K2 INC
Form 10-Q
May 06, 2005

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 March 31, 2005

Commission File No. 1-4290

K2 INC.

(Exact name of registrant as specified in its charter)

Delaware **(State of Incorporation)**	**95-2077125** **(I.R.S. Employer Identification No.)**
5818 El Camino Real	
Carlsbad, California **(Address of principal executive offices)**	**92008** **(Zip Code)**

Registrant s telephone number, including area code (760) 494-1000

Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report:

Not applicable

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x No ¨

At April 30, 2005, there were 47,559,257 shares of common stock ($1.00 par value) outstanding.

PART - 1 FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

CONSOLIDATED CONDENSED STATEMENTS OF INCOME (Unaudited)

(Thousands, except per share figures)

	Three months ended March 31	
	2005	**2004**
	(unaudited)	
Net sales	$ 318,291	$ 277,364
Cost of products sold	215,472	190,731
Gross profit	102,819	86,633
Selling expenses	58,715	42,047
General and administrative expenses	34,093	25,064
Operating income	10,011	19,522
Interest expense	7,253	3,302
Other income, net	(721)	(53)
Income before income taxes	3,479	16,273
Provision for income taxes	1,155	5,533
Net income	$ 2,324	$ 10,740
Basic earnings per share:		
Net income	$ 0.05	$ 0.31
Diluted earnings per share:		
Net income	$ 0.05	$ 0.27
Basic shares outstanding	46,177	34,353
Diluted shares outstanding	47,502	43,099

See notes to consolidated condensed financial statements.

CONSOLIDATED CONDENSED BALANCE SHEETS

(Thousands, except number of shares)

	March 31 2005	December 31 2004
	(Unaudited)	
Assets		
Current Assets		
Cash and cash equivalents	$ 39,868	$ 25,633
Accounts receivable, less allowances for doubtful accounts of $16,577 (2005) and $14,895 (2004)	310,425	369,914
Inventories, net	345,160	325,125
Deferred income taxes	21,990	29,709
Prepaid expenses and other current assets	25,190	22,775
Total current assets	742,633	773,156
Property, plant and equipment	277,617	272,959
Less allowance for depreciation and amortization	136,748	131,995
	140,869	140,964
Other Assets		
Goodwill	343,247	349,760
Tradenames	141,029	137,329
Other intangible assets, net	21,457	21,276
Deferred income taxes	7,506	7,506
Other	24,438	26,374
Total Assets	$ 1,421,179	$ 1,456,365
Liabilities and Shareholders Equity		
Current Liabilities		
Bank loans	$ 9,468	$ 31,490
Accounts payable	78,878	103,158
Income taxes payable	25,938	28,386
Accrued payroll and related	64,927	67,443
Other accruals	85,069	83,624
Current portion of long-term debt	35,650	35,074
Total current liabilities	299,930	349,175
Long-term pension liabilities	16,854	16,854
Long-term debt	274,255	250,812
Deferred income taxes	50,746	58,123
Convertible subordinated debentures	98,652	98,535
Commitments and Contingencies		
Shareholders Equity		
Preferred Stock, $1 par value, authorized 12,500,000 shares, none issued		
Common Stock, $1 par value, authorized 110,000,000 shares, issued and outstanding shares - 47,559,257 in 2005 and 47,543,108 in 2004	47,559	47,543
Additional paid-in capital	502,484	502,322
Retained earnings	148,882	146,558
Treasury shares at cost, 747,234 shares in 2005 and 2004	(9,107)	(9,107)
Accumulated other comprehensive loss	(9,076)	(4,450)
Total Shareholders Equity	680,742	682,866

Total Liabilities and Shareholders Equity	$ 1,421,179	$ 1,456,365

See notes to consolidated condensed financial statements.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

(Thousands)

	Three months ended March 31	
	2005	2004
	(unaudited)	
Operating Activities		
Net Income	$ 2,324	$ 10,740
Adjustments to reconcile net income from operations to net cash provided by operating activities:		
Depreciation and amortization	8,406	6,073
Deferred taxes	341	4,489
Changes in current assets and current liabilities	7,097	(14,825)
Net cash provided by operating activities	18,168	6,477
Investing Activities		
Property, plant & equipment expenditures	(6,757)	(6,782)
Disposals of property, plant & equipment	222	273
Purchase of business, net of cash acquired	(152)	1,780
Other items, net	500	(162)
Net cash used in investing activities	(6,187)	(4,891)
Financing Activities		
Borrowings under long-term debt	294,000	172,000
Payments of long-term debt	(269,864)	(173,732)
Net decrease in short-term bank loans	(22,022)	(5,197)
Exercise of stock options	140	3,873
Net cash provided by (used in) financing activities	2,254	(3,056)
Net increase (decrease) in cash and cash equivalents	14,235	(1,470)
Cash and cash equivalents at beginning of year	25,633	21,256
Cash and cash equivalents at end of period	$ 39,868	$ 19,786

See notes to consolidated condensed financial statements.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

March 31, 2005

NOTE 1 Basis of Presentation

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States 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 footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005.

The consolidated condensed balance sheet at December 31, 2004 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

K2 reports its financial statements using a 13 week quarter ending on the last Sunday of March, June, September and December. For purposes of the consolidated financial statements, the end of each quarter is stated as of March 31, June 30, September 30 and December 31, respectively.

The interim financial statements should be read in connection with the financial statements in K2 Inc. s (K2 s) Annual Report on Form 10-K for the year ended December 31, 2004.

NOTE 2 Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (Revised) *Share-Based Payment.* SFAS No. 123 (Revised) requires that companies recognize compensation expense equal to the fair value of stock options or other share based payments. The impact on K2 s net income will include the remaining amortization of the fair value of existing options currently disclosed as pro-forma expense in Note 3 and is contingent upon the number of future options granted, the selected transition method and the selection of either the Black-Scholes or the binominal lattice model for valuing options.

On April 14, 2005, the SEC adopted a new rule that amended the compliance dates of SFAS No. 123 (Revised) to require implementation no later than the beginning of the first fiscal year beginning after June 15, 2005 (the year beginning January 1, 2006 for K2). Early adoption of SFAS No. 123 (Revised) is permissible. K2 is in the process of evaluating the use of certain option-pricing models as well as the assumptions to be used in such models. When such evaluation is complete, K2 will determine the transition method to use, the timing of adoption and the impact any change in valuation models might have.

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K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 3 Stock Based Compensation

K2 currently applies the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation,* which allows entities to continue to apply the provisions of Accounting Principles Board (APB) Opinion No. 25 *Accounting for Stock Issued to Employees,* and related interpretations and provide pro forma net income and pro forma net income per share disclosures for employee stock option grants made as if the fair-value-based method defined in SFAS No. 123 had been applied. K2 has elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure provisions of SFAS No. 123. As such, compensation expense for stock options issued to employees is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Had compensation cost been determined based upon the fair value at the grant date for K2 s stock options under SFAS No. 123 using the Black Scholes option pricing model, pro forma net income and pro forma net income per share, including the following weighted average assumptions used in these calculations, would have been as follows:

	For the three months ended March 31,	
	2005	2004
	(Thousands, except per share data, percentages and years)	
Net income as reported	$ 2,324	$ 10,740
Add: Total stock-based compensation expense included in net income, net of taxes	83	
Less: Total stock-based compensation expense determined under fair value, based method for all awards, net of taxes	(745)	(199)
Net income, adjusted	$ 1,662	$ 10,541
Earnings per share:		
Basic-as reported	$ 0.05	$ 0.31
Basic-pro forma	$ 0.04	$ 0.31
Diluted-as reported	$ 0.05	$ 0.27
Diluted-pro forma	$ 0.03	$ 0.27
Risk free interest rate	2.55%	3.04%
Expected life of options	5 years	5 years
Expected volatility	44.2%	47.3%
Expected dividend yield		

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 3 Stock Based Compensation (Continued)

The pro forma amounts may not be representative of future disclosures since the estimated fair value of stock options is amortized to expense over the vesting period and additional options may be granted in future years. Since changes in the subjective assumptions used in the Black-Scholes model can materially affect the fair value estimate, management believes the model does not provide a reliable measure of the fair value of its options.

NOTE 4 Inventories

The components of inventories consisted of the following:

	March 31, 2005	December 31, 2004
	(Thousands)	
Finished goods	$ 249,831	$ 237,162
Work in process	17,203	15,389
Raw materials	78,126	72,574
	$ 345,160	$ 325,125

Note 5 Acquisitions

At March 31, 2005, there was approximately $6.1 million of cash and 612,466 shares of K2 common stock held in escrow or due for payment in 2005 relating to certain acquisitions. The cash and shares will be released from escrow during 2005 through 2008 subject to final agreement between the K2 and the selling parties. The cash and shares in escrow as well as future cash payments due in 2005 have been reflected in the purchase price of the related acquisition. The shares held in escrow are reflected in the calculation of diluted earnings per share for the quarter ended March 31, 2005.

During 2004, K2 completed nine acquisitions, including the acquisitions of Fotoball USA, Inc. (later renamed K2 Licensing & Promotions, Inc.) on January 23, 2004, Ex Officio on May 12, 2004, Marmot on June 30, 2004 and Völkl and Marker on July 7, 2004 as well as five smaller acquisitions completed after March 31, 2004.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

Note 5 Acquisitions (Continued)

The consolidated condensed statements of income for the three months ended March 31, 2005 includes the operating results of each of the businesses acquired in 2004, however the consolidated condensed statements of income for the three months ended March 31, 2004 does not include the results of Ex Officio, Marmot, Völkl and Marker or K2 s other acquisitions completed after the 2004 first quarter since these companies were acquired by K2 subsequent to March 31, 2004. In addition, the 2004 first quarter results include less than a full three months of results of K2 Licensing & Promotions which was acquired by K2 on January 23, 2004.

