CROWN CRAFTS INC
Form 10-Q
February 14, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q

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

For the quarterly period ended December 31, 2006

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from___ to ___

Commission File No. 1-7604

CROWN CRAFTS, INC.

(Exact name of registrant as specified in its charter)

Delaware	58-0678148
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

916 South Burnside Avenue, Gonzales, Louisiana 70737

(Address of principal executive offices)

(225) 647-9100

(Registrant s telephone number, including area code)

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 þ No o

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

Large accelerated filer o Accelerated filer o Non-Accelerated filer þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

The number of shares of common stock, $0.01 par value, of the registrant outstanding as of December 31, 2006 was 9,959,690.

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CROWN CRAFTS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2006 and April 2, 2006
(UNAUDITED)
(dollar amounts in thousands, except share and per share amounts)

	December 31, 2006	April 2, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19	$ 3,790
Accounts receivable (net of allowances of $1,249 at December 31, 2006 and $1,164 at April 2, 2006)		
Due from factor	8,285	12,465
Other	2,484	1,992
Inventories, net	11,622	9,742
Prepaid expenses	1,381	1,177
Deferred income taxes	990	990
Total current assets	24,781	30,156
Property, plant and equipment at cost:		
Land, buildings and improvements	1,350	1,375
Machinery and equipment	2,578	2,459
Furniture and fixtures	659	649
	4,587	4,483
Less accumulated depreciation	3,230	2,945
Property, plant and equipment net	1,357	1,538
Other assets:		
Goodwill, net	22,884	22,974
Deferred income taxes	1,502	3,397
Other	765	114
Total other assets	25,151	26,485
Total Assets	$ 51,289	$ 58,179
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 6,205	$ 3,511
Accrued wages and benefits	1,351	942
Accrued royalties	1,037	559
Other accrued liabilities	279	367
Current maturities of long-term debt	23	36
Total current liabilities	8,895	5,415

Non-current liabilities:				
Long-term debt		6,456		23,922
Total non-current liabilities		6,456		23,922
Commitments and contingencies				
Shareholders equity:				
Common stock par value $0.01 per share; 74,000,000 shares authorized; 9,959,690 shares outstanding at December 31, 2006 and 9,505,937 outstanding at April 2, 2006		100		95
Additional paid-in capital		38,456		38,244
Accumulated deficit		(2,618)		(9,497)
Total shareholders equity		35,938		28,842
Total Liabilities and Shareholders Equity	$	51,289	$	58,179

See notes to unaudited condensed consolidated financial statements.

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CROWN CRAFTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the Three and Nine-Month Periods Ended December 31, 2006 and January 1, 2006
(UNAUDITED)
(amounts in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006
Net sales	$ 16,453	$ 17,882	$ 54,191	$ 52,826
Cost of products sold	12,831	13,557	40,236	40,925
Gross profit	3,622	4,325	13,955	11,901
Marketing and administrative expenses	2,623	2,479	7,802	7,542
Income from operations	999	1,846	6,153	4,359
Other income (expense):				
Interest expense	(195)	(773)	(1,204)	(2,315)
Gain on debt refinancing			4,069	
Other net	4	3	144	20
Income before income taxes	808	1,076	9,162	2,064
Income tax expense	194	13	2,283	118
Net income	$ 614	$ 1,063	$ 6,879	$ 1,946
Basic income per share	$ 0.06	$ 0.11	$ 0.71	$ 0.20
Diluted income per share	$ 0.06	$ 0.05	$ 0.69	$ 0.09
Weighted average shares outstanding basic	9,953	9,506	9,716	9,506
Weighted average shares outstanding diluted	10,269	21,749	9,973	21,513

See notes to unaudited condensed consolidated financial statements.

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CROWN CRAFTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine-Month Periods Ended December 31, 2006 and January 1, 2006
(UNAUDITED)
(amounts in thousands)

	Nine Months Ended	
	December 31, 2006	January 1, 2006
Operating activities:		
Net income	$ 6,879	$ 1,946
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property, plant and equipment	342	353
Goodwill write-off	90	
Deferred income taxes	1,895	
(Gain) loss on sale of property, plant and equipment	(11)	14
Discount accretion	295	567
Gain on debt refinancing	(4,069)	
Stock-based compensation	171	
Changes in assets and liabilities		
Accounts receivable	3,688	2,335
Inventories, net	(1,880)	(186)
Prepaid expenses	(204)	(848)
Other assets	(101)	33
Accounts payable	2,694	2,102
Accrued liabilities	800	478
Net cash provided by operating activities	10,589	6,794
Investing activities:		
Capital expenditures	(161)	(435)
Payment to acquire Kimberly Grant brand	(550)	
Proceeds from disposition of assets	11	1
Net cash used in investing activities	(700)	(434)
Financing activities:		
Retirement of debt	(17,077)	(4,500)
Payments on long-term debt	(27)	(12)
Borrowings (repayments) under line of credit, net	3,468	
Debt issuance costs	(70)	
Issuance of common stock	46	
Net cash used in financing activities	(13,660)	(4,512)
Net (decrease) increase in cash and cash equivalents	(3,771)	1,848
Cash and cash equivalents at beginning of period	3,790	955

