K2 INC
Form 10-K
March 16, 2005
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ANNUAL REPORT

PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Year Ended December 31, 2004

Commission File No. 1-4290

K2 INC.

(Exact name of registrant as specified in its charter)

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

(760) 494-1000

Registrant s telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $1	New York Stock Exchange Pacific Exchange
Series A Preferred Stock Purchase Rights	New York Stock Exchange Pacific Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by an X whether the registrant has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

The aggregate market value of the voting stock of the registrants held by nonaffiliates was approximately $603,353,732 as of June 30, 2004.

47,544,140 shares of common stock outstanding as of February 25, 2005.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement for the Annual Meeting of Shareholders to be held May 12, 2005 are incorporated by reference in Part III.

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FORM 10-K ANNUAL REPORT

PART I

ITEM 1. BUSINESS:

General

K2 Inc. is a premier, branded consumer products company with a portfolio of leading brands including *Shakespeare, Pflueger* and *Stearns* in the Marine and Outdoor segment; *Rawlings, Worth* and *K2 Licensing & Promotions* in the Team Sports segment*; K2, Völkl, Marker, Ride* and *Brass Eagle* in the Action Sports segment; and *Adio, Marmot* and *Ex Officio* in the Footwear and Apparel segment. K2 s diversified mix of products is used primarily in team and individual sports activities such as fishing, watersports activities, baseball, softball, alpine skiing, snowboarding, in-line skating and mountain biking. Among K2 s other branded products are *Miken* softball bats, *Tubbs and Atlas* snowshoes, *JT* and *Worr Games* paintball products, *Planet Earth* apparel, *Hawk* skateboard shoes, and *Dana Design* backpacks. Founded in 1946, K2 has grown to approximately $1.2 billion in 2004 annual sales through a combination of internal growth and strategic acquisitions. For segment and geographic information, see Note 14, Segment Data, in the Notes to consolidated financial statements.

K2 has expanded its presence in several sporting goods markets in the U.S., Europe and Japan, including skateboard shoes, fishing tackle reels and kits and combos, outdoor marine accessories, hunting accessories, outdoor apparel, ski accessories paintball products, baseball and softball bats and ATV accessories. Management believes its products have benefited from the brand strength, reputation, distribution, and the market share positions of other K2 products, several of which are now among the top brands in their respective markets. K2 s product portfolio contains some of the most widely recognized brands in their respective market segments. K2 believes it has leading market positions with many of our branded products based on revenue or unit sales as follows:

Product	Brand	Ranking
Alpine skis	*K2* and *Völkl*	#1
Alpine ski bindings	*Marker*	#1
Snowboards	*K2, Ride, Liquid, Morrow* and *5150*	#2
Snowboard bindings	*K2, Ride, Liquid, Morrow* and *5150*	#2
Snowshoes	*TUBBS* and *Atlas*	#1
Paintball products	*Brass Eagle, JT, Viewloader* and *Worr Games*	#1
Baseballs and gloves	*Rawlings*	#1
Softballs	*Worth*	#1
Fishing kits and combos	*Shakespeare*	#1
Fishing rods	*Shakespeare* and *Ugly Stik*	#1
Personal Flotation Devices	*Stearns*	#1

In order to implement its strategy for growth, K2 has embarked upon a program to leverage its existing operations and to complement and diversify its product offerings within the sporting goods and recreational products. K2 intends to implement its internal growth strategy by continuing to improve operating efficiencies, extending its product offerings through new product launches and maximizing its extensive distribution channels. In addition, K2 will seek strategic acquisitions of other sporting goods companies with well-established brands and with complementary distribution channels. K2 believes that the growing influence of large format sporting goods retailers and retailer buying groups as well as the consolidation of certain sporting goods retailers worldwide is leading to a consolidation of sporting goods suppliers. K2 also believes that the most successful sporting goods suppliers will be those with greater financial and other resources, including those with the ability to produce or source high-quality, low cost products and deliver these products on a timely basis, to invest in

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product development projects and to access distribution channels with a broad array of products and brands. In addition, as the influence of large sporting goods retailers grows, K2 believes these retailers will prefer to rely on fewer and larger sporting goods suppliers to help them manage the supply of products and the allocation of shelf space.

