

Management's Discussion And Analysis Of Financial Condition And Results Of Operations

Overview

Net sales generated during the last five months of the year can account for over 55% of the Company's net sales and have a significant impact on the Company's results of operations. Because consumers generally purchase a large percentage of the Company's products from September through January, retail dealers generally want delivery of products from June through October for advance orders and from October through December for restocking (or "fill-in") orders. Generally mild or dry weather during the late fall and early winter has a negative impact on the Company's net sales for the current year, while cold or wet weather during such time has a favorable impact. Further, weather conditions in one season can affect future net sales, particularly where weather contributes to high or low dealer inventory levels at the season's end. To satisfy demands for its products and to provide for uniform production levels, the Company generally manufactures its footwear year-round. To assist in production scheduling, the Company's sales force calls on retail dealers from January to July to present the product line, review inventory levels and prepare an advance order. The Company offers price discounts for orders placed prior to August, although advance orders may be canceled at any time. To attempt to balance the flow of shipments and the need for warehouse space, the Company offers extended terms on receivables relating to advance orders to induce retail dealers to allow some shipments of seasonal products prior to the peak shipment period. The advance order terms provide for payment by December 1 (January 1 in the case of Southern dealers). Because of seasonal fluctuations, inventory levels are highest at mid-year and accounts receivable levels are highest during the fourth quarter.

Recently, the Company has introduced a number of new products each year, including sporting and outdoor products. A new product, if successful, often generates growing amounts of net sales during the first three to five years. In some cases, net sales of new products can help to offset adverse factors, such as mild or dry weather or adverse economic conditions. For example, in 1992, the Company's Ice King triple-insulated, high performance boot became broadly available and the Company introduced a new series of rugged outdoor boots, which together offset flat sales in the remainder of the sporting and outdoor product line. The continued growth of the Ice King and the new series of rugged outdoor boots, combined with the successful introduction of five new high performance boots, added to the Company's net sales growth.

In 1992, the Company entered into new employment-related agreements with the then president of the Company, which resulted in increased operating expenses for phantom stock compensation and related costs. In 1993, the Company and the officer amended one of the agreements, resulting in a one-time charge of \$1.0 million in 1993. Pursuant to the amended agreement, the officer received approximately 4% of the Company's pre-tax profits for 1994. The phantom stock agreement terminated on December 31, 1995 and there will be no future charges related to this agreement.

Results Of Operations

The following table shows the percentage relationship to net sales of items derived from the Consolidated Statements of Income and the percentage change from year to year.

Year ended December 31	Percentage of Net Sales			Percentage of Increase (Decrease)	
	1995	1994	1993	1995 vs.1994	1994 vs.1993
Net sales	100.0%	100.0%	100.0%	(9)%	31%
Cost of goods sold	73.1	71.4	70.9	(7)	32
Gross profit	26.9	28.6	29.1	(14)	29
Selling and					
administrative expenses	(20.1)	(17.7)	(18.1)	4	28
Phantom stock compensation	(.1)	(.5)	(2.2)	(85)	(68)
Operating Income	6.7	10.4	8.8	(41)	55
Interest expense	(1.5)	(1.4)	(1.7)	(5)	6
Other income.....	.3	.3	.2	(19)	79
Income before income taxes	5.5	9.3	7.3	(45)	67
Income taxes	(2.1)	(3.6)	(2.8)	(45)	69
Net income	3.4%	5.7%	4.5%	(46)%	66%

Year Ended December 31, 1995 Compared To Year Ended December 31, 1994

Net Sales. Net sales in 1995 decreased \$9.7 million, or 9%, to \$98.6 million from \$108.3 million in 1994 despite a \$3.0 million increase in sales of Danner products due to including Danner results for the entire year of 1995. The decrease in net sales was primarily due to the mild winter weather conditions during the 1994/95 winter which reduced the demand for LaCrosse protective footwear and left dealers with carryover inventory. The primary products affected were rubber or vinyl bottom/leather top cold weather boots. Net sales under government contracts were down \$2.3 million, as a result of the completion of a government contract in 1994.

Gross Profit. Gross profit as a percentage of net sales in 1995 decreased to 26.9% from 28.6% in 1994. Margins on LaCrosse products were down primarily as a result of lower production levels and increases in raw material costs (primarily crude rubber) in excess of plan. Margins on Danner products were down due to lower than planned production levels and start-up costs associated with new products.

Selling and Administrative Expenses. Selling and administrative expenses in 1995 increased \$.7 million, or 4%, compared to 1994 primarily due to a \$900,000 increase in expenses reported for Danner in 1995 as compared to 1994 when expenses were included from the date of acquisition of March 14, 1994. As a percent of sales, operating expenses increased from 17.7 % in 1994 to 20.1% in 1995 primarily due to the reduced sales volume of LaCrosse products and an additional \$300,000 of planned marketing and advertising expense in support of our dealers.