Cash and cash equivalents at end of period	$	19	$	2,803
Supplemental cash flow information:				
Income taxes paid (received)	$	294	$	(17)
Interest paid		765		1,606
Accrued interest converted to long-term debt				268

See notes to unaudited condensed consolidated financial statements.

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CROWN CRAFTS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
AT AND FOR THE THREE AND NINE-MONTH PERIODS ENDED DECEMBER 31, 2006 AND JANUARY 1, 2006

1. *Basis of Presentation:* The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to interim financial information and the rules and regulations of the Securities and Exchange Commission (the SEC). Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, such interim consolidated financial statements contain all adjustments necessary to present fairly the financial position of Crown Crafts, Inc. (the Company) as of December 31, 2006 and the results of its operations and cash flows for the periods presented. Such adjustments include normal, recurring accruals. Operating results for the three and nine-month periods ended December 31, 2006 are not necessarily indicative of the results that may be expected for the year ending April 1, 2007. For further information, refer to the Company s consolidated financial statements and notes thereto included in the annual report on Form 10-K for the year ended April 2, 2006.

   Revenue Recognition: Sales are recorded when goods are shipped to customers and are reported net of allowances for estimated returns and allowances in the consolidated statements of income. Allowances for returns are estimated based on historical rates. Allowances for returns, advertising allowances, warehouse allowances and volume rebates are netted against sales. These allowances are recorded commensurate with sales activity, and the cost of such allowances is netted against sales in reporting the results of operations. Shipping and handling costs, net of amounts reimbursed by customers, are relatively insignificant and are included in net sales.

   Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates are made with respect to the allowances related to accounts receivable for customer deductions for returns, allowances, and disputes. The Company has a certain amount of discontinued and irregular raw materials and finished goods, which necessitate the establishment of inventory reserves that are highly subjective. Actual results could differ from those estimates.

   Segment and Related Information: The Company operates primarily in one principal segment, infant and juvenile products. These products consist of infant bedding, bibs and soft goods.

   Impairment of Long-lived Assets, Identifiable Intangibles and Goodwill: The Company reviews for impairment of long-lived assets and certain identifiable intangibles whenever events or changes in circumstances indicate that the carrying amount of any asset may not be recoverable. In the event of impairment, the asset is written down to its fair market value. Assets to be disposed of, if any, are recorded at the lower of net book value or fair market value less cost to sell at the date management commits to a plan of disposal and are classified as assets held for sale on the consolidated balance sheet.

   Goodwill, which represents the unamortized excess of purchase price over fair value of net identifiable assets acquired in business combinations, was amortized through March 31, 2002 using the straight-line method over periods of up to 30 years. The Company discontinued amortization of goodwill effective April 1, 2002. The Company reviews the carrying value of goodwill annually and sooner if facts and circumstances suggest that the asset may be impaired. Impairment of goodwill and write-downs, if any, are measured based on estimates of future cash flows. Goodwill is stated net of accumulated amortization of $6.4 million and $6.3 million at December 31, 2006 and April 2, 2006, respectively. The Company performed fair value based impairment tests on its goodwill in

accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets . With the exception of goodwill related to Churchill Weavers, Inc. (Churchill), the Company determined that the fair value exceeded the recorded value at April 4, 2005 and April 3, 2006. Churchill s goodwill of $90,000 was written off in June 2006 due to an impairment indicator, the decline in sales volume and decline in profitability in recent years.

Provision for Income Taxes: The provisions for income taxes include all currently payable federal, state and local taxes that are based upon the Company s taxable income and the change during the fiscal year in net deferred income tax assets and liabilities. The Company provides for deferred income taxes based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates that will be in effect when the differences are expected to reverse. For the three and nine-month periods ended January 1, 2006, deferred tax assets were fully offset by a valuation allowance as available evidence did not indicate that the assets would be realized. In the fourth quarter of fiscal 2006, the Company determined that, due to taxable earnings generated in recent years, it is more likely than not that the benefit would be realized prior to the expiration of its net operating loss carryforward, and consequently the valuation allowance was removed. As a result of the removal of the deferred tax valuation allowance, the Company s net income tax expense in periods subsequent to the third quarter of fiscal year 2006 will include federal as well as state and local income taxes.