K2 s common stock was first offered to the public in 1959 and is currently traded on the New York and Pacific Stock Exchanges (symbol: KTO).

2004 Acquisitions

On January 23, 2004, K2 completed the acquisition of Fotoball USA, Inc. (Fotoball), a marketer and manufacturer of souvenir and promotional products, principally for team sports, in a stock-for-stock exchange offer/merger transaction. Subsequent to the completion of the merger, K2 changed the name of Fotoball to K2 Licensing & Promotions, Inc. K2 Licensing & Promotions, Inc. is included in K2 s Team Sports segment.

On April 19, 2004, K2 completed the acquisition of substantially all of the assets of Worr Game Products, Inc. and All-Cad Manufacturing, Inc. (collectively, Worr Games), businesses engaged in the design, manufacturing, selling and distribution of paintball markers and paintball-related products and accessories. The transaction consideration consisted of cash and the issuance of shares of K2 Inc. common stock. Worr Games is included in K2 s Action Sports segment.

Also, on April 19, 2004, K2 completed the acquisition of substantially all of the assets of IPI Innovations, Inc. (IPI), a business engaged in the design, manufacturing, selling and distribution of gun and bow mounting systems, and other products and accessories for all-terrain vehicles. The transaction consideration consisted of cash and the issuance of shares of K2 Inc. common stock. IPI is included in K2 s Marine and Outdoor segment.

On May 12, 2004, K2 also completed the acquisition of substantially all of the assets of Ex Officio, a leader in the design and manufacture of men and women s apparel for the outdoor and adventure travel markets, in an all cash transaction. Ex Officio s products are characterized by technical features, performance fabrics and outdoor styles, and are used in a variety of activities including fishing, kayaking, trekking, exploring, and other leisure activities. Ex Officio also markets a line of insect repellent clothing under the *Buzz Off* brand. Ex Officio is included in K2 s Footwear and Apparel segment.

On June 30, 2004, K2 completed the acquisition of Marmot Mountain Ltd. (Marmot). Marmot, founded in 1971, is a leader in the premium technical outdoor apparel and equipment market. Marmot s product lines include performance jackets, technical rainwear, expedition garments, fleeces, softshells, skiwear outerwear and accessories, gloves, and expedition quality tents, packs and sleeping bags. The transaction consideration consisted of cash and the issuance of shares of K2 Inc. common stock. Marmot is included in K2 s Footwear and Apparel segment.

On July 7, 2004, K2 completed the acquisitions of Völkl Sports Holding AG (Völkl) and The CT Sports Holding AG (Marker). Founded in 1889, Völkl is a well established and recognized brand in the worldwide alpine ski market. Marker was founded in 1952 and has gained worldwide recognition for its patented ski-bindings. The transaction consideration consisted of cash and the issuance of shares of K2 s common stock. Völkl and Marker are included in K2 s Action Sports segment.

During 2004, K2 also completed three smaller acquisitions. Two of these acquisitions are reported within the Marine and Outdoor segment, and one within the Team Sports segment.

2003 Acquisitions

On March 26, 2003, K2 completed the acquisition of Rawlings Sporting Goods Company, Inc. (Rawlings), in a stock-for-stock exchange offer/merger transaction. Rawlings is a leading manufacturer and marketer of baseball equipment. Rawlings was founded in 1887 and has since become a tradition in team sports equipment and uniforms. Under the *Rawlings* brand name, K2 provides competitive team sports equipment; apparel and accessories for baseball, basketball, football, soccer and volleyball; and licensed Major League Baseball, Minor League Baseball, NCAA baseball and National Federation of State High School Association retail products.

On September 16, 2003, K2 completed the acquisition of all of the outstanding capital stock of Worth, Inc. (Worth) in exchange for cash and K2 common stock. With our *Worth* brand, K2 is a leading supplier of softball products with leading market positions in aluminum bats and softballs. Worth is included in K2 s Team Sports segment.