The following summarized unaudited pro forma results of operations of K2 assume the acquisitions of Marmot and Völkl and Marker had occurred as of January 1, 2004, the earliest date for which information is presented below. This pro forma information does not purport to be indicative of what would have occurred had the acquisitions been made as of those dates, or of results which may occur in the future. Pro forma results of operations of K2 s other acquisitions completed during 2004 have not been presented because the effects of these additional acquisitions were not material on either an individual basis or aggregate basis to K2 s consolidated results of operations.

Pro Forma Information (Unaudited)

(Thousands, except per share amounts)

	For the three months ended March 31,	
	2005	2004
Net sales	$ 318,291	$ 316,392
Operating income	10,011	14,635
Net income	2,324	6,276
Diluted earnings per share	$ 0.05	$ 0.15

Pursuant to the acquisitions made by K2 during 2004 and 2003, K2 approved restructuring and exit plans related to the closure of certain facilities of the acquired companies. In accordance with Emerging Issues Task Force (EITF) 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination,* K2 established reserves for employee severance, employee relocation costs and lease termination costs totaling approximately $11.0 million and $5.1 million, during 2004 and 2003, respectively. These reserves were recognized as assumed liabilities of the acquired companies. The reserves established were not individually significant to any of K2 s acquisitions during 2004 or 2003.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

Note 5 Acquisitions (Continued)

The following table summarizes the activity in 2004 and 2005:

	Employee Severance	Employee Relocation	Subtotal	Lease Termination Costs	Total
			(Thousands)		
Balance at December 31, 2003	$ 2,411	$ 816	$ 3,227	$ 1,203	$ 4,430
Reserves established in conjunction with 2004 acquisitions	6,968	40	7,008	4,034	11,042
Adjustments to reserve estimates (reflected as an adjustment of the cost of the acquired companies)	(974)		(974)		(974)
Utilized in 2004:	(1,415)	(488)	(1,903)	(40)	(1,943)
Balance at December 31, 2004	6,990	368	7,358	5,197	12,555
Utilized in 2005:	(414)	(69)	(483)	(116)	(599)
Balance at March 31, 2005	$ 6,576	$ 299	$ 6,875	$ 5,081	$ 11,956

K2 believes that the remaining reserves for restructuring are adequate to complete its restructuring and exit plans.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 6 Intangible Assets and Goodwill

The components of intangible assets and goodwill consisted of the following:

		March 31, 2005			December 31, 2004		
	Weighted Average Useful Life	Gross Amount	Accumulated Amortization	Net Book Value	Gross Amount	Accumulated Amortization	Net Book Value
				(Thousands)			
Intangibles subject to amortization:							
Patents	8.3 years	$ 14,830	$ 3,536	$ 11,294	$ 14,142	$ 3,161	$ 10,981
Customer contracts/relationships	8.3 years	8,147	1,767	6,380	8,139	1,488	6,651
Licensing agreements	5.2 years	2,795	990	1,805	2,795	868	1,927
Tradenames/trademarks	7.1 years	955	167	788	955	128	827
Non-compete agreements	3.9 years	1,567	315	1,252	1,347	212	1,135
Order backlog and other	0.5 years	2,040	2,102	(62)	1,040	1,285	(245)
		30,334	8,877	21,457	28,418	7,142	21,276
Intangibles not subject to amortization: (by segment)							
Tradename							
Marine and Outdoor		352		352	352		352
Team sports		37,387		37,387	33,687		33,687
Action sports		81,690		81,690	81,690		81,690
Footwear and Apparel		21,600		21,600	21,600		21,600
Goodwill							
Marine and Outdoor		22,845		22,845	22,853		22,853
Team sports		83,438		83,438	88,722		88,722
Action sports		154,990		154,990	156,211		156,211
Footwear and Apparel		81,974		81,974	81,974		81,974
		484,276		484,276	487,089		487,089
Total intangibles		$ 514,610	$ 8,877	$ 505,733	$ 515,507	$ 7,142	$ 508,365

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 6 Intangible Assets and Goodwill (Continued)

The table below shows the activity in intangibles subject to and not subject to amortization for the three months ended March 31, 2005, including the preliminary purchase price allocation completed by K2 during the 2005 first quarter relating to an acquisition completed by K2 in the 2004 fourth quarter. The preliminary purchase price allocation was based on an independent third party valuation. The final allocation of the purchase price of this transaction will be completed by K2 during the 2005 second quarter.

	December 31, 2004 Net Book Value	Preliminary Purchase Price Allocation	Other Activity	Amortization	March 31, 2005 Net Book Value
Intangibles subject to amortization:					
Patents	$ 10,981	$ 410	$ 278	$ (375)	$ 11,294
Customer contracts/relationships	6,651	8		(279)	6,380
Licensing agreements	1,927			(122)	1,805
Tradenames/trademarks	827			(39)	788
Non-compete agreements	1,135	220		(103)	1,252
Order backlog and other	(245)	1,000		(817)	(62)
	21,276	1,638	278	(1,735)	21,457
Intangibles not subject to amortization: (by segment)					
Tradename					
Marine and Outdoor	352				352
Team Sports	33,687	3,700			37,387
Action Sports	81,690				81,690
Apparel and Footwear	21,600				21,600
Goodwill					
Marine and Outdoor	22,853		(8)		22,845
Team Sports	88,722	(5,125)	(159)		83,438
Action Sports	156,211		(1,221)		154,990
Apparel and Footwear	81,974				81,974
	487,089	(1,425)	(1,388)		484,276
Total intangibles	$ 508,365	$ 213	$ (1,110)	$ (1,735)	$ 505,733

Amortization expense for intangibles subject to amortization was approximately $1.7 million for the three months ended March 31, 2005. Amortization expense of purchased intangible assets subject to amortization is estimated to be approximately $4.5 million during fiscal year ending 2005, $3.7 million during 2006, $3.5 million during 2007, $3.4 million during 2008 and $2.1 million during 2009.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 6 Intangible Assets and Goodwill (Continued)

Based on the results of the annual impairment tests, K2 determined that no impairment of goodwill existed as of December 31, 2004 and no indicators of impairment were present during the three months ended March 31, 2005. However, future goodwill impairment tests could result in a charge to earnings. K2 will continue to evaluate goodwill on an annual basis or whenever events and changes in circumstances indicate that there may be a potential impairment.

K2 has evaluated the remaining useful lives of its finite-lived purchased intangible assets to determine if any adjustments to the useful lives were necessary or if any of these assets had indefinite lives and were therefore not subject to amortization. K2 determined that no adjustments to the useful lives of its finite-lived purchased intangible assets were necessary.

NOTE 7 Warranties

K2 records the estimated cost of product warranties at the time sales are recognized. K2 estimates warranty obligations by reference to historical product warranty return rates, material usage and service delivery costs incurred in correcting the product. Should actual product warranty return rates, material usage or service delivery costs differ from the historical rates, revisions to the estimated warranty liability would be required.

The following activity related to product warranty liabilities:

	Three Months Ended March 31	
(Thousands)	**2005**	**2004**
Beginning Balance	$ 9,691	$ 5,526
Charged to costs and expenses	2,226	1,531
Amounts charged to reserve	(2,593)	(1,537)
Ending Balance	$ 9,324	$ 5,520

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 8 Borrowings and Other Financial Instruments

At March 31, 2005, K2 s principal long-term borrowing facility was a five-year, $250 million revolving Credit Facility (Facility) expiring on July 1, 2009 with several banks and other financial institutions. The Facility is expandable to $350 million subject to certain conditions. The Facility has a $100 million limit for the issuance of letters of credit. Borrowings under the Facility are secured by all of K2 s assets in the United States, Canada and England. Actual borrowing availability under the Facility is based on K2 s trade receivable and inventory levels in the United States, Canada and England, subject to eligibility criteria and defined advance rates. Borrowings under the Facility are subject to an interest rate grid, but as of March 31, 2005 bear a rate equal to the prime rate, or a LIBOR interest rate plus 1.75%, and the Facility had an unused commitment fee of 0.375% per year. The Facility includes various covenants, including requirements that K2 maintain a minimum debt service coverage ratio, as well as limiting annual capital expenditures, indebtedness, dividends and certain investment activities. On March 18, 2005, K2 obtained an amendment to its Facility allowing K2 to make up to $50 million in repurchases of K2 common stock provided that unused borrowing availability under the facility is at least $50 million after such repurchases.

At March 31, 2005, borrowings of $88.0 million were outstanding under the Facility bearing an average interest rate of 4.79%. At March 31, 2005, there were also letters of credit outstanding under the Facility of $15.6 million (consisting of $13.8 million of standby letters of credit and $1.8 million of trade letters of credit expiring over the next 12 months). K2 has classified $32.5 million of seasonal borrowings outstanding under the Facility at March 31, 2005 as current. Pursuant to the terms of the Facility, an additional $145.3 million was available for borrowing at March 31, 2005.

At March 31, 2005, K2 also had $25.0 million of 7.25% convertible subordinated debentures (7.25% Debentures) due March 2010. The 7.25% Debentures are convertible into 2,097,315 shares of K2 common stock at a conversion price of $11.92 per share. Pursuant to the agreement for these debentures, the noteholders received warrants to purchase 243,260 and 524,329 additional shares of K2 s common stock at exercise prices of $13.143 and $11.92 per share, respectively, exercisable within the three and five year period ended February 14, 2006 and February 14, 2008, respectively (the Warrants). K2 assigned a total fair market value of $2,303,000 to the Warrants. At March 31, 2005, the aggregate unamortized fair market value of $1,348,000 is reflected as a reduction of the face amount of the 7.25% Debentures on K2 s balance sheet which is being amortized to interest expense using the effective interest method through the exercise periods, thereby increasing the carrying value of the debentures.

