YOUTHSTREAM MEDIA NETWORKS INC
Form 3
February 18, 2005

FORM 3

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

OMB Number:	3235-0104
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

INITIAL STATEMENT OF BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Â Lane James Nelson

(Last) (First) (Middle)

C/O DEVONWOOD CAPITAL PARTNERS,Â 335 MADISON AVE, 16TH FLOOR

(Street)

NEW YORK,Â NYÂ 10017

(City) (State) (Zip)

2. Date of Event Requiring Statement
(Month/Day/Year)
02/15/2005

3. Issuer Name **and** Ticker or Trading Symbol
YOUTHSTREAM MEDIA NETWORKS INC [OTCbb:YSTM]

4. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director
_____ 10% Owner
_____ Officer (give title below)
_____ Other (specify below)

5. If Amendment, Date Original Filed(Month/Day/Year)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Beneficially Owned

1.Title of Security (Instr. 4)	2. Amount of Securities Beneficially Owned (Instr. 4)	3. Ownership Form: Direct (D) or Indirect (I) (Instr. 5)	4. Nature of Indirect Beneficial Ownership (Instr. 5)

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

SEC 1473 (7-02)

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Table II - Derivative Securities Beneficially Owned (*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 4)	2. Date Exercisable and Expiration Date (Month/Day/Year)	3. Title and Amount of Securities Underlying Derivative Security (Instr. 4)	4. Conversion or Exercise Price of Derivative Security	5. Ownership Form of Derivative Security: Direct (D)	6. Nature of Indirect Beneficial Ownership (Instr. 5)
		Title			

	Date Exercisable	Expiration Date		Amount or Number of Shares		or Indirect (I) (Instr. 5)	
Option to purchase common stock	Â (1)	02/15/2012	Common Stock	200,000	$ 0.3	D	Â

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Lane James Nelson C/O DEVONWOOD CAPITAL PARTNERS 335 MADISON AVE, 16TH FLOOR NEW YORK,Â NYÂ 10017	Â X	Â	Â	Â

Signatures

James N. Lane (By Mark F. Coldwell by Power of Attorney)	02/18/2005
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 5(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) The option vests over a 12-month period in equal monthly installments beginning March 1, 2005

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *See* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. 1,548 Deferred financing costs, net 363 752 Other assets 656 1,724 -------- -------- Total assets $ 85,940 $ 81,251 ======== ======== LIABILITIES AND MEMBER'S EQUITY (DEFICIT) Current liabilities: Revolver debt $ 30,102 $ -- Trade accounts payable 2,092 1,871 Accrued expenses and other liabilities 16,208 15,963 Income taxes payable 198 100 -------- -------- Total current liabilities 48,600 17,934 Revolver debt -- 27,680 Senior Notes (including $13,926 and $13,726, respectively, payable to Members of Parent and affiliates) 21,994 21,460 Pension and other employee benefits 9,108 20,604 Other liabilities 2,289 3,483 -------- -------- Total liabilities 81,991 91,161 Commitments and contingencies Member's equity : Member's capital 24,902 24,902 Accumulated deficit (2,350) (8,845) Accumulated other comprehensive loss (18,603) (25,967) -------- -------- Total member's equity (deficit) 3,949 (9,910) -------- -------- Total liabilities and member's equity (deficit) $ 85,940 $ 81,251 ======== ======== See accompanying notes. F-2 EJ FOOTWEAR GROUP (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Combined Statements of Operations (In thousands) 2004 2003 2002 -------- -------- -------- Net sales $146,802 $124,787 $124,541 Operating costs and expenses: Cost of products sold 78,914 67,225 76,578 Selling, general and adminstrative expenses 52,116 47,550 44,948 Management and advisory fees 1,347 1,116 1,622 Provision for doubtful accounts 803 510 750 Impairment, restructuring and other charges -- -- 2,426 -------- -------- -------- Operating income (loss) 13,622 8,386 (1,783) Interest expense 5,101 4,967 6,329 Interest income from affiliates (289) (67) -- Loss on debt extinguishment, net -- -- 1,099 Other expense, net 788 591 592 -------- -------- -------- Income (loss) before income taxes 8,022 2,895 (9,803) Income tax expense (benefit) 1,527 (1,590) 1,298 -------- -------- -------- Net income (loss) $ 6,495 $ 4,485 $(11,101) ======== ======== ======== See accompanying notes. F-3 EJ FOOTWEAR GROUP (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Combined Statements of Member's Equity (Deficit) (In thousands) MEMBER'S ACCUMULATED ACCUMULATED OTHER EQUITY DEFICT COMPREHENSIVE LOSS TOTAL -------- ---------- ------------------ -------- Balance at October 1, 2001 $ 117 $ (2,229) $ -- $ (2,112) Transfer of Senior Notes to SILLC Holdings 6,694 -- -- 6,694 Capital contribution from SILLC Holdings 20,929 -- -- 20,929 Assets transferred and liabilities assumed from