Phantom Stock Compensation. Phantom stock compensation in 1995 decreased \$493,000, to \$85,000, or .1% of net sales, from \$578,000, or .5% of net sales in 1994. The decrease was due to the lower level of profitability in 1995 as compared to 1994.

Interest Expense. Interest expense in 1995 decreased \$72,000, or 5%, as compared to 1994. The decrease was primarily the result of lower short-term interest rates.

Income Tax Expense. The Company's effective income tax rate in 1995 increased to 39.2% from 38.7% in 1994 primarily due to a slight increase in non-deductible expenses and a higher effective state income tax rate.

Year Ended December 31, 1994 Compared To Year Ended December 31, 1993

Net Sales. Net sales in 1994 increased \$25.9 million, or 31%, to a record \$108.3 million from \$82.4 million in 1993. Net sales growth was primarily due to the acquisition of Danner Shoe Manufacturing Co. on March 14, 1994 which contributed \$17.1 million in net sales and an increase in net sales of rubber or vinyl bottom/leather top boots. Cold and wet weather conditions in late 1993 and early 1994 along with new product introductions contributed to the increased net sales of the sporting and outdoor leather top boots. Additional net sales growth occurred in occupational footwear products, as a result of the addition of a major industrial distributor in late 1993, and in children's boots.

Gross Profit. Gross profit as a percentage of net sales in 1994 decreased to 28.6% from 29.1% in 1993 despite the addition of the Danner business at a slightly higher gross profit percentage. Margins on the LaCrosse products were down due to increased sales through large national accounts at slightly lower margins, increases in raw material costs in the second half of the year and increases in manufacturing overhead costs somewhat in excess of production level increases.

Selling and Administrative Expenses. Selling and administrative expenses in 1994 increased \$4.2 million, or 28.%, compared to 1993, but declined as a percent of net sales from 18.1% in 1993 to 17.7% in 1994. Approximately \$3.4 million of the 1994 increase results from the Danner Shoe Mfg. Co. acquisition with the balance occurring mainly in direct selling expenses corresponding to the increase in volume.

Phantom Stock Compensation. Phantom stock compensation in 1994 decreased \$1.2 million, to \$.6 million, or .5% of net sales, from \$1.8 million, or 2.2% of net sales, in 1993. The decrease was primarily due to amending the phantom stock agreement in December 1993 which resulted in a one-time charge of \$1.0 million in 1993 and reduced charges for 1994 and 1995.

Interest Expense. Interest expense in 1994 increased \$86,000, or 6%, as compared to 1993. The increase was primarily a result of bank borrowings to finance the Danner purchase from March 14, 1994 until the completion of the initial public offering and higher short-term interest rates.

Income Tax Expense. The Company's effective income tax rate in 1994 increased to 38.7% from 38.2% in 1993 primarily because of an increase in the taxable income taxed at the 35% maximum rate and an increase in non-deductible expenses due to a change in the tax law for 1994.

Liquidity And Capital Resources

The Company has historically financed its operations with cash generated from operations, long-term lending arrangements and short-term borrowings under its line of credit. The Company requires working capital primarily to support fluctuating accounts receivable and inventory levels caused by the Company's seasonal business cycle. The Company's working capital needs are lowest in the first quarter and highest in the third quarter. The Company invests excess cash balances in short-term investment grade securities or money market investments.

Consolidated Balance Sheets

In Thousands - Year Ended December 31

1995

1994

Assets


Current Assets

Cash and cash equivalents	\$ 3,036	\$ 4,743
Trade accounts receivable, less allowances of \$.8 and \$.7 million	15,563	15,656
Inventories ~ Note 3	26,007	25,071
Prepaid expenses and deferred tax assets ~ Note 4	3,281	2,699
Total current assets	47,887	48,169

Property And Equipment

Land and land improvements and buildings	5,818	5,494
Machinery and equipment	20,994	17,568
.....	26,812	23,062
Less accumulated depreciation and amortization	14,964	12,463
.....	11,848	10,599

Other Assets

Goodwill, net of amortization of \$.9 million and \$.4 million	13,653	14,137
Deferred tax and other assets ~ Note 4	1,474	1,917
.....	\$74,862	\$74,822

Liabilities And Common Shareholders' Equity

Current Liabilities

Current maturities of long-term obligations ~ Note 5	\$ 1,761	\$ 1,758
Accounts payable	4,812	4,430
Accrued expenses ~ Note 9	5,644	5,904
Dividends payable	629	634
Income taxes payable	504	61
Total current liabilities	13,350	12,787