At March 31, 2005, K2 also had $75 million of 5.00% convertible senior debentures (5% Debentures) due June 2010. The 5% Debentures are convertible into 5,706,458 shares of K2 common stock at a conversion price of $13.143 per share. The debentures are redeemable by K2 in whole or in part at K2 s option on or after June 15, 2008 at a redemption price of 101.429% beginning on June 15, 2008 and ending on June 14, 2009, and at 100.714% beginning on June 15, 2009 and ending on June 14, 2010.

At March 31, 2005, K2 also had $200.0 million of 7.375% senior, unsecured notes (Senior Notes) due July 1, 2014. The Senior Notes are redeemable by K2 in whole or in part at K2 s option at any time prior to July 1, 2009 at a price equal to 100% of the principal amount plus accrued and unpaid interest plus a make-whole premium as defined in the indenture. Thereafter, K2 may redeem all or a portion of the notes at the redemption prices set forth in the indenture. The Senior Notes include various incurrence covenants, including limitations on indebtedness, restricted payments and sales of assets.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 8 Borrowings and Other Financial Instruments (Continued)

At March 31, 2005, K2 also had $31.3 million outstanding under various foreign lending arrangements.

NOTE 9 Pension Plans

K2 sponsors several trusteed non-contributory defined benefit pension plans covering about 850 of its domestic employees. Benefits are generally based on years of service and the employee s highest average compensation for five consecutive years during the years of credited service. Contributions are intended to provide for benefits attributable to service to date and service expected to be provided in the future. K2 funds these plans in accordance with the Employee Retirement Income Security Act of 1974.

Effective August 31, 2004, the domestic pension plans (the plans) were amended to freeze the accrual of future benefits for almost all of the employees. This resulted in active participants no longer accruing benefits under the plans. Participants will remain eligible to receive benefits they have earned under the plans through August 31, 2004 when they retire. New employees will not be eligible to accrue any benefit under the plans. Only a small group of about 20 employees subject to a collective bargaining agreement will continue to accrue a benefit. The impact of this plan change on K2 s benefit costs is a one-time recognized curtailment loss of $0.4 million in the 2004 third quarter. The impact on future benefit costs is the elimination of the service cost and an $8.0 million reduction of the projected benefit obligation for future pay increases. This plan change has further resulted in an estimated reduction in net periodic pension costs for the 2005 year of $2.8 million.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 9 Pension Plans (Continued)

The components of net periodic pension cost consisted of the following:

(Thousands)	For the three months ended March 31 2005	2004
Service cost	$ 25	$ 450
Interest cost	1,010	1,030
Expected return on assets	(1,034)	(910)
Amortization of:		
Prior service cost		15
Actuarial loss	162	135
Total net periodic pension cost	$ 163	$ 720

The decline in the net periodic benefit cost for the three months ended March 31, 2005 as compared to March 31, 2004 is due to K2 freezing its pension plans (the plans) effective August 31, 2004. This resulted in active participants no longer accruing benefits under the plans. Participants will remain eligible to receive benefits they have earned under the plans through August 31, 2004 when they retire. New employees will not be eligible to accrue any benefit under the plans. Only a small group of about 20 employees subject to a collective bargaining agreement will continue to accrue a benefit. The impact of this plan change on K2 s benefit costs was a one-time recognized curtailment loss of $0.4 million in the 2004 third quarter. The impact on future benefit costs was the elimination of the service cost and an $8.0 million reduction of the projected benefit obligation for future pay increases. This plan change has further resulted in an estimated reduction in net periodic pension costs for the 2005 year of $2.8 million.

K2 s expected cash contribution to its plans in 2005 is $5.7 million. During the three months ended March 31, 2005, K2 made contributions totaling approximately $0.5 million to the plans.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 10 Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

	Currency Translation Adjustments	Additional Minimum Pension Liability	Derivative Financial Instruments	Total
		(Thousands)		
Balance at December 31, 2004	$ 7,143	$ (10,525)	$ (1,068)	$ (4,450)
Currency translation adjustment	(5,304)			(5,304)
Reclassification adjustment for amounts recognized in cost of sales			366	366
Change in fair value of derivatives, net of $155 in taxes			312	312
Balance at March 31, 2005	$ 1,839	$ (10,525)	$ (390)	$ (9,076)

Total comprehensive income (loss) was ($2.3) million and $10.8 million for the three months ended March 31, 2005 and 2004, respectively. Total comprehensive income (loss) includes the net change in accumulated other comprehensive loss for the period.

NOTE 11- Earnings Per Share Data

Basic earnings per share (EPS) is determined by dividing net income or loss by the weighted average number of shares outstanding during the period. Diluted EPS reflects the potential dilutive effects of stock options, restricted stock, shares held in escrow and warrants, using the treasury stock method, and of the debentures using the if converted method. The following represents a reconciliation from basic shares to fully diluted shares for the respective periods. Options to purchase 3,517,041 and 2,570,160 shares of common stock were outstanding at March 31, 2005 and 2004, respectively. At March 31, 2005, there were also 130,000 unvested restricted stock awards outstanding and 612,466 shares held in escrow relating to certain acquisitions. At March 31, 2005 and 2004, shares of common stock issuable upon conversion of the $100 million of convertible debentures totaling 7,803,742 and warrants to purchase 767,589 of shares of common stock were outstanding. For the three months ended March 31, 2005 and 2004, approximately 435,000 and 412,000 stock options, respectively, were excluded since their inclusion would have been antidilutive. For the three months ended March 31, 2005 and 2004, 612,466 and 88,673 shares of K2 common stock held in escrow, respectively, were included in the calculation of diluted earnings per shares. The EPS calculation for three months ended March 31, 2005 also excluded 7,803,742 shares from the issuance of the $100 million convertible subordinated debentures since their inclusion would have also been antidilutive.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 11- Earnings Per Share Data (Continued)

The table below outlines the determination of the number of diluted shares of common stock used in the calculation of diluted EPS as well as the calculation of diluted EPS for the periods presented:

	2005	2004
	(Thousands, except per share amounts)	
Determination of diluted number of shares:		
Average common shares outstanding	46,177	34,353
Assumed conversion of dilutive stock options, restricted stock awards, warrants and shares in escrow	1,325	943
Assumed conversion of subordinated debentures		7,803
Diluted average common shares outstanding	47,502	43,099
Calculation of diluted earnings per share:		
Net income	$ 2,324	$ 10,740
Add: interest component on assumed conversion of subordinated debentures, net of taxes		904
Net income, adjusted	$ 2,324	$ 11,644
Diluted earnings per share (a)	$ 0.05	$ 0.27

(a) Diluted earnings per share is calculated by dividing net income, adjusted, by diluted average common shares outstanding for the respective period.

NOTE 12- Segment Information

As a result of recent acquisitions, beginning in the third quarter of 2004, K2 reclassified its business into the following four segments based on similar product types and distribution channels: Marine and Outdoor, Team Sports, Action Sports and Footwear and Apparel.

The Marine and Outdoor segment includes *Shakespeare* fishing tackle and monofilament products as well as *Stearns* outdoor products. The Team Sports segment includes baseball and softball products and *K2 Licensing & Promotion* products. The Action Sports segment includes skis, snowboards, snowshoes, in-line skates and paintball products. The Apparel and Footwear segment includes *Marmot* and *Ex Officio* products as well as skateboard shoes and related apparel.

The segment information for the 2004 period has been restated to reflect these reclassifications.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 12- Segment Information (Continued)

The segment information presented below is for the three months ended March 31:

	Net Sales to Unaffiliated Customers		Intersegment Sales		Operating Profit (Loss)	
	2005	2004 (a)	2005	2004 (a)	2005	2004 (a)
	(Millions)					
Marine and Outdoor	$ 112.4	$ 98.8	$ 33.2	$ 20.4	$ 16.0	$ 15.3
Team Sports	92.6	94.1			8.9	11.0
Action Sports	80.4	75.0	2.7		(12.4)	(4.6)
Apparel and Footwear	32.9	9.5	0.8	0.3	0.9	0.5
Total segment data	$ 318.3	$ 277.4	$ 36.7	$ 20.7	13.4	22.2
Corporate expenses, net					(2.7)	(2.6)
Interest expense					(7.2)	(3.3)
Income before provision for income taxes					$ 3.5	$ 16.3

(a) Results for the three months ended March 31, 2004 do not include the results of Ex Officio, Marmot, Völkl and Marker or K2 s other acquisitions completed after the 2004 first quarter since these companies were acquired by K2 Inc. subsequent to March 31, 2004. In addition, the 2004 first quarter results include less than a full three months of results of K2 Licensing & Promotions which was acquired by K2 on January 23, 2004.

NOTE 13 Contingencies

Certain of K2 s products are used in relatively high risk recreational settings and from time to time K2 is named as a defendant in lawsuits asserting product liability claims relating to its sporting goods products. To date, none of these lawsuits has had a material adverse effect on K2, and K2 does not expect any lawsuit now pending to have such an effect. K2 maintains product liability, general liability and excess liability insurance coverage. No assurances can be given such insurance will continue to be available at an acceptable cost to K2 or such coverage will be sufficient to cover one or more large claims, or that the insurers will not successfully disclaim coverage as to a pending or future claim.