affiliate (2,838) -- -- (2,838) Net loss -- (11,101) -- (11,101) Minimum pension liability adjustment (net of income tax benefit of $1,240) -- -- (18,705) (18,705) -------- Comprehensive loss (29,806) ------- -------- -------- -------- Balance at September 30, 2002 24,902 (13,330) (18,705) (7,133) Net income -- 4,485 -- 4,485 Minimum pension liability adjustment (net of income taxes of nil) -- -- (7,262) (7,262) -------- Comprehensive loss (2,777) ------- -------- -------- -------- Balance at September 30, 2003 24,902 (8,845) (25,967) (9,910) Net income -- 6,495 -- 6,495 Minimum pension liability adjustment (net of income taxes of $4) -- -- 7,364 7,364 -------- Comprehensive income 13,859 ------- -------- -------- -------- Balance at September 30, 2004 $24,902 $ (2,350) $(18,603) $ 3,949 ======= ======== ======== ======== See accompanying notes F-4 EJ FOOTWEAR GROUP (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Combined Statements of Cash Flows (In thousands) YEAR ENDED SEPTEMBER 30 --------------------------- 2004 2003 2002 ------- ------- -------- OPERATING ACTIVITIES Net income (loss) $ 6,495 $ 4,485 $(11,101) Adjustments to reconcile net (loss) income to net cash provided by operating activities: Depreciation and amortization 691 831 1,568 Amortization of debt discount and deferred financing costs 923 923 876 Deferred income taxes 446 (1,731) 1,298 Provision for doubtful accounts 803 510 750 Loss on sale of machinery and equipment and idle assets, net 278 -- 55 Loss on debt extinguishment, net -- -- 1,099 Impairment, restructuring and other charges -- -- 1,860 Changes in operating assets and liabilities: Trade receivables (6,380) (3,729) 2,146 Inventories 746 (2,572) 11,812 Other current assets 387 (136) 436 Other assets 342 (13) (523) Trade accounts payable 221 (887) (1,068) Accrued expenses and other liabilities 343 3,217 1,303 Other non-current liabilities (5,323) 428 (676) ------- ------- -------- Net cash (used in) provided by operating activities (28) 1,326 9,835 INVESTING ACTIVITIES Loans to affiliates (2,500) (5,500) -- Purchases of machinery and equipment (602) (543) (579) Proceeds from sale of machinery and equipment and idle assets 434 -- 5,867 ------- ------- -------- Net cash (used in) provided by investing activities (2,668) (6,043) 5,288 FINANCING ACTIVITIES Proceeds from (repayment of) revolver, net 2,422 4,694 (13,370) Proceeds from long-term debt -- -- 9,401 Repayments of Senior Notes -- -- (32,200) Deferred financing costs -- -- (322) Capital contribution - Parent -- -- 20,929 ------- ------- -------- Net cash provided by (used in) financing activities 2,422 4,694 (15,562) ------- ------- -------- Net decrease in cash (274) (23) (439) Cash at beginning of year 368 391 830 ------- ------- -------- Cash at end of year $ 94 $ 368 $ 391 ======= ======= ======== See accompanying notes. F-5 EJ FOOTWEAR GROUP (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Combined Statements of Cash Flows (In thousands) YEAR ENDED SEPTEMBER 30 ------------------------- 2004 2003 2002 ------- ------ ------- SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION Cash paid for interest $ 5,622 $4,005 $ 4,120 ======= ====== ======= Cash paid for income taxes $ 982 $ -- $ -- ======= ====== ======= NON-CASH TRANSACTIONS Minimum pension liabilty $(7,368) $7,262 $19,945 ======= ====== ======= Senior Notes transferred to SILLC Holdings (net of debt discount) $ -- $ -- $ 6,694 ======= ====== ======= Assets transferred and liabilities assumed from affiliate $ -- $ -- $(2,838) ======= ====== ======= F-6 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 1. BASIS OF PRESENTATION AND DESCRIPTION OF THE GROUP EJ Footwear Group ("the Group") is made up of three separate companies, EJ Footwear LLC ("EJ Footwear"), HM Lehigh Safety Shoe Co. LLC ("Lehigh"), and Georgia Boot LLC ("Georgia Boot"), each of which are wholly owned subsidiaries of SILLC Holdings, LLC ("SILLC Holdings"). SILLC Holdings, a wholly-owned subsidiary of Strategic Industries, LLC ("Strategic"), acquired EJ Footwear on March 24, 2000, and has owned 100% of EJ Footwear since such date. Prior to December 1, 2001 Lehigh and Georgia Boot were wholly-owned subsidiaries of EJ Footwear. The acquisitions of Georgia Boot and Lehigh by SILLC Holdings from EJ Footwear on December 1, 2001 did not result in a change in the historical carrying values of their respective assets and liabilities as all entities were under common control. The members of Strategic are not personally liable for any liabilities of the Group. Strategic and its majority member, Citicorp Venture Capital LP Holdings, Limited ("CVC"), individually or collectively are referred to as the Parent depending on the context. NATURE OF BUSINESS The Group is a designer, developer, marketer, and distributor of high-quality, branded footwear products in the work, western boot, outdoor, and occupational safety markets. The Group's products are sold primarily in the United States under owned brands including Georgia Boot, Lehigh, Durango, and Barclay Shoe, and licensed brands including Dickies, John Deere, and After Six. The Group sources 100% of its products from low-cost suppliers, primarily throughout Asia. These suppliers work closely with the Group in the design, development, and manufacture of its products. 2. SIGNIFICANT ACCOUNTING POLICIES PRINCIPLES OF COMBINATION: The combined financial statements include the accounts of EJ Footwear, Georgia Boot, Lehigh and their subsidiaries. The accounts, results of operations and cash flows of the companies in the Group have been combined due to the common ownership of SILLC Holdings in these entities. The accompanying financial statements do not represent those of a single legal entity. Intercompany accounts and transactions within the Group are eliminated. FISCAL YEAR: The Group's fiscal year ends on the Saturday nearest to September 30. The fiscal year data contained herein reflect results of operations for the 53 week period ended October 2, 2004, and the 52 week periods ended September 27, 2003 and September 28, 2002. Fiscal year end dates are presented as September 30 for convenience of reference. USE OF ESTIMATES: The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. INVENTORIES AND CONCENTRATION OF SUPPLIERS: Inventories are valued at the lower of cost, determined under the first-in, first-out method, or market and consist predominately of finished goods. A significant portion of the Group's purchases are made from four suppliers, which together accounted for approximately 56%, 61% and 69% of the total inventory purchases for the years ended September 30, 2004, 2003 and 2002, respectively. These suppliers are located in foreign countries, principally the Far East. Although there is a concentration of sources of supply, management has taken steps to broaden the supplier base thereby reducing the reliance place on the suppliers. F-7 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) MACHINERY AND EQUIPMENT: Machinery and equipment are stated on the basis of cost less accumulated depreciation provided under the straight-line method over the estimated useful lives of the assets. Machinery and equipment are depreciated based on lives varying from three to ten years. Leasehold improvements are amortized over the shorter of their estimated useful lives or the initial terms of the Group's leases. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the Group reviews the recoverability of machinery and equipment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be recoverable. If impairment has been determined, the carrying amount of the long-lived assets is reduced by the difference between the carrying amount and estimated fair value, as determined by discounted cash flow analysis over the remaining useful life. DEFERRED FINANCING COSTS: Deferred financing costs consist of costs incurred in connection with the Strategic Credit Facility and the Senior Notes and are being amortized on a straight-line basis over the terms of the respective agreements. Amortization expense related to these costs was $389, $389 and $363 for the fiscal years ended September 30, 2004, 2003, and 2002, respectively, would not differ materially from amortization computed using the interest method, and is included in interest expense. REVENUE RECOGNITION: Revenue is recognized upon shipment of product to the customer. Provisions are made for warranty and return costs at the time of sale. SHIPPING AND HANDLING COSTS: Shipping and handling costs are included in selling, general and administrative expenses and were $4,107, $3,505 and $3,128 for the years ended September 30, 2004, 2003 and 2002, respectively. ADVERTISING COSTS: Advertising costs are expensed as incurred. Such amounts totaled $3,813, $2,933 and $2,692 for the years ended September 30, 2004, 2003 and 2002, respectively. F-8 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) INCOME TAXES: Effective with the sale of Georgia Boot and Lehigh by EJ Footwear to SILLC Holdings, each of the companies in the Group elected to be treated as a C Corporation for tax purposes. Each company independently generates its own income taxes and files its own tax returns. The sum of such is reflected in the income taxes as presented in the combined statements of operations. Prior to December 1, 2001 the companies within the Group were not subject to income taxation at the entity level as they filed as limited liability companies which, for income tax purposes, passed items of income and expense through to its members. Accordingly, such members were responsible for any income tax liabilities resulting from the Group's operations prior to December 1, 2001. Deferred tax assets and liabilities of the Group are computed based on the difference between the financial reporting and tax bases of assets and liabilities using enacted tax rates and laws. Deferred income tax expense or benefit is based on the changes in the asset or liability from period to period. FINANCIAL INSTRUMENTS: The fair market value of all short-term financial instruments approximates their carrying value due to their short maturity. The fair market value of all long-term financial instruments, other than the Group's Senior Notes, also approximate carrying value as they are based on floating interest rates and terms that continue to be available to the Group. The fair value of the Group's Senior Notes approximates $20,274 at September 30, 2004 and $19,600 at September 30, 2003.