On December 16, 2003, K2 completed the acquisition of Brass Eagle, Inc. (Brass Eagle) in a stock-for-stock exchange offer/merger transaction. Brass Eagle is a worldwide leader in the design, manufacture, marketing and distribution of paintball products, including paintball markers, paintballs and accessories. Brass Eagle is included in K2 s Action Sports segment.

During 2003, K2 also completed four smaller acquisitions. One of these acquisitions is reported within the Marine and Outdoor segment, two in the Action Sports segment and one within the Team Sports segment.

For additional information on these acquisitions see note 2 to Notes to Consolidated Financial Statements.

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

Marine and Outdoor

Net sales for the Marine and Outdoor segment were $336.9 million in 2004, $324.0 million in 2003 and $328.7 million in 2002. The following table lists K2 s principal Marine and Outdoor products and the brand names under which they are sold.

Product	Brand Name
Fishing rods, reels and fishing kits and combos	*Shakespeare, Ugly Stik, All Star* and *Pflueger*
Active water and outdoor sports products, ATV accessories	*Stearns, Mad Dog* and *Sospenders*
Monofilament line	*Shakespeare*
Marine and military radio antennas	*Shakespeare*

Fishing rods, reels and fishing kits and combos. K2 sells fishing rods, reels and fishing kits and combos throughout the world. K2 believes Shakespeare s *Ugly Stik* models have been the best selling fishing rods in the U.S. over the past 20 years. The success of these fishing rods has allowed K2 to establish a strong position with retailers and mass merchandisers, thereby increasing sales of new rods, reels and kits and combos and allowing K2 to introduce new products such as the expansion of its *Pflueger* product line, licensed children s kits and combos and premium fishing rods using the *All Star* brand name. K2 s rods and reels are manufactured principally in China. *Shakespeare* products are sold directly by K2 and through independent sales representatives to mass merchandisers and sporting goods retailers in the U.S., Europe and Australia and through independent and company-owned distributors in Europe and Australia.

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Active water and outdoor sports products. K2 sells *Stearns* and *Sospenders* flotation vests, jackets and suits (personal flotation devices), cold water immersion products, wet suits, waders, outdoor products, rainwear and inflatable and towable water products and *Mad Dog* hunting and ATV accessories in the U.S. and in certain foreign countries. In the U.S., occupants of boats are required by law either to wear or have available personal flotation devices meeting U.S. Coast Guard standards. *Stearns* and *Sospenders* personal flotation devices are manufactured to such standards and are subject to rigorous testing for certification by Underwriters Laboratories, an independent not-for-profit, product-safety testing and certifying organization. K2 manufactures most of its personal flotation devices in the U.S., manufactures certain components in China and sources its other products from Asia. *Stearns*, *Sospenders* and *Mad Dog* products are sold principally through an in-house sales department and independent sales representatives to mass merchandisers, specialty shops and chain stores and to the off-shore oil industry, commercial fishermen and other commercial users through independent sales representatives.

Monofilament line. Nylon and polyester monofilament line is manufactured in the U.S. and the U.K. and sold by K2 in a variety of diameters, tensile strengths and softness. Monofilament is used in various applications including the manufacture of woven mats for use by paper producers in the U.S., Europe and South America, as fishline and for use as line in weed trimmers in the U.S. and is sold directly to paperweavers, directly to retailers of fishline and distributors of cutting line and to others through independent sales representatives. Monofilament sold in Europe for woven mats is manufactured primarily in K2 s U.K. facility. *Shakespeare* monofilament also manufactures various products for industrial applications.

Marine and military radio antennas. K2 manufactures fiberglass radio antennas in the U.S. and in China for marine, citizen band and military application under the *Shakespeare* name. The products are sold primarily in the U.S. K2 also distributes marine accessories under the *Shakespeare* name that are manufactured in Asia to K2 s specifications. An in-house sales department and independent sales representatives sell the antennas, radios and other marine accessories to specialty marine dealers.

During 2004, one customer accounted for more than 10% of the net sales of the Marine and Outdoor segment. The loss of this customer could have a material adverse affect on the Marine and Outdoor segment.