K2 is one of several named potentially responsible parties (PRP) in three Environmental Protection Agency matters involving discharge of hazardous materials at old waste sites in South Carolina and Michigan. Although environmental laws technically impose joint and several liability upon each PRP at each site, the extent of K2 s required financial contribution to the cleanup of these sites is expected to be limited based upon the number and financial strength of the other named PRP s and the volume and types of waste involved which might be attributable to K2.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 13 Contingencies (Continued)

Environmental and related remediation costs are difficult to quantify for a number of reasons including the number of parties involved, the difficulty in determining the extent of the contamination, the length of time remediation may require, the complexity of environmental regulation and the continuing advancement of remediation technology. K2 accrues for liabilities of this nature when it is probable a liability has been incurred and the amount can be reasonably estimated. At March 31, 2005 and December 31, 2004, K2 had recorded an estimated liability of approximately $800,000 for environmental liabilities. The estimate is based on K2 s share of the costs to remediate as provided by the PRP s consultants and in ongoing discussions with the EPA or other environmental agencies. The ultimate outcome of these matters cannot be predicted with certainty, however, and taking into consideration reserves provided, management does not believe these matters will have a material adverse effect on K2 s financial statements.

K2 is involved in lawsuits, claims, investigations and proceedings, including those identified above, consisting of product liability, patent, commercial, employment and environmental matters, which arise in the ordinary course of business. In accordance with SFAS No. 5, *Accounting for Contingencies*, K2 makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. K2 believes that it has adequate provisions for such matters. K2 reviews these provisions at least quarterly and adjusts these provisions to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular legal matter. Litigation is inherently unpredictable. However, K2 believes that it has valid defenses with respect to legal matters pending against it. Nevertheless, it is possible that cash flows or results of operations could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies.

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 14 Supplemental Guarantor Information

Obligations to pay principal and interest on K2 s Senior Notes are guaranteed fully and unconditionally by K2 s existing and future wholly-owned U.S. subsidiaries. Separate financial statements of the guarantors are not provided, as subsidiary guarantors are 100% owned by K2 and guarantees are full, unconditional, and joint and several. The non-guarantor subsidiaries are K2 s consolidated non-U.S. subsidiaries. Supplemental condensed consolidating financial information of the K2 s guarantors is presented below.

	For the three months ended March 31, 2005				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Net sales	$	$ 248,894	$ 106,062	$ (36,665)	$ 318,291
Cost of products sold		169,289	81,383	(35,200)	215,472
Gross profit		79,605	24,679	(1,465)	102,819
Selling expenses	555	41,281	16,879		58,715
General and administrative expenses	6,960	20,233	6,900		34,093
Operating income (loss)	(7,515)	18,091	900	(1,465)	10,011
Other (income) expense, net	(806)	201	(116)		(721)
Interest expense	6,746	153	354		7,253
Income (loss) before income taxes	(13,455)	17,737	662	(1,465)	3,479
Provision for income taxes		1,040	115		1,155
Net income (loss)	$ (13,455)	$ 16,697	$ 547	$ (1,465)	$ 2,324

	For the three months ended March 31, 2004				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Net sales	$	$ 233,112	$ 64,985	$ (20,733)	$ 277,364
Cost of products sold	1,403	159,704	50,349	(20,725)	190,731
Gross profit	(1,403)	73,408	14,636	(8)	86,633
Selling expenses	180	36,337	5,580	(50)	42,047
General and administrative expenses	5,069	17,422	2,573		25,064
Operating income (loss)	(6,652)	19,649	6,483	42	19,522
Other (income) expense, net	2	(108)	43	10	(53)

Interest expense	3,182	107	13		3,302
Income (loss) before income taxes	(9,836)	19,650	6,427	32	16,273
Provision for income taxes		3,348	2,185		5,533
Net income (loss)	$ (9,836)	$ 16,302	$ 4,242	$ 32	$ 10,740

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 14 Supplemental Guarantor Information (Continued)

Condensed Consolidating Balance Sheets

(Thousands)

	March 31, 2005				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Assets					
Current Assets					
Cash and cash equivalents	$ 4,364	$ 3,131	$ 32,373	$	$ 39,868
Accounts receivable, net	30,064	257,498	113,888	(91,025)	310,425
Inventories, net	354	238,523	111,204	(4,921)	345,160
Deferred income taxes	23,315	(3,078)	1,753		21,990
Prepaid expenses and other current assets	352	7,530	17,308		25,190
Total current assets	58,449	503,604	276,526	(95,946)	742,633
Property, plant and equipment	11,606	155,529	110,482		277,617
Less allowance for depreciation and amortization	754	96,295	39,699		136,748
	10,852	59,234	70,783		140,869
Investment in affiliates	689,799	58,251	1	(748,051)	
Advances to affiliates		452,248	5,076	(457,324)	
Deferred taxes	7,507				7,507
Intangible assets, net	490,031	14,412	6,290	(5,000)	505,733
Other	20,324	2,804	1,309		24,437
Total Assets	$1,276,962	$1,090,553	$359,985	$(1,306,321)	$1,421,179
Liabilities and Shareholders Equity					
Current Liabilities					
Bank loans	$	$ 41	$ 9,427	$	$ 9,468
Accounts payable	858	91,696	60,619	(74,295)	78,878
Accrued liabilities	62,466	66,752	46,716		175,934
Current portion of long-term debt	32,480	67	3,103		35,650
Total current liabilities	95,804	158,556	119,865	(74,295)	299,930
Long-term pension liabilities	16,854				16,854
Long-term debt	255,520	20	18,715		274,255
Deferred taxes	47,764	2,982			50,746
Advances from affiliates	117,302	436,255	73,588	(627,145)	
Convertible subordinated debentures	98,652				98,652

Shareholders Equity	645,066	492,740	147,817	(604,881)	680,742
Total Liabilities and Shareholders Equity	$ 1,276,962	$ 1,090,553	$ 359,985	$ (1,306,321)	$ 1,421,179

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K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 14 Supplemental Guarantor Information (Continued)

Condensed Consolidating Balance Sheets

(Thousands)

	As of December 31, 2004				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Assets					
Current Assets					
Cash and cash equivalents	$ 3,167	$ 5,098	$ 17,368	$	$ 25,633
Accounts receivable, net	54,123	240,539	176,633	(101,381)	369,914
Inventories, net	1,479	214,336	115,337	(6,027)	325,125
Deferred income taxes	27,970	14	1,725		29,709
Prepaid expenses and other current assets	716	5,582	16,477		22,775
Total current assets	87,455	465,569	327,540	(107,408)	773,156
Property, plant and equipment	8,548	153,883	110,528		272,959
Less allowance for depreciation and amortization	638	93,939	37,418		131,995
	7,910	59,944	73,110		140,964
Investment in affiliates	572,860	58,121	1	(630,982)	
Advances to affiliates		506,099	4,767	(510,866)	
Intangible assets, net	484,109	13,431	5,825	5,000	508,365
Deferred Income Taxes	7,506				7,506
Other	20,707	2,702	2,965		26,374
Total Assets	$1,180,547	$1,105,866	$414,208	$(1,244,256)	$1,456,365
Liabilities and Shareholders Equity					
Current Liabilities					
Bank loans	$	$	$ 31,490	$	$ 31,490
Accounts payable	3,054	95,462	84,369	(79,727)	103,158
Accrued liabilities	59,993	58,520	60,940		179,453
Current portion of long-term debt	30,455	421	4,198		35,074
Total current liabilities	93,502	154,403	180,997	(79,727)	349,175
Long-term pension liabilities	16,854				16,854
Long-term debt	229,736	1,624	19,452		250,812
Deferred income taxes	52,048	6,075			58,123
Advances from affiliates	138,814	473,454	65,127	(677,395)	
Convertible subordinated debentures	98,535				98,535

Shareholders Equity	551,058	470,310	148,632	(487,134)	682,866
Total Liabilities and Shareholders Equity	$ 1,180,547	$ 1,105,866	$ 414,208	$ (1,244,256)	$ 1,456,365

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 14 Supplemental Guarantor Information (Continued)

Condensed Consolidating Statements of Cash Flows

(Thousands)

	For the three months ended March 31, 2004				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Operating Activities					
Net income (loss)	$ (13,455)	$ 16,697	$ 547	$ (1,465)	$ 2,324
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Depreciation and amortization	2,488	3,471	2,447		8,406
Deferred taxes	370	(1)	(28)		341
Changes in current assets and current liabilities	25,825	(38,010)	25,311	(6,030)	7,096
Net cash provided by (used in) operating activities	15,228	(17,843)	28,277	(7,495)	18,167
Investing Activities					
Property, plant & equipment expenditures	(461)	(3,982)	(2,886)	572	(6,757)
Disposals of property, plant & equipment	87	583	124	(572)	222
Purchase of businesses, net of cash acquired	(152)				(152)
Other items, net	96,880	4,670	5,233	(106,282)	501
Net cash provided by (used in) investing activities	96,354	1,271	2,471	(106,282)	(6,186)
Financing Activities					
Borrowings (payments) under long-term debt, net	27,926	(1,958)	(1,832)		24,136
Net increase (decrease) in short-term bank loans		41	(22,063)		(22,022)
Proceeds received from exercise of stock options	140				140
Net cash provided by (used in) financing activities	28,066	(1,917)	(23,895)		2,254
(Increase) decrease in investment in subsidiaries	(116,939)	(130)		117,069	
Advances (to) from affiliates	(21,512)	16,652	8,152	(3,292)	
Net increase (decrease) in cash and cash equivalents	1,197	(1,967)	15,005		14,235
Cash and cash equivalents at beginning of year	3,167	5,098	17,368		25,633
Cash and cash equivalents at end of period	$ 4,364	$ 3,131	$ 32,373	$	$ 39,868

K2 INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

March 31, 2005

NOTE 14 Supplemental Guarantor Information (Continued)

Condensed Consolidating Statements of Cash Flows

(Thousands)