Long-Term Obligations ~ Note 5

4,893 7,340

Deferred Compensation ~ Note 7

2,042 2,489

Accrued Postretirement Benefit Cost ~ Note 12

1,298 1,095

Total Liabilities


21,583 23,711

Commitments And Contingencies ~ Notes 2, 6, 7, 8, 11 and 12

Redeemable Preferred Stock, at redemption price ~ Note 8

1,957 1,957

Common Shareholders' Equity

Common stock, par value \$.01 per share; authorized 50,000,000 shares; issued and outstanding, 6,667,627 and 6,717,627 shares, respectively ~ Notes 2, 8 and 10	67	67
Additional paid-in capital	27,579	27,579
Retained earnings ~ Note 5	24,119	21,508
Less cost of 50,000 shares of treasury stock ~ Note 8	(443)	—
Total common shareholders' equity	51,322	49,154
.....	\$74,862	\$74,822

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements**Note 1. Nature of Business and Significant Accounting Policies****Nature of business**

The Company designs, manufactures, and markets premium quality protective footwear for sale principally throughout the United States. The Company grants credit to its customers who are primarily domestic retail stores, direct mail catalog merchants, wholesalers, industrial and private label customers. No customer accounted for greater than 10% of net sales for any of the periods presented.

Significant accounting policies

Principles of consolidation: The consolidated financial statements include the accounts of LaCrosse Footwear, Inc. and its wholly owned subsidiaries, (the "Company"). All material intercompany accounts and transactions have been eliminated in consolidation.

Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair value of financial instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments: The carrying amount of cash and cash equivalents approximates fair value because of the short maturity of those investments.

The carrying amount of long-term debt and redeemable preferred stock approximates fair value based on the interest rates, maturities and collateral requirements currently available for similar financial instruments.

Concentrations of credit risk

The Company grants credit to customers based on an evaluation of the customer's financial condition. Exposure to losses on receivables is principally dependent on each customer's financial condition. The Company monitors its exposure for credit losses and maintains an allowance for anticipated losses.

Cash and cash equivalents

The Company considers all highly liquid debt instruments (including short-term investment grade securities and money market instruments) purchased with maturities of three months or less to be cash equivalents. The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Inventories

Inventories are stated at the lower of cost or market. All inventories, except for vinyl products, boot liners, leather boots and leather boot components, are valued using the last-in, first-out (LIFO) method. Vinyl products, boot liners, leather boots and leather boot components, are valued using the first-in, first-out (FIFO) method.

Property and equipment

Property and equipment are carried at cost and are being depreciated over their estimated useful lives using straight-line and accelerated methods.

Intangible assets

Goodwill, representing the excess of cost over net assets acquired in the Danner acquisition, is being amortized on a straight-line basis over 30 years. The Company reviews its intangibles periodically to determine potential impairment by comparing the carrying value of the intangibles with expected future net cash flows provided by operating activities of the business. Should the sum of the expected future net cash flows be less than the carrying value, the Company would determine whether an impairment loss should be recognized. An impairment loss would be measured by comparing the amount by which the carrying value exceeds the fair value of the intangible based on appraised market value.

Revenue recognition

Revenue is recognized at the time footwear products are shipped to customers. Revenue is recorded net of freight, estimated discounts and returns.

Income taxes

Deferred taxes are provided on a liability method in accordance with FASB Statement No. 109 whereby deferred tax assets and liabilities are recognized for temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Earnings per common and common equivalent share

Per share earnings are based on the weighted average number of common and common equivalent shares outstanding during each year, after reducing net income by dividends on preferred stock. Common equivalent shares consist principally of the dilutive effect, where material, of common stock options.



Note 2. Acquisition


In March 1994, the Company acquired substantially all of the assets of Danner Shoe Manufacturing Co. for \$13.5 million in cash, 277,778 shares of the Company's common stock valued at \$13 per share and the assumption of approximately \$4.4 million in liabilities for an aggregate purchase price of approximately \$21.5 million. The Company used short-term borrowings of approximately \$12.9 million and available cash as the source of funds to make the cash payment and to repay certain assumed liabilities. The acquisition agreement provides that in the event the cash and aggregate market value of the common stock (valued as of March 1, 1999) delivered in the Danner acquisition is less than \$18.0 million, the Company will make an additional cash payment on March 1, 1999 equal to the difference. If the Danner shareholders have the opportunity to sell their common stock under a Company-filed registration statement or under Rule 144 promulgated under the Securities Act of 1933, as amended, and choose not to sell after receiving a Company request to sell, then the Company's obligation can be reduced or eliminated to the extent of the number of shares permitted to be sold based upon the then prevailing market price for the common stock. The Company has also guaranteed that Danner's shareholders will realize, by March 31, 1999, after-tax proceeds from this transaction of not less than \$10.0 million. The acquisition has been accounted for as a purchase. Accordingly, the purchase price is being allocated to assets and liabilities based on their estimated fair values as of the date of acquisition and the cost in excess of net assets acquired of approximately \$14.5 million is being amortized on a straight-line basis over a 30-year term.