ACCUMULATED OTHER COMPREHENSIVE LOSS: Accumulated other comprehensive loss consists of the Group's minimum pension liability adjustment net of taxes. RECENT ACCOUNTING PRONOUNCEMENTS: In December 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 132 (revised 2003), Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB statements No. 87, 88 and 106. This Statement revises employers' disclosures about pension plans and other postretirement benefit plans. It does not change the measurement and recognition of those plans required by FASB Statements 87, 88 and 106. This Statement retains the disclosure requirements contained in the original Statement 132. It requires additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit plans and other defined benefit postretirement plans. This Statement is effective for financial statements with fiscal years ending after December 15, 2003, except for the disclosure of estimated future benefit payments and information about foreign plans, which is effective for fiscal years ending after June 15, 2004. The Group adopted this Statement in fiscal 2004 and has incorporated all required disclosure provisions relating to the Group. F-9 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity. SFAS No. 150 established standards for how a company classifies and measures certain financial instruments with characteristics of both liabilities and equity. FAS 150 was effective for financial instruments entered into or modified after May 31, 2003, and was otherwise effective for the Company during the fourth quarter of 2003. The adoption of SFAS No. 150 did not have any impact on the Group's operating results or financial position. In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46). FIN 46 addresses consolidation by business enterprises of variable interest entities with certain defined characteristics. FIN 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first annual reporting period beginning after December 15, 2004, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The Group does not have any interests in any variable interest entities. This interpretation is not expected to have any impact on the accompanying financial statements. In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit of Disposal Activities. This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit and Activity (including Certain Costs Incurred in a Restructuring). The primary difference between this Statement and EITF Issue 94-3 relates to its requirements for recognition of a liability for a cost associated with an exit or disposal activity. This Statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. The Group adopted this Statement on January 1, 2003 and has incorporated the requirements of this statement into these combined financial statements. F-10 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 3. TRADE RECEIVABLES Trade receivables are summarized as follows: SEPTEMBER 30, ---------------- 2004 2003 ------- ------- Trade receivables $41,813 $35,721 Allowances for doubtful accounts and returns (2,229) (1,714) ------- ------- $39,584 $34,007 ======= ======= The Group operates principally in North America. The Group performs periodic credit evaluations of its customers' financial condition and does not require collateral. Credit losses have been within management's estimates and historical trends. For each period presented in the accompanying financial statements, no single customer accounted for more than 5% of combined net trade receivables or of combined net sales. 4. MACHINERY AND EQUIPMENT Machinery and equipment are summarized as follows: SEPTEMBER 30, ---------------- 2004 2003 ------- ------- Machinery and equipment $ 4,394 $ 3,918 Computer hardware and software 1,705 1,575 Accumulated depreciation and amortization (4,287) (3,607) ------- ------- $ 1,812 $ 1,886 ======= ======= Depreciation expense was $691, $831 and $1,558 for the years ended September 30, 2004, 2003 and 2002, respectively. 5. ACCRUED EXPENSES AND OTHER LIABILITIES Accrued expenses and other liabilities consist of the following: SEPTEMBER 30, ---------------- 2004 2003 ------- ------- Accrual for inventory purchases $11,031 $ 8,995 Compensation related 1,255 1,263 Accrued interest 21 1,493 Other 3,901 4,212 ------- ------- $16,208 $15,963 ======= ======= F-11 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 6. DISPOSITIONS In April 2004, EJ Footwear sold its Glendale, New York facility that it held as an idle asset in other non-current assets in the amount of $727 at September 30, 2003. The transaction resulted in a loss of $293 that is included in "other expense, net". EJ Footwear received a $129 property tax refund on the property that is also included in "other expense, net". In May 2004, Georgia Boot exercised its option to terminate the Hummer licensing agreement with a third party and sold all remaining inventory and dedicated production molds for $387, resulting in a loss of $430 (including costs to terminate the license agreement). The loss incurred on the sale is principally included in cost of products sold in fiscal 2004. Georgia Boot had entered into the license agreement in December 2002. The accompanying combined financial statements of the Group include the following operating results for the Hummer brand of products: YEAR ENDED SEPTEMBER 30, ----------------------- 2004 2003 ------- ----- Sales $ 1,259 $ 279 Pre-tax loss (1,359) (638) 7. IMPAIRMENT, RESTRUCTURING AND OTHER CHARGES The impairment, restructuring and other charges in fiscal 2002 are a result of the Group's management assessing its long-term strategy and deciding to eliminate all manufacturing operations and to focus principally on marketing and distributing product sourced from outside suppliers. In January 2002, management approved a plan to close the remaining domestic manufacturing facility and sell the warehouse operated by the Group. The production and distribution activities for these businesses have been out sourced to third parties. The restructuring plan, substantially completed in March 2002, resulted in a charge of $2,426 relating to employee costs of $1,056 (workforce reduction of 144 employees consisting primarily of production laborers), asset impairment of $852 and $518 for closing costs. In connection with the restructuring of the Group's operations, the Group also incurred inventory markdowns and other related costs aggregating $3,111. These costs are reflected in cost of products sold ($1,835) and selling, general and administrative costs ($1,276). During the year ended September 30 2002, the Group paid $566 related to the restructuring and other charges. The remaining costs related to the restructuring and other charges were paid in fiscal 2003. F-12 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 8. LONG-TERM DEBT Long-term debt consists of the following: SEPTEMBER 30, ---------------- 2004 2003 ------- ------- Strategic Credit Facility $30,102 $27,680 Senior Notes 23,594 23,594 ------- ------- 53,696 51,274 Less: Current portion of long-term debt 30,102 -- Unamortized debt discount 1,600 2,134 ------- ------- Long-term debt $21,994 $49,140 ======= ======= Strategic Credit Facility: The Group participates with other subsidiaries of SILLC Holdings in a revolving credit facility ("the Strategic Credit Facility"). The Strategic Credit Facility, as amended, provides for a senior secured revolving credit facility of up to $175,000 that matures March 24, 2005. The Strategic Credit Facility is collateralized by substantially all of the assets of the subsidiaries of SILLC Holdings, excluding certain foreign entities, and is guaranteed by SILLC Holdings. Total available borrowings are limited to certain percentages of certain eligible assets, primarily accounts receivable, inventory and equipment. Management of SILLC Holdings is currently in negotiations with the lender to amend the facility and to extend its terms and is of the opinion this will be accomplished before the Strategic Credit Facility matures. Borrowings under the Strategic Credit Facility are classified as a current liability at September 30, 2004. Interest rates on the Strategic Credit Facility are variable and are based on, at the option of SILLC Holdings, LIBOR or prime plus an applicable margin. In addition to paying interest on borrowings under the credit facility, SILLC Holdings is required to pay a commitment fee to the lenders on the unused portion of the revolving credit line. At September 30, 2004, 2003 and 2002, amounts outstanding under the Strategic Credit Facility bore interest at an average effective rate of 4.8%, 3.9% and 4.5% per annum, respectively. SILLC Holdings had approximately $43,000 available under the Strategic Credit Facility at September 30, 2004 (including $22,211 relating to the Group). The Group's usage of credit under the Strategic Credit Facility at September 30, 2004 and 2003 includes $1,740 and $2,053, respectively, under letters of credit (including standby letters of credit of nil and $355, respectively). F-13 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 8. LONG-TERM DEBT (CONTINUED) The Strategic Credit Facility contains mandatory prepayment provisions, subject to certain exceptions. The Strategic Credit Facility also contains financial covenants based on EBITDA, as defined in the amended facility, and limitations on incurrence of liens, incurrence of debt, issuance of equity interests, payment of dividends, transactions with affiliates, capital expenditures, loans, advances and investment. In addition, SILLC Holding's subsidiaries participating in the Strategic Credit Facility are restricted by their respective credit agreements from making payment of cash dividends, loans or advances to SILLC Holdings. Senior Notes: On March 24, 2000, in connection with the formation of SILLC Holdings and the acquisition of EJ Footwear (see Note 1), Strategic Finance Company, a wholly owned subsidiary of SILLC Holdings, issued, as agent for several of SILLC Holdings'