	For the three months ended March 31, 2004				
	K2 Inc.	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminating Entries	Consolidated K2 Inc.
Operating Activities					
Net income (loss)	$ (9,836)	$ 16,302	$ 4,242	$ 32	$ 10,740
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Depreciation and amortization	1,345	4,010	718		6,073
Deferred taxes	(711)	1,438	33	3,729	4,489
Changes in current assets and current liabilities	23,738	(36,610)	(6,788)	4,835	(14,825)
Net cash provided by (used in) operating activities	14,536	(14,860)	(1,795)	8,596	6,477
Investing Activities					
Property, plant & equipment expenditures	(352)	(4,283)	(2,147)		(6,782)
Disposals of property, plant & equipment		171	102		273
Purchase of businesses, net of cash acquired	1,780				1,780
Other items, net	52,758	(510)	(4,513)	(47,897)	(162)
Net cash provided by (used in) investing activities	54,186	(4,622)	(6,558)	(47,897)	(4,891)
Financing Activities					
Borrowings (payments) under long-term debt, net	(1,830)		98		(1,732)
Net increase (decrease) in short-term bank loans		(13)	(5,184)		(5,197)
Proceeds received from exercise of stock options	3,873				3,873
Net cash provided by (used in) financing activities	2,043	(13)	(5,086)		(3,056)
(Increase) decrease in investment in subsidiaries	(50,568)	8		50,560	
Advances (to) from affiliates	(18,973)	19,305	10,927	(11,259)	
Net increase (decrease) in cash and cash equivalents	1,224	(182)	(2,512)		(1,470)
Cash and cash equivalents at beginning of year	2,683	2,198	16,375		21,256
Cash and cash equivalents at end of period	$ 3,907	$ 2,016	$ 13,863	$	$ 19,786

ITEM 2 Management s Discussion and Analysis of Financial Condition and Results of Operations

Certain statements in Management s Discussion and Analysis are forward-looking as defined in the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations that are subject to risks and uncertainties. Actual results may differ materially from expectations as of the date of this filing because of the factors discussed below under the *Statement Regarding Forward-Looking Disclosure* section and elsewhere in this quarterly report on Form 10-Q.

K2 Inc. is a premier, branded consumer products company with a portfolio of leading brands including *Shakespeare*, *Pflueger* and *Stearns* in the Marine and Outdoor segment; *Rawlings*, *Worth* and *K2 Licensing & Promotions* in the Team Sports segment; *K2*, *Völkl*, *Marker*, *Ride* and *Brass Eagle* in the Action Sports segment; and *Adio*, *Marmot* and *Ex Officio* in the Footwear and Apparel segment. K2 s diversified mix of products is used primarily in team and individual sports activities such as fishing, watersports activities, baseball, softball, alpine skiing, snowboarding, in-line skating and mountain biking.

Matters Affecting Comparability

Operating Segments. As a result of recent acquisitions, K2 has reclassified its business into the following four segments based on similar product types, distribution channels and management s perspective in evaluating K2 s various lines of business: Marine and Outdoor, Team Sports, Action Sports and Footwear and Apparel. The Marine and Outdoor segment includes *Shakespeare* fishing tackle and monofilament products as well as *Stearns* outdoor products. The Team Sports segment includes baseball and softball products and *K2 Licensing & Promotions* products. The Action Sports segment includes skis, bindings, snowboards, snowshoes, in-line skates and paintball products. The Footwear and Apparel segment includes skateboard shoes and apparel, technical apparel and equipment and outdoor and adventure travel apparel. All periods presented have been recasted to reflect these changes in the segments.

The Marine and Outdoor segment represented $112.4 million, or 35.3%, of K2 s 2005 first quarter consolidated net sales, the Team Sports segment had net sales of $92.6 million, or 29.1% of 2005 first quarter consolidated net sales, the Action Sports segment represented $80.4 million, or 25.3% of 2005 first quarter consolidated net sales and the Footwear and Apparel segment had net sales of $32.9 million, or 10.3% of 2005 first quarter consolidated net sales.

Acquisitions. The consolidated condensed statement of income for the three months ended March 31, 2005 includes the operating results of each of the businesses acquired by K2 in 2004, however the consolidated condensed statement of income for the three months ended March 31, 2004 does not include the results of Ex Officio, Marmot, Völkl and Marker or K2 s other acquisitions completed after the 2004 first quarter since these companies were acquired by K2 subsequent to March 31, 2004. In addition, the 2004 first quarter results include less than a full three months of results of K2 Licensing & Promotions which was acquired by K2 on January 23, 2004. Net sales from acquisitions completed by K2 subsequent to March 31, 2004 accounted for $53.2 million of

2005 first quarter net sales. For further discussion of K2 s acquisition activities see Note 5 to Notes to Consolidated Condensed Financial Statements.

Consolidated Results of Operations

The following table sets forth certain ratios and relationships calculated from the Consolidated Condensed Statements of Income for the three months ended March 31:

	For the three months ended March 31			
			Increase (Decrease)	
(In millions, except per share data and percentages)	**2005**	**2004**	**$**	**%**
Net sales	$ 318.3	$ 277.4	$ 40.9	14.7%
Gross profit	102.8	86.6	16.2	18.7%
Operating income	10.0	19.5	(9.5)	(48.7%)
Net income	2.3	10.7	(8.4)	(78.5%)
Diluted earnings per share	$ 0.05	$ 0.27	$ (0.22)	(81.5%)
Expressed as a percentage of net sales:				
Gross margin (a)	32.3%	31.2%		
Selling, general and administrative expense	29.2%	24.2%		
Operating margin (b)	3.1%	7.0%		

(a) Gross Margin is defined as gross profit divided by net sales as presented in the Consolidated Condensed Statements of Income.

(b) Operating Margin is defined as operating income divided by net sales as presented in the Consolidated Condensed Statements of Income.

Acquisitions

During 2004, K2 completed nine acquisitions, including the acquisitions of Fotoball USA, Inc. (later renamed K2 Licensing & Promotions, Inc.) on January 23, 2004, Ex Officio on May 12, 2004, Marmot on June 30, 2004 and Völkl and Marker on July 7, 2004 as well as five smaller acquisitions completed after March 31, 2004.

Downsizing and Restructuring Activities

Pursuant to acquisitions made by K2 during 2004 and 2003, K2 approved restructuring and exit plans related to the closure of certain facilities of the acquired companies. In accordance with EITF 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination* , K2 established reserves for employee severance, employee relocation costs and lease termination costs totaling approximately $11.0 million and

$5.1 million during 2004 and 2003, respectively. These reserves were recognized as assumed liabilities of the acquired companies. The reserves established were not individually significant to any of K2 s acquisitions during 2003 or 2004.

Comparative First Quarter Results of Operations

Net sales of K2 for the three months ended March 31, 2005 were $318.3 million as compared with $277.4 million in the year-earlier period. Net income for the first quarter of 2005 was $2.3 million, or $0.05 per diluted share, as compared with $10.7 million, or $0.27 per diluted share, in the first quarter of 2004.

Net Sales. In the Marine and Outdoor segment, net sales increased to $112.4 million in the 2005 first quarter as compared with $98.8 million in the prior year s first quarter. The overall improvement in net sales during 2005 resulted from increased sales of *Shakespeare f*ishing tackle products of $9.3 million, higher sales of *Stearns* products of $4.5 million, new sales of all-terrain vehicle accessory products of $1.2 million, partially offset by lower sales of *Shakespeare* monofilament products of $1.4 million. The increase in sales of *Shakespeare* fishing tackle products reflected growth in the sales of *Pflueger* reels, kits and combos, fish line, marine and military antennas and the new sales of *All-Star* rods. Increased sales of *Stearns* outdoor products reflected higher demand for children s flotation products and water-ski vests.

Net sales of the Team Sports segment were $92.6 million for the 2005 first quarter as compared to $94.1 million in the prior year s first quarter. The decline in net sales was primarily due to a decrease in sales of metal softball bats of $3.7 million, gloves of $1.3 million and basketballs of $0.6 million, partially offset by a $4.3 million increase in sales of composite softball bats.

In the Action Sports segment, net sales increased to $80.4 million in the 2005 first quarter as compared to $75.0 million in the prior year s first quarter. The increase is primarily the result of $23.7 million in 2005 first quarter net sales resulting from the acquisitions of Völkl and Marker in July 2004 partially offset by lower sales of in-line skates of $8.4 million, paintball products of $5.6 million, snowboards of $2.0 million and snowshoes of $1.3 million. The decline in in-line skates sales is the result of sluggish worldwide retail sales for the industry caused by soft consumer demand. The decline in sales of paintball products also reflects soft consumer demand in the industry. Sales of snowboards in Asia and snowshoes declined in a seasonally slow shipping quarter due to fewer reorder sales and the timing of shipments quarter over quarter.

Net sales of the Apparel and Footwear segment were $32.9 million in the 2005 first quarter as compared to $9.5 million in the prior year s first quarter. The increase in net sales from 2004 is the result of the acquisitions of Ex Officio and Marmot after the 2004 first quarter which had combined sales of $19.4 million for K2 in the 2005 first quarter as well as higher sales of skateboard shoes and apparel of $4.0 million. The increase in sales of skateboard shoes and apparel reflects the strong sell through of the *Adio* shoe brand.

K2 s international operations (operating locations outside of the United States) represented $75.6 million, or 23.8% of K2 s consolidated net sales for the three months ended March 31, 2005 as compared to $63.9 million, or 23.0% of K2 s consolidated net sales for the three months ended March 31, 2004. The increase in net sales from international operations was due to the acquisitions of Marmot and Völkl and Marker in mid-2004 which had 2005 first quarter net sales from international operations of $4.0 million and $18.5 million, respectively, partially offset by lower sales of in-line skates of $7.1 million, snowboards of $1.8 million and footwear of $0.7 million.