Allowances Against Accounts Receivable: The Company s allowances against accounts receivable are primarily contractually agreed upon deductions for items such as advertising and warehouse allowances and volume rebates. These deductions are recorded throughout the year commensurate with sales activity. Funding of the majority of the Company s allowances occurs on a per-invoice basis.

The allowances for customer deductions, which are netted against accounts receivable in the consolidated balance sheets, consist of agreed upon advertising support, markdowns and warehouse and other allowances. Consistent with the guidance provided in EITF 01-9, all such allowances are recorded as direct offsets to sales, and such costs are accrued commensurate with sales activities. When a customer requests deductions, the allowances are reduced to reflect such payments.

The Company analyzes the components of the allowances for customer deductions monthly and adjusts the allowances to the appropriate levels. The timing of the customer-initiated funding requests for advertising support can cause the net balance in the allowance account to fluctuate from period to period. The timing of such funding requests should have no impact on the consolidated statements of income since such costs are accrued commensurate with sales activity.

Royalty Payments: The Company has entered into agreements that provide for royalty payments based on a percentage of sales with certain minimum guaranteed amounts. These royalty amounts are accrued based upon historical sales rates adjusted for current sales trends by customers. Total royalty expenses included in cost of sales amounted to $3.2 million and $3.7 million in the nine-month periods ended December 31, 2006 and January 1, 2006, respectively.

Recently Issued Accounting Standards: In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections . This statement is a replacement of APB Opinion No. 20, Accounting Changes , and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements , and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle and to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This statement requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine period-specific effects of an accounting change on one or more individual prior periods presented. In such circumstances the new accounting principle would be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable with a corresponding adjustment made to the opening balance of retained earnings for that period rather than being reported in an income statement. Further, the accounting principle is to be applied prospectively from the earliest date when it is impracticable to determine the effect to all prior periods. This statement is effective for the Company as of April 3, 2006. Adoption of this statement had no impact on the results of operations for the three and nine-month periods ended December 31,

2006. Adoption of this statement could have an impact if there are future voluntary accounting changes and error corrections.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting and disclosure for uncertain tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company has not yet determined the impact this interpretation will have on its results from operations or financial position.

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2. *Stock-Based Compensation:* The Company has two incentive stock plans, the 1995 Stock Option Plan (1995 Plan) and the 2006 Omnibus Incentive Plan (2006 Plan). The Company granted non-qualified stock options to employees and non-employee directors from the 1995 Plan through the fiscal year ended April 2, 2006. In conjunction with the approval of the 2006 Plan by the Company s stockholders at its Annual Meeting in August 2006, options may no longer be issued from the 1995 Plan.

   The 2006 Plan is intended to attract and retain directors, officers and employees of the Company and its subsidiaries and to motivate these persons to achieve performance objectives related to the Company s overall goal of increasing stockholder value. The principal reason for adopting the 2006 Plan is to ensure that the Company has a mechanism for long-term, equity-based incentive compensation to directors, officers and employees. Awards granted under the 2006 Plan may be in the form of qualified or non-qualified stock options, restricted stock, stock appreciation rights (SARs), long-term incentive compensation units consisting of a combination of cash and shares of the Company s common stock, or any combination thereof within the limitations set forth in the 2006 Plan. The 2006 Plan is administered by the compensation committee of the board of directors, which selects eligible employees and non-employee directors to participate in the 2006 Plan and determines the type, amount and duration of individual awards.

   On April 3, 2006, the Company adopted SFAS No. 123(R), Share Based Payment . This standard requires expensing of stock options and other share-based payments and supersedes SFAS No. 123, Accounting for Stock-Based Compensation, and Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related implementation guidance that had previously allowed companies to choose between expensing stock options or providing pro-forma disclosure only. SFAS No. 123(R) eliminates the ability to account for stock-based compensation transactions using the intrinsic value method under APB Opinion No. 25 and instead requires that such transactions be accounted for using a fair-value-based method. In addition, the SEC issued Staff Accounting Bulletin 107 in April 2005, which provides supplemental implementation guidance for SFAS No. 123(R).