Explanation of Responses:

subsidiaries, the original Senior Notes to members of the Parent. The Senior Notes bear interest payable semiannually on April 1 and October 1 of each year at 12 1/2% per annum through maturity on October 1, 2007, with a principal payment of $3,500 from SILLC Holdings due on April 1, 2007. The Senior Notes are guaranteed on an unsecured senior basis by SILLC Holdings, the Group and several of SILLC Holdings' other domestic subsidiaries, and are subordinated to all existing and future secured indebtedness. SILLC Holdings and the guaranteeing subsidiaries have the option to redeem the Senior Notes at prices set forth in the Indenture Agreement, or as agreed to with specific noteholders, and may repurchase the Senior Notes if certain assets are sold or must offer to repurchase if there is a change in control (as defined in the Indenture Agreement). SILLC Holdings and its domestic subsidiaries had $99,628 of Senior Notes outstanding at September 30, 2004. The Senior Notes of the Group have been reduced by unamortized debt discount of $1,600 and $2,134 at September 30, 2004 and 2003, respectively, which was recorded to reflect the fair value of the Senior Notes allocated to the Group at the time of issuance. The debt discount is being amortized over the life of the issuance. Debt Refinancing: On January 16, 2002, SILLC Holdings completed a transaction whereby the Group and the other domestic subsidiaries of SILLC Holdings acquired the original Senior Notes from affiliates of U.S. Industries, Inc. ("USI"), the former parent of the Group, and settled the accrued interest thereon at a discount. The Group realized a net loss of $1,099 in connection with the repurchase of the Senior Notes (write off of debt discount of $1,934 net of $835 gain due to the lower interest payment). SILLC Holdings funded the repurchase of the Senior Notes and payment of other costs incurred in connection with the transaction principally with proceeds from (i) the issuance of new Senior Notes, (ii) borrowings under the Strategic Credit Facility, (iii) and additional equity from its Parent. In connection with the transaction, the Group repaid $32,200 of Senior Notes owed to USI, issued new Senior Notes for $9,275 (including $2,111 to members and related parties of the Parent), borrowed $2,849 under the Strategic Credit Facility and received a capital contribution of $20,929 from SILLC Holdings. In addition, at the time of this transaction with USI, CVC charged a $462 advisory fee to the Group. F-14 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 8. LONG-TERM DEBT (CONTINUED) Principal payments on long-term debt recorded by the Group for the next five years ended September 30 are as follows: 2005 $30,102 2006 -- 2007 -- 2008 23,594 2009 -- Thereafter -- ------- $53,696 ======= 9. PENSION AND OTHER POST-RETIREMENT BENEFITS The Group is a member of the Strategic Industries Group Pension Plan ("Pension Plan") which covers all of the employees of the Parent and its domestic subsidiaries. The investments of the Pension Plan are managed under a single master trust. Benefits under the Pension Plan are based primarily on years of credited service and compensation as defined under the respective plan provisions or on a flat amount per credited year of service. SILLC Holdings' funding policy is to contribute amounts to the plans sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974. SILLC Holdings uses a measurement date of June 30 for its pension plan and September 30 for the other postretirement plan. On June 30, 2003, the Board of Directors of SILLC Holdings approved a plan to freeze the Pension Plan for all non-bargained employees effective July 1, 2003. The impact of the plan freeze resulted in a decrease to the Group's benefit obligation of $2,548 related to an unrecognized gain. In connection with the fiscal 2004 and 2003 valuations, the Group was required to recognize a minimum pension liability of $19,839 and $27,207 as of September 30, 2004 and 2003, respectively, and a related benefit (charge) to other comprehensive income (loss) of $7,364 (net of income taxes of $4) and $(7,262) (net of income tax benefit of nil) for the years then ended. The minimum liability is equal to the excess of the accumulated benefit obligation over plan assets. SILLC Holdings and certain subsidiaries, including the Group, participate in the Strategic Industries LLC Retirement and Savings Investment Plan (the "Plan"). The 401(k) defined contributions plan covers substantially all employees. The Plan provides that eligible employees may contribute a portion of their eligible earnings to the Plan. On July 1, 2003, the Plan was amended from an employer's matching contribution of 50% of the employee's first 6% of contributions to 100% of the employees first 4% of contributions. Employees are immediately vested in the Plan once they have met the eligibility requirements. The Plan, similar to the Pension Plan, is managed under a single master trust. The Group contributed $451, $258 and $299 during the years ended September 30, 2004, 2003, and 2002, respectively. Several of the Parent's subsidiaries also provide health care and life insurance benefits for certain groups of retirees. In October 2003, the Group curtailed the benefits offered to certain retirees and recognized a gain of $975. The resulting gain is netted in selling, general and administrative expenses for the year ended September 30, 2004. F-15 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 9. PENSION AND OTHER POST-RETIREMENT