Gross profit. Gross profits for the first quarter of 2005 increased 18.7% to $102.8 million, or 32.3% of net sales, as compared with $86.6 million, or 31.2% of net sales, in the year ago quarter. The improvement in gross profit dollars for the quarter was attributable to the increase in first quarter sales volume and an increase in gross profit as a percentage of net sales. The improvement in the gross profit percentage was due to a more favorable product mix as compared to 2004 and higher gross margin product sales resulting from K2 s acquisitions completed after the 2004 first quarter, particularly the acquisitions of Marmot and Ex Officio in the Footwear and Apparel segment.

Costs and Expenses. Selling expenses for the 2005 first quarter were $58.7 million, or 18.4% of net sales, as compared with $42.0 million, or 15.1% of net sales, in the prior year s first quarter. General and administrative expenses for the 2005 first quarter were $34.1 million, or 10.7% of net sales, as compared with $25.1 million, or 9.0% of net sales, in the prior year s first quarter. The increase in selling expenses in dollars was attributable to the increase in sales volume for the first quarter as compared to the prior year and acquisitions completed after the 2004 first quarter by K2 which resulted in additional selling expenses of $14.6 million. The increase in general and administrative expenses in dollars for the 2005 first quarter was primarily attributable to higher sales volume during the first quarter and recent acquisitions made by K2 which resulted in additional general and administrative expenses of $7.0 million. As a percentage of net sales, selling, general and administrative expenses increased due to the seasonality associated with the acquisitions of Marmot, Völkl and Marker in mid-2004. These acquired companies have higher selling, general and administrative expenses as a percentage of net sales in the first and second quarters of the year due to having lower sales volume as compared to the third and fourth quarters.

Operating Income. Operating income for the 2005 first quarter was $10.0 million, or 3.1% of net sales, as compared to operating income of $19.5 million, or 7.0% of net sales, a year ago. The decrease in operating income was due to the increase in selling, general and administrative expenses as discussed above, partially offset by higher sales volume and gross profit in the 2005 first quarter as compared to the prior year.

K2 s international operations (for operating locations outside of the United States) represented $0.2 million of K2 s operating income, for the three months ended March 31, 2005 as compared with $4.4 million, or 22.6% of K2 s operating income, in the year ago quarter. The decrease in operating income from international operations was attributable to the acquisitions of Marmot, Völkl and Marker in mid-2004. These acquired companies have higher selling, general and administrative expenses as a percentage of net sales in the first and second quarters of the year due to lower sales volume as compared to the third and fourth quarters. In addition, operating income from international operations declined due to lower sales of in-line skates and snowboards.

Interest Expense. Interest expense was $7.3 million in the 2005 first quarter as compared to $3.3 million in the year-earlier period. The increase in interest expense for 2005 was primarily attributable to higher average borrowing levels during the 2005 first quarter as compared to 2004. Borrowings on average were higher in the 2005 first quarter due to borrowings made to fund acquisitions and the seasonal working capital requirements of businesses acquired after the 2004 first quarter.

Income Taxes. During the 2005 first quarter, the effective income tax rate was 33.2% as compared to 34.0% during the 2004 first quarter. The decrease in the effective tax rate was primarily attributable to a greater percentage of income being taxed in relatively lower tax jurisdictions as a result of K2 s acquisitions after the 2004 first quarter.

Liquidity and Capital Resources

Cash Flow Activity

K2 s operating activities provided $18.2 million of cash in the current year s first quarter as compared to $6.5 million in the 2004 first quarter. The increase in cash from operations during 2005 was primarily attributable to a decrease in accounts receivable during the 2005 period of $58.5 million as compared to a prior year s increase of $16.8 million, partially offset by lower net income in 2005 of $8.4 million as compared to 2004, and an increase in inventories during 2005 of $21.3 million as compared to an decrease in 2004 of $23.4 million. The decline in net income during the 2005 first quarter was attributable to lower operating income and higher interest expense as compared to the 2004 first quarter as discussed above.

Net cash used for investing activities was $6.2 million in the current year s first quarter, as compared to $4.9 million of cash used for investing activities in the prior year. The increase in cash used in investing activities was due to $0.2 million of cash used to acquire new businesses in the 2005 period as compared to $1.8 million of net cash acquired in acquisitions during the 2004 first quarter. There were no material commitments for capital expenditures at March 31, 2005.

Net cash provided by financing activities was $2.3 million in the current year s first quarter as compared with $3.1 million of cash used in the corresponding year-ago period. The increase in cash provided by financing activities during the 2005 period was due to net borrowings under long-term debt of $24.1 million in the 2005 first quarter as compared to net payments under long-term debt of $1.7 million in the 2004 first quarter, partially offset by a larger decrease in short-term bank loans of $16.8 million and lower proceeds received from stock option exercises of $3.7 million.

Capital Structure and Resources

K2 s principal long-term borrowing facility is a $250 million revolving credit facility (Facility), secured by all of K2 s assets in the United States, Canada and England. Total availability under the Facility is determined by a borrowing formula based on eligible trade receivables and inventory and defined advance rates. The Facility is expandable to $350 million and has a $100 million limit for the issuance of letters of credit. The Facility expires on July 1, 2009. At March 31, 2005, there were $88.0 million of borrowings outstanding under the Facility, $15.6 million of outstanding letter of credit issuances (consisting of $13.8 million of standby letters of credit and $1.8 million of trade letters of credit which expire over the next 12 months) and $145.3 million of available borrowing capacity. At March 31, 2005, K2 also had outstanding $25.0 million of 7.25% convertible subordinated debentures due March 2010, $75.0 million of 5.00% convertible senior debentures due June 2010 and $200.0 million of senior notes due July 2014. At March 31, 2005, K2 had $31.3 million outstanding under various foreign lending arrangements. On March 18, 2005, K2 obtained an amendment to its Facility allowing K2 to make up to $50 million in repurchases of K2 common stock provided that unused borrowing availability under the facility is at least $50 million after such repurchases.

K2 believes that the credit available under the Facility, together with cash flow from operations will be sufficient for K2 s business needs through March 31, 2006. K2 s ability to arrange debt financing from other sources, should such additional financing become necessary, could be limited by the fact that substantially all of K2 s assets in the United States, Canada and England are subject to security interests pursuant to the Facility. In addition, K2 s Senior Notes and 5% Debentures place limitations on the incurrence of indebtedness by K2.

Long-term Financial Obligations and Other Commercial Commitments

The following summarizes the outstanding borrowings and long-term contractual obligations of K2 at March 31, 2005 and the effects such obligations are expected to have on liquidity and cash flow in future periods.

Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
			(Thousands)		
Long-term debt (1)	$ 409,905	$ 3,950	$ 5,774	$ 116,945	$ 283,236
Operating leases (2)	64,034	15,493	20,280	12,696	15,565
Licensing arrangements (3)	12,541	6,560	4,793	1,188	
Endorsement and sponsorship arrangements (4)	6,899	5,850	1,011	38	
Pension contributions (5)	5,250	5,250			
Amounts due related to acquisitions (6)	3,779	3,779			
Total contractual cash obligations	$ 502,408	$ 40,882	$ 31,858	$ 130,867	$ 298,801

(1) Includes principal payments contractually outstanding under K2 s lending arrangements. See Note 8 to Notes to Consolidated Condensed Financial Statements, for additional information on K2 s long-term debt obligations.

(2) In the ordinary course of business, K2 enters into operating leases for the use of buildings, machinery and equipment. These amounts represent the contractual minimum payments due under these agreements.

(3) In the ordinary course of business, K2 enters into licensing arrangements whereby future minimum payments are due. These amounts represent the contractual minimum payments due under these agreements.

(4) In the ordinary course of business, K2 enters into endorsement and sponsorship contracts with athletes whereby future minimum payments are due. These amounts represent the contractual minimum payments due under these agreements.

(5) These amounts include estimated contributions for K2 s pension plans. See Note 9 to Notes to Consolidated Condensed Financial Statements, for additional information on K2 s pension plans.

(6) These amounts include payments to be made during 2005 related to K2 s completed acquisitions.

Off-Balance Sheet Arrangements

K2 did not enter into any off-balance sheet arrangements during 2005 or 2004, nor did K2 have any off-balance sheet arrangements outstanding at March 31, 2005 or December 31, 2004.

Critical Accounting Policies

K2 s discussion and analysis of its financial condition and results of operations are based upon K2 s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires K2 to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities.

Discussed below are several significant accounting policies, which require the use of judgments and estimates that may materially affect the consolidated financial statements.

The estimates described below are reviewed from time to time and are subject to change if the circumstances so indicate. The effect of any such change is reflected in results of operations for the period in which the change is made. Establishment of the reserves affecting inventories and the allowance for doubtful accounts are among the most important.

Revenue Recognition

K2 recognizes revenue from product sales when title passes and the risks and rewards of ownership have passed to the customer, based on the terms of sale. Title passes generally upon shipment or upon receipt by the customer depending on the country of the sale and the agreement with the customer. In some instances, products are shipped directly from K2 suppliers to K2 customers and revenue is recognized when the product is delivered to and accepted by the customer or a representative of the customer. K2 revenues may fluctuate in cases when our customers delay accepting shipment of product for periods up to several weeks. Reserves for estimated returns are established based upon historical return rates and recorded as reductions of sales.

Warranty

K2 records the estimated cost of product warranties at the time sales are recognized. K2 estimates warranty obligation by reference to historical product warranty return rates, material usage and service delivery costs incurred in correcting the product. Should actual product warranty return rates, material usage or service delivery costs differ from the historical rates, revisions to the estimated warranty liability would be required.

Accounts Receivable and Allowances

Accounts receivable are the result of K2 s worldwide sales activities. Although K2 s credit risk is spread across a large number of customers within a wide geographic area, periodic concentrations within a specific industry occur due to the seasonality of its businesses and with certain customers as the result of K2 s acquisition activities. K2 generally does not require collateral but performs periodic credit evaluations to manage its credit risk.