The Company's consolidated statement of income for the year ended December 31, 1994 includes Danner's results of operations since its acquisition on March 14, 1994. The following unaudited pro forma information presents the consolidated results of operations as if the acquisition had occurred as of the beginning of 1993 and does not purport to be indicative of what would have occurred had the acquisition been made as of that date or of results which may occur in the future.

In Thousands, Except For Earnings Per Share ~ Year Ended December 31	1994	1993
Net sales	\$ 111,501	\$ 97,436
Net income	6,162	4,177
Earnings per common and common equivalent share .....	.97	.82

Note 3. Inventories


A summary of inventories is as follows:

In Thousands ~ Year Ended December 31	1995	1994
Finished goods at: FIFO	\$ 4,940	\$ 3,939
Finished goods at: LIFO	13,431	12,130
.....	18,371	16,069
Work-in process at: FIFO	871	1,093
Work-in process at: LIFO	1,051	1,258
.....	1,922	2,351
Raw materials at: FIFO	3,954	3,673
Raw materials at: LIFO	1,760	2,978
.....	5,714	6,651
 Total inventories	\$ 26,007	\$ 25,071

If all inventories were valued on the FIFO method, total inventories for 1995 and 1994 would have been \$30.1 and \$27.8 million, respectively.

Note 4. Income Tax Matters

Net deferred tax assets and liabilities consist of the following components:

In Thousands ~ Year Ended December 31	1995	1994
Deferred tax assets:		
Receivable allowances	\$ 366	\$ 221
Inventory differences	493	421
Property and equipment	—	45
Deferred compensation	806	970
Accrued compensation and benefits	855	826
Accrued insurance reserves and other	497	280
.....	3,017	2,763
Deferred tax liabilities:		
Amortization of intangibles	354	180
Pension and retirement benefits	158	155
Property and equipment	15	—
.....	527	335
.....	\$ 2,490	\$ 2,428




The components giving rise to the net deferred tax assets described above have been included in the accompanying consolidated balance sheets as follows:


In Thousands - Year Ended December 31	1995	1994
Current assets	\$1,621	\$1,284
Noncurrent assets	869	1,144
.....	\$2,490	\$2,428

No valuation allowance is required on the deferred tax assets as of December 31, 1995 and 1994.

The provision for income taxes consists of the following:

In Thousands - Year Ended December 31	1995	1994	1993
Current:			
Federal	\$1,723	\$3,539	\$2,732
State	482	579	534
Deferred	(62)	(239)	(975)
.....	\$2,143	\$3,879	\$2,291

The differences between statutory federal tax rates and the effective tax rates are as follows:


Year Ended December 31	1995	1994	1993
Statutory federal tax rate	35.0%	35.0%	34.0%
State taxes, net of federal tax benefit	4.5	3.8	4.0
Other	(0.3)	(0.1)	0.2
 Effective tax rate	39.2%	38.7%	38.2%

Note 5. Financing Arrangements

Line of Credit

The Company has a \$30 million unsecured bank revolving line of credit which expires on December 31, 1997 of which \$10 million can be used to support letters of credit. At December 31, 1995, the Company qualified for an interest rate of LIBOR plus .75%. The loan agreement contains various covenants including minimum consolidated tangible net worth, sale of assets, indebtedness, current ratio and leverage ratio. The revolving line of credit is used to finance peak inventory and accounts receivable levels and commitments for letters of credit. At December 31, 1995 and 1994, there were no amounts outstanding under this facility but there were letter of credit commitments outstanding of \$2.7 and \$4.2 million, respectively.

Long-term obligations

In Thousands - Year Ended December 31	1995	1994
10.26% unsecured note payable, due in annual installments of \$1.4 million excluding interest, interest payable semi-annually (a)	\$5,143	\$7,143
10.73% unsecured note payable, due in annual installments of \$.3 million excluding interest, interest payable semi-annually (a)	1,028	1,428
Other	483	527
.....	6,654	9,098
Less current maturities	1,761	1,758
.....	\$4,893	\$7,340

(a) The loan agreement contains various covenants including minimum tangible net worth, working capital, current ratio, permitted indebtedness, net income before income taxes to interest expense and total permitted investments and restricted payments. Retained earnings available for dividends under these agreements amount to approximately \$8.3 million at December 31, 1995.

Long-term obligations at December 31, 1995 mature as follows:

In Thousands - Year Ended December 31	Amount
1996	\$1,761
1997	1,759
1998	1,829
1999	1,061
2000	27
Later years	217