BENEFITS (CONTINUED) The following table provides a reconciliation of changes in the projected benefit obligation, fair value of plan assets and the funded status of the Group's share of the Pension Plan and their postretirement benefit plans with the amounts recognized in the combined balance sheets: PENSION BENEFITS OTHER POST-RETIREMENT BENEFITS YEAR ENDED SEPTEMBER 30, YEAR ENDED SEPTEMBER 30, ----------------------- ----------------------------- 2004 2003 2004 2003 -------- -------- ----- ----- CHANGES IN PROJECTED BENEFIT OBLIGATION Benefit obligation at beginning of period $ 60,591 $ 57,498 $ 291 $ 557 Service cost -- 720 -- 2 Interest cost 3,754 4,065 -- 21 Plan amendments (curtailment and settlement) -- -- (291) -- Actuarial (loss) gain (4,013) 2,692 -- (122) Benefits paid (4,687) (4,384) -- (167) -------- -------- ----- ----- Benefit obligation at end of period $ 55,645 $ 60,591 $ -- $ 291 ======== ======== ===== ===== CHANGES IN FAIR VALUE OF PLAN ASSETS Fair value of assets at beginning of period $ 40,963 $ 44,785 $ -- $ -- Actual return on plan assets 5,783 550 -- -- Employer contributions 1,490 -- -- -- Benefits paid (4,675) (4,372) -- -- Assets transferred 309 -- -- -- -------- -------- ----- ----- Fair value of assets at end of period $ 43,870 $ 40,963 $ -- $ -- ======== ======== ===== ===== FUNDED STATUS OF PLANS Plan assets less than projected benefit obligation $(11,775) $(19,628) $ -- $(291) Employer contributions 2,692 3 -- -- Unrecognized prior service cost -- -- -- -- Unrecognized net actuarial (gain) loss 19,814 27,203 -- (684) -------- -------- ----- ----- Net amount recognized $ 10,731 $ 7,578 $ -- $(975) ======== ======== ===== ===== AMOUNTS RECOGNIZED IN THE BALANCE SHEET CONSIST OF Prepaid benefit cost $ -- $ -- $ -- $ -- Accrued benefit liability (9,108) (19,629) -- (975) Intangible asset -- -- -- -- Accumulated other comprehensive income 19,839 27,207 -- -- -------- -------- ----- ----- Net amount recognized $ 10,731 $ 7,578 $ -- $(975) ======== ======== ===== ===== At September 30, 2004 and 2003, the Group's projected benefit obligation is in excess of the fair value of plan assets. The Group's accumulated benefit obligation for all defined pension plans was $55,363 and $60,300 at September 30, 2004 and 2003, respectively. Included in the accrued pension benefit liability is the Group's unfunded Supplemental Executive Retirement Plan of $330 and $325 at September 30, 2004 and 2003. The Group's accumulated benefit obligation for this plan was $282 and $291 at September 30, 2004 and 2003 respectively. F-16 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 9. PENSION AND OTHER POST-RETIREMENT BENEFITS (CONTINUED) The change in the Pension Plan's actuarial assumptions had the effect of decreasing the Group's projected benefit obligation by $3,056 and increasing the projected benefit obligation by $5,180 for the years ended September 30, 2004 and 2003, respectively. PENSION BENEFITS OTHER POST-RETIREMENT BENEFITS YEAR ENDED SEPTEMBER 30, YEAR ENDED SEPTEMBER 30, --------------------------- ----------------------------- 2004 2003 2002 2004 2003 2002 ------- ------- -------- ----- ----- ----- WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE BENEFIT OBLIGATIONS Discount rate 7.00% 6.50% 7.25% N/A 6.50% 6.75% Rate of compensation increase -- -- 3.00% N/A -- 4.00% WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE NET PERIODIC BENEFIT COST Discount rate 6.50% 7.25% 7.25% N/A 6.50% 6.75% Expected return on plan assets 10.00% 10.00% 10.00% N/A -- -- Rate of compensation increase -- 3.00% 3.00% N/A -- 4.00% COMPONENTS OF NET PERIODIC BENEFIT COST Defined benefit plans: Service cost $ -- $ 720 $ 2,406 $ -- $ 2 $ -- Interest cost 3,754 4,065 8,103 -- 21 42 Expected return on plan assets (3,943) (4,265) (10,368) -- -- -- Amortization of gain 1,245 1,019 379 (684) (77) (33) Curtailment -- -- -- (291) -- -- ------- ------- -------- ----- ----- ----- Net periodic benefit cost (income) for defined benefit plans 1,056 1,539 520 (975) (54) 9 Defined contribution plans 451 258 299 -- -- -- ------- ------- -------- ----- ----- ----- Net periodic benefit cost $ 1,507 $ 1,797 $ 819 $(975) $ (54) $ 9 ======= ======= ======== ===== ===== ===== (Decrease) increase in minimum liability included in other comprehensive loss $(7,368) $ 7,262 $ 19,945 N/A N/A N/A ======= ======= ======== ===== ===== ===== The Pension Plan's weighted average asset allocations at June 30, 2004 and 2003 by asset category are as follows: PLAN ASSETS TARGET AT JUNE 30, ALLOCATION ---------- ASSET CATEGORY 2005 2004 2003 ------------- ---------- ---- ---- Equity securities 65% 68% 54% Fixed income funds 30 17 35 Limited Partnership 5 14 -- Real estate -- -- 9 Other -- 1 2 --- --- --- 100% 100% 100% === === === The fair value of the plan assets for the Pension Plan was $104,406 and $86,125 at September 30, 2004 and 2003, respectively. F-17 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 9. PENSION AND OTHER POST-RETIREMENT BENEFITS (CONTINUED) The pension trust is managed by an outside investment manager. The investment objectives for the trust are to satisfy all pension benefit payments and to earn a real (inflation-adjusted) rate of return over an extended time period. The Group expects to contribute $533 to its pension plan in fiscal 2005. The expected benefit payments from the plan over the next ten years are as follows: 2005 $ 4,390 2006 4,414 2007 4,498 2008 4,628 2009 4,669 2010-2014 25,476 10. INCOME TAXES Federal and state income tax expense (benefit) consists of: YEAR ENDED SEPTEMBER 30, ------------------------- 2004 2003 2002 ------ ------- ------ Current: Federal $ 770 $ 113 $ -- State 311 28 -- ------ ------- ------ 1,081 141 -- DEFERRED: Federal 160 (1,731) 1,177 State 286 -- 121 ------ ------- ------ 446 (1,731) 1,298 ------ ------- ------ $1,527 $(1,590) $1,298 ====== ======= ====== Income before taxes was generated principally in the United States. Effective income taxes for the Group differ from statutory federal income taxes as follows: YEAR ENDED SEPTEMBER 30, -------------------------- 2004 2003 2002 ------- ------- ------- Statutory federal income taxes $ 2,819 $ 1,013 $(3,430) State income taxes (net of federal benefit) 373 141 (268) Losses with no tax benefit -- -- 670 Change in tax status of subsidiary -- -- 1,575 Change in valuation allowance (1,748) (2,919) 2,749 Other 83 175 2 ------- ------- ------- $ 1,527 $(1,590) $ 1,298 ======= ======= ======= F-18 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Finacial Statements (Dollars in thousands) 10. INCOME TAXES (CONTINUED) SEPTEMBER 30, ------------------ 2004 2003 ------- -------- DEFERRED TAX LIABILITIES Machinery and equipment $ (257) $ (185) Unamortized debt discount (46) (61) ------- -------- Total deferred tax liabilities (303) (246) DEFERRED TAX ASSETS Accruals and allowances 1,401 1,986 Inventories 733 534 Pension and other employee benefits 3,529 7,981 Deductible goodwill 991 1,088 Net operating loss carryforwards 888 1,061 Valuation allowance (5,958) (10,673) ------- -------- Total deferred tax assets 1,584 1,977 ------- -------- Net deferred tax assets $ 1,281 $ 1,731 ======= ======== The classification of the deferred tax balance is: SEPTEMBER 30, -------------- 2004 2003 ------ ------ Current assets $ 600 $ 183 Non-current assets 681 1,548 ------ ------ Net deferred tax (liability) assets $1,281 $1,731 ====== ====== Approximately $2,900 of the change in the valuation allowance for the year ended September 30, 2004 is attributable to the decrease in the Group's minimum pension liability which has been recorded as an other comprehensive loss. The Group has net operating loss carryforwards (NOLs) of $2,322 for federal income tax purposes that