K2 evaluates the collectibility of accounts receivable based on a combination of factors. In circumstances where there is knowledge of a specific customer s inability to meet its financial obligations, a specific reserve is recorded against amounts due to reduce the net recognized receivable to the amount that is reasonably believed to be collected. For all other customers, reserves are established based on historical bad debts, customer payment patterns and current economic conditions. The establishment of these reserves requires the use of judgment and assumptions regarding the potential for losses on receivable balances. If the financial condition of K2 s customers were to deteriorate, resulting in an impairment of their ability to make payments to K2, additional allowances may be required.

Inventories

Inventories are valued at the lower of cost or market value. Cost is substantially determined by the first-in, first-out method, including material, labor and factory overhead. K2 records adjustments to its inventory for estimated obsolescence or diminution in market value equal to the difference between the cost of inventory and the estimated market value, based on market conditions from time to time. These adjustments are estimates, which could vary significantly, either favorably or unfavorably, from actual experience if future economic conditions, levels of consumer demand, customer inventory levels or competitive conditions differ from expectations.

Long-Lived and Finite Lived Intangible Assets

Purchased intangible assets with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, ranging from one to eleven years.

Long-lived assets, such as property, plant and equipment and purchased intangible assets with finite lives, are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. K2 assesses the fair value of the assets based on the future cash flow the assets are expected to generate and recognizes an impairment loss when estimated undiscounted future cash flow expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When an impairment is identified, K2 reduces the carrying amount of the asset to its estimated fair value based on a discounted cash flow approach or, when available and appropriate, comparable market values. K2 determined there were no indicators of material impairment of long-lived assets as of March 31, 2005.

K2 has evaluated the remaining useful lives of its finite-lived purchased intangible assets to determine if any adjustments to the useful lives were necessary or if any of these assets had indefinite lives and were therefore not subject to amortization. K2 determined that no adjustments to the useful lives of its finite-lived purchased intangible assets were necessary. The finite-lived purchased intangible assets consist of patents, customer contracts and customer lists, licensing agreements, tradenames/trademarks and non-compete arrangements which at March 31, 2005 have weighted average useful lives of approximately 8 years, 8 years, 5 years, 7 years and 4 years, respectively.

Indefinite Lived Intangible Assets

Goodwill and intangible assets with indefinite lives are not amortized but instead are measured for impairment at least annually, or when events indicate that a likely impairment exists. The impairment tests for goodwill and other indefinite-lived intangible assets are assessed for impairment using fair value measurement techniques. Specifically, goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a K2 reporting unit with the net book value (or carrying amount), including goodwill. If the fair value of the reporting unit exceeds the carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit exceeds the fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit s goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination, accordingly the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. The impairment test for other intangible assets consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

Determining the fair value of a reporting unit under the first step of the goodwill impairment test and determining the fair value of individual assets and liabilities of a reporting unit under the second step of the goodwill impairment test is judgmental in nature and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the extent of such charge. K2 s estimates of fair value utilized in goodwill and other indefinite-lived intangible asset tests may be based upon a number of factors, including assumptions about the projected future cash flows, discount rate, growth rate, determination of market comparables, technological change, economic conditions, or changes to K2 s business operations. Such changes may result in impairment charges recorded in future periods.

K2 determined in accordance with SFAS No. 142 that K2 s segments meet the criteria for aggregation and therefore performed its analysis at the reporting segment level. The fair value of K2 s reporting units was determined using a combination of the income approach and the market approach. Under the income approach, the fair value of a reporting unit is calculated based on the present value of estimated future cash flows. The present value of estimated future cash flows uses K2 s estimates of revenue for the reporting units, driven by assumed market growth rates and assumed market segment share, and estimated costs as well as appropriate discount rates. These estimates are consistent with the plans and estimates that K2 uses to manage the underlying businesses. Under the market approach, fair value is estimated based on market multiples of revenue or earnings for comparable companies.

In performing the fiscal 2004 annual test for the Marine and Outdoor segment, K2 assumed a sales growth rate of 5%; gross profit margins of 37%; an income tax rate of 35%; and a discount rate of 12%. For the Team Sports segment, K2 assumed a sales growth rate of 3%; gross profit margins ranging from 34% to 36%; an income tax rate of 35%; and a discount rate of 12%. For the Action Sports segment, K2 assumed a sales growth rate of 5%; gross profit margins of 34%; an income tax rate of 35%; and a discount rate of 12%. For the Footwear and Apparel segment, K2 assumed a sales growth rate of 5%; gross profit margins of 40%; an income tax rate of 35%; and a discount rate of 12%. Based on the results of the annual impairment tests, K2 determined that no impairment of goodwill existed as of December 31, 2004. However, future goodwill impairment tests could result in a charge to earnings. K2 will continue to evaluate goodwill on an annual basis and whenever events and changes in circumstances indicate that there may be a potential impairment.

Income Taxes

Income taxes are recorded using the liability method. K2 estimates actual current tax exposure together with temporary differences that result from differing treatment of items for tax and accounting purposes. These temporary differences result in deferred tax assets and liabilities. K2 then assesses the likelihood that deferred tax assets will be recovered from future taxable income and to the extent that recovery is unlikely, a valuation allowance must be established. A significant portion of K2 s deferred tax assets relate to net operating loss carryovers for both domestic and foreign purposes. The realization of these assets is based upon estimates of future taxable income. In those jurisdictions where the realization of these carryovers is not likely, a valuation allowance has been established.

Pensions

K2 sponsors several trusteed non-contributory defined benefit pension plans covering about 850 of its domestic employees. Benefits are generally based on years of service and the employee s highest average compensation for five consecutive years during the years of credited service. Contributions are intended to provide for benefits attributable to service to date and service expected to be provided in the future. K2 funds these plans in accordance with the Employee Retirement Income Security Act of 1974.

Effective August 31, 2004, the domestic pension plans (the plans) were amended to freeze the accrual of future benefits for almost all of the employees. This resulted in active participants no longer accruing benefits under the plans. Participants will remain eligible to receive benefits they have earned under the plans through August 31, 2004 when they retire. New employees will not be eligible to accrue any benefit under the plans. Only a small group of about 20 employees subject to a collective bargaining agreement will continue to accrue a benefit. The impact of this plan change on K2 s benefit costs is a one-time recognized curtailment loss of $353,000 in the 2004 third quarter. The impact on future benefit costs is the elimination of the service cost and an $8.0 million reduction of the projected benefit obligation for future pay increases. This plan change has further resulted in an estimated reduction in net periodic pension costs for the 2005 year of $2.8 million.

Pension costs and liabilities are actuarially calculated. These calculations are based on assumptions related to the discount rate, projected compensation increases and expected return on assets. The discount rate assumption is based on current market interest rates of long-term bonds as of December 31, 2004. There is no salary growth assumption for the future due to the freezing of the plans on August 31, 2004, whereby no additional benefits will accrue. Long-term return on plan assets is determined based on historical portfolio results and management s future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio. K2 evaluates the assumptions used on a periodic basis and makes adjustments as necessary. As of December 31, 2003, K2 s assumption related to the discount rate, projected compensation increases and expected return on assets was 6.25%, 4.00% and 8.25%, respectively. Due to the declining interest rate environment for long-term bonds in 2004, K2 lowered its discount rate assumption to 5.75% at December 31, 2004. A continued change in the discount rate and actual vs. expected return on plan assets could have a significant impact on the pension costs recorded.

Due to the lower discount rate and declines in the stock market during 2002, actual asset returns on K2 s pension assets did not meet K2 s original assumption of 2003 expected returns. This resulted in 2003 pension expense being higher than 2002 pension expense by approximately $2.1 million. Pension expense for the 2004 year was approximately $0.1 million lower than the 2003 year. The 2004 decrease in pension expense was attributable to: the plan freeze on August 31, 2004 resulting in a reduction in expense of approximately $0.6 million; better than expected 2003 asset returns resulting in a reduction to expense of approximately $0.3 million; all of which were offset by an increase in pension expense of approximately $0.8 million due to changes in assumptions regarding the discount rate, expected return on assets, mortality rates, administrative expenses and changes in participant demographics. For 2005, pension expense is estimated to be approximately $0.6 million, a reduction of $2.7 million from the 2004 year. This decrease in overall expense is expected to result from the following: a $0.2 million decrease in expense due to better than expected asset returns during 2004; a $2.8 million decrease in expense due to the freezing of the plan during 2004; all of which are expected to be offset by a $0.3 million increase in pension expense due to the decrease in the discount rate from 6.25% to 5.75% at December 31, 2004.

K2 s expected cash contribution to its plans in 2005 is $5.7 million. During the three months ended March 31, 2005, K2 made contributions totaling approximately $0.5 million to the plans.

Based on the decrease in the discount rate and lower expected asset returns, the accumulated benefit obligation of the plans exceeded the fair value of the assets of the plans by $22.5 million and $15.6 million at December 31, 2004 and 2003, respectively. These asset shortfalls resulted in K2 recording a non-cash charge to Other Comprehensive Income, a component of K2 s shareholders equity, of $14.5 million ($9.4 million, net of taxes) at December 31, 2004. Based on this amount recorded, K2 had $22.5 million and $15.2 million, of net pension liabilities as of December 31, 2004 and 2003, respectively, consisting of $22.5 and $15.6 million, respectively, in asset shortfalls and an intangible asset for the unrecognized prior service cost of $0.4 million at December 31, 2003. As of March 31, 2005 and December 31, 2004, K2 classified $5.2 million and $5.7 million, respectively, of the pension liability as current and $16.8 million as long-term.