   The Company uses the Black-Scholes option-pricing model to determine the fair-value of stock-based awards under SFAS No. 123(R), consistent with the method previously used for pro forma disclosures under SFAS No. 123. The Company elected to use the modified prospective transition method permitted by SFAS No. 123(R). Under the modified prospective method, SFAS No. 123(R) applies to new awards issued on or after April 3, 2006 as well as the unvested portion of awards that were outstanding as of April 2, 2006, including those that are subsequently modified, repurchased or cancelled. Under the modified prospective approach, compensation cost recognized in the three and nine-month periods ended December 31, 2006 includes compensation cost for all share-based payments granted prior to, but not yet vested as of, April 2, 2006 in accordance with the original provisions of SFAS No. 123. Prior periods were not restated to reflect the impact of adopting the new standard.

   Prior to adoption of SFAS No. 123(R), the Company measured compensation expense for its stock-based compensation plan using the intrinsic value recognition and measurement principles as prescribed by APB Opinion No. 25 and related interpretations. The Company also used the disclosure provision of SFAS No. 123. The following table illustrates the effect on net earnings and earnings per share for the three and nine-month periods ended January 1, 2006 had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123(R).

	Three months ended January 1, 2006	Nine months ended January 1, 2006
Net income, as reported	$ 1,063	$ 1,946
	(5)	(27)

Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards				
Pro forma net income	$	1,058	$	1,919
Income per share:				
Basic as reported	$	0.11	$	0.20
Basic pro forma	$	0.11	$	0.20
Diluted as reported	$	0.05	$	0.09
Diluted pro forma	$	0.05	$	0.09

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The Company recorded $123,000 and $171,000 of stock-based compensation during the three and nine-month periods ended December 31, 2006, respectively, as a result of the adoption of SFAS No. 123(R), which affected basic and diluted earnings per share by $0.01 and $0.02 for the three and nine-month periods, respectively. No stock-based compensation costs were capitalized as part of the cost of an asset as of December 31, 2006.

Stock Options: The following table represents stock option activity for the nine-month period ended December 31, 2006.

	Weighted-average Exercise Price	Number of Options Outstanding
Outstanding, April 2, 2006	$ 0.80	536,100
Granted	3.15	212,000
Exercised	0.59	78,753
Forfeited	0.78	31,999
Outstanding, December 31, 2006	$ 1.61	637,348
Exercisable, December 31, 2006	$ 0.85	413,354

During the quarter ended October 1, 2006, the Company granted 212,000 non-qualified options at the market price at the date of grant, which options vest over a two-year period, assuming continued service. The following weighted-average assumptions were used for grants issued during the quarter ended October 1, 2006. No options were granted during the quarter ended December 31, 2006.

	Options Issued to Employees	Options Issued to Directors
Options Issued	200,000	12,000
Dividend Yield		
Expected Volatility	70.00%	70.00%
Risk free interest rate	4.76%	4.79%
Expected life, years	5.75	3.25
Forfeiture rate	5.00%	5.00%

For the three-month period ended December 31, 2006, the Company recognized $48,000 of compensation expense associated with the stock option grants of which $11,000 was included in cost of products sold and $37,000 was included in marketing and administrative expenses in the accompanying consolidated statements of income. For the nine-month period ended December 31, 2006, the Company recognized $68,000 of compensation expense associated with the stock option grants of which $16,000 was included in cost of products sold and $52,000 was included in marketing and administrative expenses in the accompanying statements of income. The Company recognized $1,000 and $4,000 of compensation expense associated with unvested stock options outstanding at April 2, 2006.

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A summary of stock options outstanding and exercisable at December 31, 2006 is as follows:

Range of Exercise Prices	Number of Options Outstanding	Weighted Avg. Remaining Contractual Life	Weighted Avg. Exercise Price of Options Outstanding	Number of Shares Exercisable	Weighted Avg. Exercise Price of Shares Exercisable
$0.18	20,000	4.56 years	$ 0.18	20,000	$ 0.18
$0.65	123,165	6.16 years	0.65	119,169	0.65
$0.66	11,333	3.61 years	0.66	3,335	0.66
$0.71	167,750	5.42 years	0.71	167,750	0.71
$1.06-2.31	103,100	3.43 years	1.45	103,100	1.45
$3.15	212,000	9.37 years	3.15		0.00
	637,348			413,354	

As of December 31, 2006, total unrecognized stock-option compensation costs amounted to $320,000. Unvested stock option compensation costs will be recognized as the underlying stock options vest over a period of up to two years. The amount of unrecognized stock-option compensation will be affected by any future stock option grants and by the termination of any employee that has received stock options that are unvested as of such employee s termination date. The aggregate intrinsic value of options outstanding and options exercisable at December 31, 2006 was $1.7 million and $1.4 million, respectively.