expire fiscal 2017 through 2024. For financial reporting purposes, a valuation allowance of $888 at September 30, 2004 was recognized to offset the deferred tax assets related to these NOLs. The change in the Group's, tax status from a limited liability company to a C corporation, resulted in a deferred tax expense and related liability of $1,575 in fiscal 2002. F-19 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Finacial Statements (Dollars in thousands) 11. MEMBER'S EQUITY 100% of the outstanding common units of each company comprising the Group are owned by SILLC Holdings, LLC. The following table depicts the composition of the member's equity at September 30, 2004: RETAINED ACCUMULATED EARNINGS/ OTHER MEMBER'S (ACCUMULATED COMPREHENSIVE CAPITAL DEFICIT) LOSS -------- ------------ ------------- EJ FOOTWEAR $ 7,589 $(1,749) $(13,043) LEHIGH 13,544 (6,986) (2,228) GEORGIA BOOT 3,769 6,385 (3,332) ------- ------- -------- $24,902 $(2,350) $(18,603) ======= ======= ======== Each company in the group has 100 common units authorized and outstanding. In November 2001, the Group transferred $7,000 face value of Senior Notes to SILLC Holdings, less $306 of unamortized debt discount. The transaction resulted in a net increase to Member's Capital of $6,694. In connection with SILLC Holding's debt refinancing transaction in January 2002, (see note 8), a capital contribution of $20,929 was made to the Group by SILLC Holdings. In June 2002, SILLC Holdings sold the majority of the assets of its wholly-owned subsidiary, SCF Industries, Inc ("SCF"), a manufacturer and distributor of folding chairs and tables. On September 28, 2002, SILLC Holdings transferred the remaining assets and liabilities of SCF to EJ Footwear, resulting in a $2,838 decrease to Member's Capital. The following table summarizes the assets and liabilities transferred to EJ Footwear: Accounts receivable, net $ 106 Deferred financing costs, net 64 ------ Total assets 170 Trade accounts payable 65 Accrued expenses and other liabilities 606 Revolver debt 689 Other long-term liabilities 511 Senior notes (net of debt discount of $63) 1,137 ------ Total liabilities 3,008 ------ Net liabilities assumed $2,838 ====== F-20 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 12. RELATED PARTY TRANSACTIONS MANAGEMENT AND ADVISORY FEES: Strategic and a subsidiary have provided certain services to the Group in connection with its operations. These services principally included legal, finance, tax, risk management, employee benefits and acquisition and divestiture related services. The management fees charged to the Group for these services were $999, $928, and $1,064 for the years ended September 30, 2004, 2003, and 2002, respectively. Management fees were paid prior to year-end and were allocated in the direct proportion of the Group's revenues to the consolidated revenues of SILLC Holdings. The management fees are not necessarily indicative of the costs that would have been incurred if the Group had been a stand-alone entity. Effective January 15, 2002, CVC began to charge the domestic subsidiaries of SILLC Holdings an annual fee for advisory services that will be the greater of $1,000 or 2% of annual combined EBITDA (as defined in the agreement). The Group was charged $348, $188, and $558 for the years ended September 30, 2004, 2003, and 2002, respectively. The advisory fees were paid to CVC after the Group's fiscal year end for each period. LOANS WITH AFFILIATES: The Group made loans of $2,500 in fiscal 2004 and $5,500 in fiscal 2003 to two wholly-owned subsidiary companies of SILLC Holdings. The principal balances of $8,000 and $5,500 were outstanding at September 30, 2004 and 2003, respectively. The loans are payable on demand and bear interest (paid monthly) at the annual rate of 4%. The Group recognized interest income relating to these loans of $289 and $67 for the years ended September 30, 2004 and 2003, respectively. For the years ended September 30, 2004, 2003 and 2002, the Group incurred interest expense of $2,015, $2,015, and $3,175, respectively, on its Senior Notes payable to the majority members and affiliates of Strategic. At September 30, 2004 and 2003, the Group had accrued interest of nil and $908, respectively, payable to the majority members and affiliates of Strategic. OTHER TRANSACTIONS WITH AFFILIATES: The Group performs certain importing services for two wholly-owned subsidiaries of SILLC Holdings. In 2004, the Group recorded sales of $796 relating to one of these entities for activities started in such period. Net profit relating to the services rendered were $69, $79 and $31 for the years ended September 30, 2004, 2003 and 2002, respectively, and is recorded in the cost of products sold. The charges are settled in the normal course of business. F-21 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 12. RELATED PARTY TRANSACTIONS (CONTINUED) In 2003, pursuant to the pending sale of a wholly-owned subsidiary by SILLC Holdings, Georgia Boot purchased the receivable balance of an account in bankruptcy from the subsidiary at the estimated net realizable value (carrying value) of $430. Subsequent to the transfer of the receivable, the bankruptcy case was settled, and the Group realized net gains of $787 and $769 in 2004 and 2003, respectively, which was recorded in Selling, General and Administrative expense. 13. COMMITMENTS AND CONTINGENCIES LICENSING AGREEMENTS: The Group has a licensing agreement with a third party for the use of the "Dickies" trademark. The agreement, which matures in December 2007, may be terminated by Dickies if contract minimums are not met for any contract year. The Group is contracted to pay royalties at 5% of net shipments with minimum royalties averaging approximately $350 in each calendar year through 2007. Royalty expense under the agreement was $644, $418, and $219 for fiscal years ended September 30, 2004, 2003 and 2002, respectively. In fiscal 2003, the Group entered into a licensing agreement with a third party for the use of the "John Deere" trademark. The agreement covers the United States of America and its possessions, military posts exchanges, and Canada. The agreement expires in July 2005 with an early cancellation clause that is exercisable if royalties earned through January 2005 are less than $125. The agreement requires minimum royalties of $600 for the period of July 30, 2003 to July 30, 2006 if the early cancellation clause is not exercised. The agreement automatically renews for an additional 3-year term if minimum royalties are met. Royalty expense was $75 for the year ended September 30, 2004 for royalties earned under this agreement. The Group has a licensing agreement with a third party for the use of the "After Six" trademark. The agreement covers the United States of America and its territories and possessions, Mexico and Canada. The current term expires in June 2005. Renewals must be negotiated. The agreement calls for royalties earned based upon 5% of applicable net sales with minimum annual royalties of $100. Royalty expense was $96, $117, and $212 for the years ended September 30, 2004, 2003 and 2002, respectively. Royalty expenses are included in selling, general and administrative expenses. F-22 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 13. COMMITMENTS AND CONTINGENCIES (CONTINUED) SERVICE AGREEMENT: In fiscal 2002, the Group entered into a warehouse and fulfillment service agreement with a third party to warehouse and distribute the Group's product. The agreement runs through October 2007 and contains an early cancellation clause. Charges under the agreement are based upon set rates per pair shipped with minimum monthly charges of $138 per month. Distribution and handling charges