except per share data):

	13 weeks ended August 4, 2001	**26 weeks ended August 4, 2001**
Reported net income	$ 1,895	$ 2,500
Add back goodwill amortization, net of tax	153	153
Adjusted net income	$ 2,048	$ 2,653
Basic earnings per share:		
Reported net income	$ 0.20	$ 0.30
Add back goodwill amortization, net of tax	0.01	0.01
Adjusted net income	$ 0.21	$ 0.31
Diluted earnings per share:		
Reported net income	$ 0.18	$ 0.27
Add back goodwill amortization, net of tax	0.02	0.02
Adjusted net income	$ 0.20	$ 0.29

The carrying amount of intangible assets is as follows (in thousands):

As of August 3, 2002

	Gross Carrying Amount	Accumulated Amortization
Goodwill	$ 45,672	$ (734)
Favorable leases	13,491	(2,111)
Loan origination fees	4,043	(1,929)
Lease acquisition costs	3,100	(561)
Total	$ 66,306	$ (5,335)

The Company recorded an additional $1,021,000 of goodwill in the 13 weeks ended August 3, 2002 as a result of certain adjustments related to the purchase accounting for the acquisition of Oshman's. During the three months ended August 3, 2002, amortization of intangible assets expense was $756,000. The estimated amortization of intangible assets for each of the five fiscal years ending in fiscal 2006 is as follows (in thousands):

Fiscal Year	Amortization Expense
2002	$ 3,176
2003	$ 2,734
2004	$ 2,302
2005	$ 1,572
2006	$ 1,099

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 addresses certain implementation issues related to SFAS No. 121,

"Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" and establishes a single accounting model, based on the framework established in SFAS No. 121, for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired. The Company adopted this statement on February 3, 2002 and there was not a material impact on results of operations or financial position.

In May 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, 64, Amendment of SFAS No. 13, and Technical Corrections." SFAS No. 145 rescinds FASB No. 4, "Reporting Gains and Losses from Extinguishment of Debt," and an amendment of that statement, SFAS No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements." As a result, gains and losses from extinguishment of debt will no longer be aggregated and classified as an extraordinary item, net of related income tax effect, on the statement of earnings. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002, with earlier application encouraged.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 requires that a liability for a cost associated with an exit or disposal activity is recognized at fair value when the liability is incurred rather than at the date of a commitment to an exit or disposal plan. This statement is effective for exit or disposal activities initiated after December 31, 2002.

4. SHARE REPURCHASE PROGRAM

The Company repurchased 459,999 common shares totaling approximately $9.4 million during the quarter ended August 3, 2002 under a common share repurchase program approved by the Board of Directors. As of August 8, 2002, the Company has authorization from its Board of Directors to repurchase up to an additional $15.1 million of shares.

5. EARNINGS PER SHARE

The following table sets forth the computations of basic and diluted earnings per share (in thousands, except share and per share amounts):

	Thirteen weeks ended		Twenty-six weeks ended	
	August 3, 2002	August 4, 2001	August 3, 2002	August 4, 2001
Net income	$ 6,334	$ 1,895	$ 8,924	$ 2,500
Weighted average shares of common stock outstanding basic	12,282,536	9,529,185	11,562,880	8,447,488
Basic earnings per share	$ 0.52			