Non-vested Stock: The fair value of non-vested stock is determined based on the number of shares granted and the quoted closing price of the Company s common stock on the date of grant. All non-vested stock awards issued under the 2006 Plan vest based upon continued service.

During the quarter ended October 1, 2006, the Company granted 375,000 shares of non-vested stock with a weighted-average grant date fair value of $3.15. These shares have four-year cliff vesting. The Company recognized $73,000 and $98,000 of compensation expense for the three and nine-month periods ended December 31, 2006, respectively, that was included in marketing and administrative expenses in the accompanying consolidated statements of income. The deferred amount is being amortized by monthly charges to earnings over the four-year vesting period. No non-vested stock was granted during the quarter ended December 31, 2006.

As of December 31, 2006, the amount of unrecognized non-vested stock compensation costs amounted to $1.1 million. The amount of unrecognized non-vested stock compensation will be affected by any future non-vested stock grants and by the separation from the Company of any employee who has received non-vested stock grants that are unvested as of such employee s separation date.

3. Inventory: Major classes of inventory were as follows (in thousands):

	December 31, 2006	**April 2, 2006**
Raw Materials	$ 45	$ 442
Work in Process	73	73
Finished Goods	11,504	9,227

	$	11,622	$	9,742

Inventory is net of reserves for inventories classified as irregular or discontinued of $0.8 million at December 31, 2006 and $0.5 million at April 2, 2006.

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4. Financing Arrangements

Factoring Agreement: The Company assigns the majority of its trade accounts receivable to a commercial factor. Under the terms of the factoring agreement, the factor remits payments to the Company on the average due date of each group of invoices assigned. The factor bears credit losses with respect to assigned accounts receivable that are within approved credit limits. The Company bears losses resulting from returns, allowances, claims and discounts.

Notes Payable and Other Credit Facilities: At December 31, 2006 and April 2, 2006, long-term debt consisted of:

	December 31, 2006	April 2, 2006
Revolving credit facility	$ 3,468	$
Senior subordinated notes		16,000
Non-interest bearing notes	4,000	8,000
Capital leases	31	58
PIK notes		1,077
Original issue discount	(1,020)	(1,177)
	6,479	23,958
Less current maturities	23	36
	$ 6,456	$ 23,922

The Company s credit facilities at December 31, 2006 include the following:

Revolving Credit of up to $22 million, including a $1.5 million sub-limit for letters of credit. The interest rate is prime minus 1.00% (7.25% at December 31, 2006) for base rate borrowings or LIBOR plus 2.25% (7.57% at December 31, 2006). The maturity date is July 11, 2009. The facility is secured by a first lien on all assets. There was $3.5 million outstanding at December 31, 2006. The Company had $11.6 million available at December 31, 2006. As of December 31, 2006, letters of credit of $655,000 were outstanding against the $1.5 million sub-limit for letters of credit.

The financing agreement for the $22 million revolving credit facility contains usual and customary covenants for transactions of this type, including limitations on other indebtedness, liens, transfers of assets, investments and acquisitions, merger or consolidation transactions, dividends, transactions with affiliates and changes in or amendments to the organizational documents for the Company and its subsidiaries. The Company was in compliance with these covenants as of December 31, 2006.

Subordinated Notes of $4 million. The notes do not bear interest and are due in two equal installments of $2 million each, the first of which is payable on July 11, 2010 and the second of which is payable on July 11, 2011. The original issue discount of $1.1 million on this non-interest bearing obligation at a market interest rate of 7.25% is being amortized over the life of the notes. The remaining unamortized balance of $1.0 million is included in the consolidated balance sheet as of December 31, 2006.

The Company also had other obligations at December 31, 2006 of $6,000 and $25,000, which expire in May 2007 and July 2008, respectively.

As of April 2, 2006, the Company had senior subordinated notes of $16 million with a fixed interest rate of 10% plus an additional 1.65% payable by delivery of a promissory note for which $1.1 million had been accrued and a

non-interest bearing note of $8 million carried at a book value of $6.8 million, net of unamortized original issue discount. These balances were refinanced on July 11, 2006 using internally generated cash and funds available under the revolving credit line described above. Concurrent with the refinancing of the senior subordinated notes, the Company settled the $8 million non-interest bearing note and extinguished related common stock purchase warrants by issuance of the $4 million subordinated notes described above. The refinancing resulted in a gain of $4.1 million ($3.7 million net of tax) reported in the quarter ended October 1, 2006. Approximately $3.1 million of the gain was not subject to federal income tax.