incurred under the agreement were $2,862 and $2,158 for the years ended September 30, 2004 and 2003, respectively. The agreement required the Group to share in the initial set up costs of the distribution center. For the year ended September 30, 2002, $1,276 for set up costs was included in selling, general and administrative expenses. ENVIRONMENTAL: The Group is subject to a wide range of environmental protection laws. EJ Footwear has been named as a Potentially Responsible Party ('PRP') at three 'Superfund' sites pursuant to the Comprehensive Environmental Response, Compensation and Liability Act of 1980 or comparable statutes. Remediation work has been completed at two of the sites and remedial and investigatory activities are currently underway at the third site. It is often difficult to estimate the future impact of environmental matters, including potential liabilities. The Group accrues for losses associated with environmental remediation obligations when such losses are probable and reasonably estimable. This practice is followed whether the claims are asserted or unasserted. Accruals for estimated losses from environmental remediation are based primarily upon internal or third party environmental studies, and estimates as to the number, participation level, and financial viability of any other PRP's, the extent of contamination, and the nature of required remedial actions. Such accruals are adjusted as further information develops or circumstances change. Costs of future expenditures for environmental remediation obligations are not discounted to their present value. At September 30, 2004, the Group had accrued as long-term obligations approximately $362 for various environmental related liabilities of which the Group is aware. Management expects that the amount accrued will be paid out over the periods of remediation for the applicable sites which range up to 30 years and that such accruals are adequate based on all current data. Remediation work has been completed at two of the sites and remedial and investigatory activities are currently underway at the third site; however, no currently available information reasonably suggests that projected expenditures associated with remedial action or compliance with environmental laws for any single site or for all sites in the aggregate, will have a material adverse effect on the Group's financial condition, results of operations or cash flow. Recoveries of environmental remediation costs from other parties are recognized as assets when their receipt is deemed probable. The Group recovered $328 in fiscal 2003 which is netted in selling, general and administrative expenses. In 2004, the Group filed proof of claims for environmental remediation costs already paid totaling $722 against its excess insurance carrier. The insurance carrier is currently in liquidation, controlled by the state of New Hampshire. A supplemental claim was also filed with the New York State Department of Insurance Liquidation Bureau under their insurance guarantee fund. Collection of the claim is uncertain and recovery of this claim has not been recognized by the Group. F-23 EJ Footwear Group (Comprised of wholly-owned subsidiaries of SILLC Holdings, LLC) Notes to Combined Financial Statements (Dollars in thousands) 13. COMMITMENTS AND CONTINGENCIES (CONTINUED) OTHER LEGAL MATTERS The Group is a defendant or plaintiff in lawsuits that have arisen in the normal course of business. While certain of these matters involve substantial amounts, it is management's opinion, based on the advice of counsel, that the ultimate resolution of such litigation will not have a material adverse effect on the Group's financial condition, results of operations or cash flows. LEASES: The Group leases office and warehouse facilities under noncancellable operating leases. These leases, for the most part, contain renewal options as well as inflationary escalation clauses. Rental expense for operating leases was $2,897, $2,875 and $2,914 for the years ended September 30, 2004, 2003 and 2002, respectively. Future minimum rental commitments under non-cancelable operating leases as of September 30, 2004 are: 2005 $2,093 2006 1,226 2007 758 2008 225 ------ $4,302 ====== 14. SUBSEQUENT EVENT (UNAUDITED) On December 6, 2004, SILLC Holdings executed a definitive agreement to sell the Group to Rocky Shoes and Boot ("Rocky"). The total purchase price for 100% of the equity interest of EJ Footwear, Georgia Boot and Lehigh will be $87,700 in cash plus 484,254 restructured shares of Rocky's common stock, which were valued at an aggregate of $10,000 at the date of the definitive agreement. Net proceeds to SILLC Holdings after closing and other related costs is estimated to be approximately $90,758. The closing is expected in early January 2005 and is subject to Rocky's receipt of obtaining a firm financing commitment and other customary conditions. In connection with this transaction, SILLC Holdings will repay or retain the Group's debt obligations of $52,096 at September 30, 2004 and will retain the Group's pension obligation and certain other employee related obligations totaling $10,176, and environmental liabilities of $362 at September 30, 2004. F-24 PRO FORMA CONSOLIDATED FINANCIAL DATA The unaudited pro forma consolidated financial statements have been derived from the application of pro forma adjustments to the historical consolidated financial statements of Rocky Shoes & Boots, Inc. and EJ Footwear LLC, Georgia Boot LLC, and HM Lehigh Safety Shoe Co. LLC (the "EJ Footwear Group"). The unaudited pro forma consolidated financial statements are not necessarily indicative of the results that would have actually occurred if the transaction had been in effect on the dates indicated below or that may occur in the future. The accompanying unaudited pro forma consolidated balance sheet of the combined companies at December 31, 2004, and the related unaudited statement of operations for the year then ended give effect of the pro forma basis of the transaction. The unaudited pro forma consolidated statement of operations for the year ended December 31, 2004 includes the consolidated statement of operations of Rocky Shoes & Boots, Inc. for the year ended December 31, 2004, and the consolidated statement of operations of the EJ Footwear Group for the year ended September 30, 2004, as if the transaction were consummated on January 1, 2004. The unaudited pro forma adjustments and preliminary allocation of the purchase price are based on valuations and other studies that have not yet been completed. Accordingly, the actual allocation of purchase price and the resulting effect on net income may differ significantly from the pro forma accounts included herein. The unaudited pro forma financial information is presented for informational purposes only. The EJ Footwear acquisition will be accounted for by the purchase method of accounting. Under purchase accounting, the total purchase price will be allocated to the tangible and intangible assets and liabilities of EJ Footwear based upon their respective fair values. A preliminary allocation of the purchase price has been made to major categories of assets and liabilities based on available information. The actual allocation of purchase price and the resulting effect on income from operations may differ significantly from the pro forma amounts included herein. The aggregate purchase price for the interests of EJ Footwear Group was $91.2 million in cash, 484,261 shares of the Company's common stock (the "Shares"), which were valued at $10 million on the date of signing of the Agreement and $11,573,000 on the closing date, and direct transactions costs of $1.6 million, including legal, accounting and advisory