Foreign Currency Translation

The functional currency for most foreign operations is the local currency. The financial statements of foreign subsidiaries have been translated into U.S. dollars. Asset and liability accounts have been translated using the exchange rate in effect at the balance sheet date. Revenue and expense accounts have been translated using the average exchange rate for the period. The gains and losses associated with the translation of the financial statements resulting from the changes in exchange rates from period to period have been reported in the other comprehensive income or loss account in shareholders equity. To the extent assets and liabilities of the foreign operations are realized or the foreign operations pay back intercompany debt, amounts previously reported in other comprehensive income or loss account would be included in net income or loss in the period in which the transaction occurs. Transaction gains or losses, other than those related to intercompany accounts and investments deemed to be of a long-term nature, are included in net income or loss in the period in which they occur.

Other Contingencies

In the ordinary course of business, K2 is involved in legal proceedings regarding contractual and employment relationships, product liability claims, environmental matters, intellectual property rights, and a variety of other matters. K2 records contingent liabilities resulting from claims when it is probable that a liability has been incurred and the amount of the loss is reasonably estimable. Estimating probable losses requires analysis of multiple factors, in some cases including judgments about the potential actions of third party claimants and courts. Therefore, actual losses in any future period are inherently uncertain. Currently, K2 does not believe that any of its pending legal proceedings or claims will have a material impact on its financial position or results of operations. However, if actual or estimated probable future losses exceed K2 s recorded liability for such claims, additional charges would be recorded as an expense during the period in which the actual loss or change in estimate occurred.

Statement Regarding Forward-Looking Disclosure

This Quarterly Report on Form 10-Q, including Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 2, contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause the results of K2 Inc. and its consolidated subsidiaries (K2) to differ materially from those expressed or implied by such forward-looking statements. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including any projections of net sales, gross margin, expenses, earnings or losses from operations, synergies or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements concerning developments, performance or industry rankings relating to products; any statements regarding future economic conditions or performance; any statements of expectation or belief; and any statements of assumptions underlying any of the foregoing. The risks, uncertainties and assumptions referred to above include to successfully execute its acquisition plans and growth strategy, integration of acquired businesses, weather conditions, consumer spending, continued success of manufacturing in the People s Republic of China, global economic conditions, product demand, financial market performance and other risks that are described herein, including but not limited to the items described from time to time in K2 s Securities Exchange Act reports including K2 s Annual Report for the year ended December 31, 2004. K2 cautions that the foregoing list of important factors is not exclusive, any forward-looking statements included in this report are made as of the date of filing of this report with the Securities and Exchange Commission, and K2 assumes no obligation and does not intend to update these forward-looking statements.

ITEM 3 Quantitative and Qualitative Disclosures About Market Risk

Fluctuations in foreign currency exchange rates can affect K2 s earnings and cash flows. K2 manages its exposures to changes in foreign currency exchange rates on certain firm purchase commitments and anticipated, but not yet committed purchases, by entering into some foreign currency forward contracts. K2 s risk management objective is to reduce its exposure to the effects of changes in exchange rates on the cost of products sold over annual time horizons. Foreign currency exchange rate movements also affect K2 s competitive position, as exchange rate changes may affect business practices and/or pricing strategies of non-U.S. based competitors and may affect the profitability and pricing strategies of K2 as well. K2 s foreign currency risk policies entail entering into foreign currency derivative instruments only to manage risk of currency fluctuations over a given period of time, not for speculative investments. At March 31, 2005, K2 had foreign exchange contracts with maturities of within one year to exchange various foreign currencies to dollars in the aggregate amount of $32.9 million.

Considering both the anticipated cash flows from firm purchase commitments and anticipated purchases for the next quarter and the foreign currency derivative instruments in place at year end, a hypothetical 10% weakening of the U.S. dollar relative to other currencies would not materially adversely affect expected second quarter 2005 earnings or cash flows. This analysis is dependent on actual purchases during the next quarter occurring within 90% of budgeted forecasts. The effect of the hypothetical change in exchange rates ignores the effect this movement may have on other variables including competitive risk. If it were possible to quantify this competitive impact, the results could well be different than the sensitivity effects shown above. In addition, it is unlikely currencies would uniformly strengthen or weaken relative to the U.S. dollar. In reality, some currencies may weaken while others may strengthen. Moreover, any negative effect of a weakening U.S. dollar in terms of increase materials costs would likely be partially offset by a positive impact on revenues due to K2 s sales internationally and the conversion of those international sales to U.S. dollars.

K2 is also exposed to interest rate risk in connection with its borrowings under the revolving bank credit facility and term loan which bear interest at floating rates based on London Inter-Bank Offered Rate (LIBOR) or the prime rate plus an applicable borrowing margin. For the $100 million of convertible subordinated debentures, interest rate changes affect the fair market value but do not impact earnings or cash flows. Conversely, for variable rate debt, interest rate changes generally do not affect the fair market value but do impact future earnings and cash flows, assuming other factors are held constant.

As of March 31, 2005, K2 had $300.0 million in principal amount of fixed rate debt represented by the convertible subordinated debentures and senior notes and $119.4 million of variable rate debt represented by borrowings under the revolving credit facilities and foreign credit lines. Based on the balance outstanding under the variable rate facilities as of March 31, 2005, an immediate change of one percentage point in the applicable interest rate would have caused an increase or decrease in interest expense of approximately $1.2 million on an annual basis. At March 31, 2005, up to $145.3 million of variable rate borrowings were available under K2 s $250 million revolving bank credit facility. K2 may use derivative financial instruments, where appropriate, to manage its interest rate risks. However, as a matter of policy, K2 does not enter into derivative or other financial investments for trading or speculative purposes. At March 31, 2005, K2 had no such derivative financial instruments outstanding.

ITEM 4 Controls and Procedures

K2 maintains disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) that are designed to ensure that information required to be disclosed in K2 s reports filed under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to K2 s management, including K2 s Principal Executive Officer, Principal Financial Officer and Chief Operating Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of K2 s management, including K2 s Principal Executive Officer, Principal Financial Officer and Chief Operating Officer, of the effectiveness of the design and operation of K2 s disclosure controls and procedures as of the end of the period covered by this report (the Evaluation Date). Based upon that evaluation, the Principal Executive Officer, Principal Financial Officer and Chief Operating Officer have concluded that K2 s disclosure controls and procedures were effective at the reasonable assurance level as of the Evaluation Date.

In addition, the Principal Executive Officer, Principal Financial Officer and Chief Operating Officer have concluded that there have been no changes to K2 s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the last fiscal quarter, that has materially affected, or are reasonably likely to materially affect, K2 s internal control over financial reporting, other than the remedies of the deficiencies noted above and currently in process.

Rawlings®, Worth®, Miken®, deBeer®, Gait, Ten, Hilton®, Shakespeare®, Pflueger®, Ugly Stik®, All Star, Brass Eagle®, Viewloader®, Autococker®, Stearns®, Sospenders®, Mad Dog®, K2®, Völkl ®, Ride®, Morrow®, 5150®, Liquid®, Velvet, Recon, Marmot®, Ex Officio®, Marker®, Planet Earth®, Adio®, Hawk® skateboard shoes, Holden, Tubbs®, Atlas®, Little Bear®, JT®, Worr Games®, and Dana Designs®, are protected trademarks or registered trademarks of K2 or its subsidiaries in the United States and other countries worldwide. Olin® and Buzz Off are trademarks licensed to K2 or its subsidiaries from third parties.

Registered and other trademarks and trade names of K2 s products are italicized in this Form 10-Q.

PART II - OTHER INFORMATION

ITEM 6 Exhibits and Reports on Form 8-K

(a) Exhibits

10(a)	Second Amendment to the Amended and Restated Credit Agreement dated as of March 18, 2005.
31.1	Certification of the Chief Executive Officer Pursuant Rule 13a-15(e) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer Pursuant to Rule 13a-15(e) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.3	Certification of the Chief Operating Officer Pursuant to Rule 13a-15(e) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certifications of the Chief Executive Officer, Chief Financial Officer and Chief Operating Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K filed in the three months ended March 31, 2005.

Report on Form 8-K dated January 21, 2005, furnished by the Company, under Item 8.01, Other Events, containing the Company s press release dated January 21, 2005 announcing the expiration of an exchange offer with respect to its 7 3/8 Senior Notes due 2014.

Report on Form 8-K dated February 11, 2005, furnished by the Company: under Item 1.01, Entry into a Material Definitive Agreement, the Company entered into employment agreements with certain employees of the Company; under Item 1.02, Termination of Material Definitive Agreement, the prior employment agreement of Mr. Rangel was terminated on February 14, 2005; under item 5.02, Departure of Directors or Principal Officer; Election of Directors; Appointment of Principal Officers, the Company s press release dated February 17, 2005 announcing the election of Ann Meyers to the

Board of Directors of the Company on February 11, 2005; under item 5.03, Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year, the Board of Directors of the Company amended the By-Laws of the Company; and under Item 8.01, Other Events, containing the Company s press release dated February 17, 2005 announcing the record and meeting dates for the 2005 annual meeting of shareholders.

Report on Form 8-K dated March 1, 2005, furnished by the Company, under Item 2.02, Results of Operations and Financial Condition, containing the Company s press release dated March 1, 2005 announcing financial results for the quarter ended December 31, 2004 and forward-looking statements relating to the first quarter 2005 and the fiscal year 2005.

Report on Form 8-K dated March 1, 2005, furnished by the Company, under Item 7.01, Regulation FD Disclosure, containing certain statements made by the Company in connection with the Company s fourth quarter 2004 earnings conference call and furnishing of its earnings release dated March 1, 2005.

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

K2 INC.
(registrant)

Date: May 6, 2005

/s/ *THOMAS R. HILLEBRANDT*
Thomas R. Hillebrandt
Corporate Controller
(Chief Accounting Officer)