services. PF-1 PRO FORMA CONSOLIDATED BALANCE SHEET AS OF DECEMBER 31, 2004 Rocky Shoes and Adjustments Boots, Inc EJ Footwear Group for Seller- Transaction December 31, 2004 December 31, 2004 retained Items Adjustments Total ---------------- ---------------- ------------- ---------- ------------ ASSETS Cash and cash equivalents $ 5,060,859 $ (317,633) $ 317,633 $ -- $ 5,060,859 Trade receivables - net 27,182,198 29,521,892 -- 56,704,090 Other receivables 1,114,959 8,000,000 (8,000,000) 1,114,959 Inventories 32,959,124 33,880,758 -- 66,839,882 Deferred income taxes 230,151 600,000 (600,000) 1,071,154(E) 1,301,305 Income tax receivable 2,264,531 2,264,531 Prepaid expenses & other current assets 588,618 263,086 -- 851,704 ----------- ------------ ------------ Total current assets 69,400,440 71,948,103 134,137,330 Fixed assets - net 20,179,486 1,708,155 825,000(A) 22,712,641 Deferred pension asset 1,347,824 -- 1,347,824 Deferred income taxes 681,000 (681,000) -- -- Finite-lived intangible assets 8,500,000(B) 8,500,000 Indefinite lived intangible assets 2,725,886 38,500,000(B) 41,225,887 Goodwill 1,557,861 361,000 (361,000) 16,378,517(G) 17,936,378 Other assets 1,494,157 735,366 (159,351) 1,968,300(C) 4,038,472 ----------- ------------ ------------ Total Assets $96,705,654 $ 75,433,624 $229,898,532 =========== ------------ ============ LIABILITIES AND STOCKHOLDERS' EQUITY LIABILITIES: Current Liabilities Accounts Payable $ 4,349,248 $ 449,179 $ -- $ -- $ 4,798,427 Current maturities - long-term debt 6,492,020 27,928,305 (27,928,305) 6,492,020 Income taxes 627,074 (627,074) -- Accrued salaries and wages 1,295,722 1,115,781 -- 2,411,503 Accrued other 1,651,400 6,664,157 (663,570) 7,651,987 ----------- ------------ ------------ Total current liabilities 13,788,390 36,784,496 -- 21,353,937 Long-term debt - less current maturities 10,044,544 22,127,079 (22,127,079) 94,783,812(D) 104,828,356 Pension and other employee benefits 89,195 8,770,573 (8,770,573) 89,195 Deferred income taxes 1,205,814 -- 17,935,223(E) 19,141,037 Deferred liabilities 206,913 2,742,296 (1,407,838) 1,541,371 ----------- ------------ ------------ Total liabilities 25,334,856 70,424,444 146,953,896 SHAREHOLDERS' EQUITY: Common stock - no par value 38,399,114 -- 11,573,838(F) 49,972,952 Additional paid-in capital 24,901,868 (24,901,868) 0 Accumulated other comprehensive loss (1,077,586) (18,603,233) 18,603,233 (1,077,586) Retained earnings (deficit) 34,049,270 (1,289,455) 1,289,455 34,049,270 ----------- ------------ ------------ Total Shareholders' equity 71,370,798 5,009,180 82,944,636 ----------- ------------ ------------ TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY $96,705,654 $ 75,433,624 $229,898,532 =========== ============ ============ See notes to pro forma consolidated balance sheet PF-2 Rocky Shoes & Boots, Inc. Footnotes to Pro Forma Consolidated Balance Sheet December 31, 2004 (A) Adjust fixed assets to estimated fair value (B) Record estimated fair value of intangible assets acquired Finite lived intangibles: Customer list $ 3,500,000 License agreements 2,000,000 Patents 2,000,000 Internet domain names 1,000,000 ----------- $ 8,500,000 ----------- Indefinite lived intangibles: Trade names & trademarks $38,500,000 ----------- Estimated amounts are subject to final allocation based on independent appraisal of the fair value of assets acquired. (C) Record debt financing costs Total costs $2,901,803 Amounts paid prior to December 31, 2004 (933,503) ---------- $1,968,300 ---------- (D) Record debt incurred: GMAC term loan $18,000,000 American Capital Financial Services term loan 30,000,000 GMAC revolving credit agreement 46,783,812 ----------- $94,783,812 ----------- (E) Record deferred tax related to the acquisition. (F) Record the issuance of 484,261 common shares at $23.90, the average price of three days prior to and three days following the announcement of the transaction. PF-3 (G) Purchase price allocation: Cash $ 91,227,215 Common shares - 484,261 at $23.90 a share 11,573,838 Transaction costs 1,588,296 ------------ 104,389,349 ------------ Allocated to: Accounts receivable - net 29,521,892 Inventories 33,880,758 Deferred taxes 1,071,154 Other current assets 263,086 Fixed assets 2,533,155 Identified intangible assets 47,000,000 Other assets 576,015 Liabilities (8,900,005) Deferred taxes - long term (17,935,223) ------------ Goodwill $ 16,378,517 ------------ Cash purchase price is subject to final working capital adjustment. Estimated amounts are subject to final allocation based on independent appraisal of the fair value of assets acquired. Goodwill is not tax deductible. PF-4 PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS AS OF DECEMBER 31, 2004 Eliminate Impact of Rocky Shoes and EJ Footwear Items Boots, Inc Group Retained by Transaction December 31, 2004 September 30, 2004 Seller Adjustments Total ----------------- ------------------ ----------- ------------- ------------ Net sales $132,248,963 $146,801,962 $279,050,925 Cost of sales 93,606,600 78,914,242 172,520,842 ------------ ------------ ------------ Gross margin 38,642,363 67,887,720 -- -- 106,530,083 Selling, general and administrative expenses 25,617,944 54,267,123 (2,638,835)(A) 2,039,583(E) 79,285,815 ------------ ------------ ------------ Income (loss) before interest and taxes 13,024,419 13,620,597 27,244,268 Other income and (expenses) Interest expense (1,335,100) (5,101,347) 5,101,347(B) (6,677,838)(F) (8,012,938) Other - net 381,073 (498,976) (289,444)(C) (407,347) ------------ ------------ ------------ Total other - net (954,027) (5,600,323) (8,420,285) ------------ ------------ ------------ Income (loss) before income taxes 12,070,392 8,020,274 18,823,983 Total income taxes (benefit) 3,476,000 1,527,000 (1,527,000)(D) 2,566,400(G) 6,042,400 ------------ ------------ ------------ Net income $ 8,594,392 $ 6,493,274 $ 12,781,583 ============ ============ ============ Net income (loss) per share Basic $ 1.89 $ 2.54 Diluted $ 1.74 $ 2.35 Weighted average number of common shares outstanding Basic 4,557,283 5,041,544 Diluted 4,953,529 5,437,790 See notes to pro forma consolidated statement of income PF-5 Rocky Shoes & Boots, Inc. Footnotes to Pro Forma Consolidated Statement of Income Year ended December 31, 2004 (A) Eliminate EJ Footwear expenses related to pension expense ($1,037,787), management fees ($1,347,000), transaction costs incurred by EJ Footwear related to the transaction ($242,654) and deferred compensation ($11,394). (B) Eliminate EJ Footwear interest expense (C) Eliminate EJ Footwear related party interest income. (D) Eliminated EJ Footwear income tax expense. (E) Record depreciation and amortization. Cost Life Expense ---------- -------- ---------- Fixed assets $ 825,000 4 years $ 206,250 Customer list 3,500,000 5 years 700,000 License agreements 2,000,000 3 years 666,667 Patents 2,000,000 15 years 133,333 Internet domain names 1,000,000 3 years 333,333 ---------- $2,039,583 ---------- Estimated amounts and amortization lives are subject to final allocation based on independent appraisal of the fair value of assets acquired. (F) Record interest expense on debt incurred. Debt Rate Interest ----------- ----- ---------- GMAC term loan $18,000,000 5.65% $ 889,878 American Capital Financial Services term loan 30,000,000 10.40% 3,120,000 GMAC revolving credit agreement 46,783,812 4.90% 2,292,408 Amortization of debt financing costs 375,552 ---------- $6,677,838 All debt incurred is variable rate based on LIBOR. Interest rates assume a LIBOR rate of 2.25% throughout the period. PF-6 (G) Record tax effect. EJ Footwear pre tax income $ 8,020,274 Net effect of adjustments (1,266,683) ----------- 6,753,591 Effective tax rate 38% ----------- $ 2,566,400 ----------- PF-7