Action Sports

Net sales for Action Sports products were $502.7 million in 2004, $247.0 million in 2003 and $217.9 million in 2002. The following table lists K2 s principal Action Sports products and brand names under which they are sold.

Product	Brand Name
Alpine skis	*K2, Völkl* and *Olin*
Alpine ski bindings	*Marker*
Snowboards and accessories	*K2, Ride, Morrow, 5150, Liquid* and *Nitro*
Snowshoes and accessories	*TUBBS, Atlas* and *Little Bear*
In-line skates	*K2*
Mountain and BMX bikes	*K2*
Paintball markers, paintballs and accessories	*Brass Eagle, Viewloader, JT, Worr Games* and *Autococker*

Alpine skis and bindings. K2 sells its alpine skis under the names *K2*, *Völkl* and *Olin* and its alpine ski bindings under the name *Marker* in the three major ski markets of the world the U.S., Europe and Japan. K2 believes that participation rates for alpine skiing have been relatively flat in Europe and the U.S., but have been declining in Japan over the last several years. K2 believes that industry retail sales have in general mirrored these participation trends in the worldwide market during the same period. K2 believes that participation rates, together with the impact of the weather conditions, the high cost of skiing, the opportunity to participate in alternative activities such as snowboarding, the increased use of rental or demo skis and general economic conditions all have an impact on retail sales of alpine ski equipment. *K2* skis, however, have benefited from their increasing

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popularity among retail purchasers, resulting from growing market acceptance of *K2 s* women s ski line, positioning at popular price points and from attractive graphics and creative marketing. *Völkl* has benefited, principally in the U.S. and Europe, from its positioning as a premium-priced, highly innovative producer of well-engineered, high quality skis with a well-respected race program. Each brand is also benefiting from exclusive integrated bindings and systems developed exclusively with *Marker* bindings.

K2 and *Olin* skis are manufactured by K2 primarily in its facility in China. *Völkl* skis are manufactured by K2 primarily in its facility in Germany. *Marker* bindings are manufactured by K2 primarily in its facility in the Czech Republic. The skis, bindings and accessories, including helmets and ski poles, are sold to specialty retail shops and sporting goods chains in the U.S. by independent sales representatives and in Europe and Japan through independent and Company-owned distributors. *K2, Völkl* and *Olin* alpine skis are marketed to skiers ranging from beginners to top racers to meet the performance, usage and terrain requirements of the particular consumer.

From a pricing perspective, K2 positions the *K2* brand in the mid-level and higher price points, and positions the Völkl brand at generally higher price points reflecting the quality of materials used in construction, the continual incorporation of technological innovations and the type of skiing it is intended for. To assist in its marketing efforts, *K2* sponsors mainly freestyle skiers while *Völkl* sponsors primarily well-known professional and amateur race-oriented skiers.

Snowboards and accessories. K2 sells snowboards, boots, bindings and snowboard outerwear under the *K2*, *Ride, Nitro, Morrow, 5150* and *Liquid* brands. Accessories, including backpacks for carrying snowboards and other gear when hiking into the back country and snowboard apparel are being marketed under the *K2* and *Ride* brands. Growth in retail sales in the snowboard market has slowed, resulting in fewer, larger, better capitalized brands. K2 manufactures most of its own snowboards in its manufacturing facility in China. K2 believes its manufacturing capability and ability to innovate provide it a competitive advantage. Like its alpine skis, *K2* and *Ride* snowboards are of high quality and have innovative features.

K2 s snowboard brands are sold to specialty retail shops and sporting goods chains in the U.S. by independent sales representatives and in Europe and Japan through independent and Company-owned distributors. Like *K2* skis, *K2, Ride, Nitro, Morrow, 5150* and *Liquid* snowboard products are marketed using youthful and energetic advertising, and K2 sponsors well-known professional and amateur snowboarders.

In-line skates. K2 introduced its *K2* soft boot in-line skates in 1994. Although the worldwide market underwent several years of growth, it has declined in recent years with the sharpest decline occurring in 2001, resulting in a consolidation of brands.

K2 s in-line skates target the enthusiast and are priced at the mid to upper end of the industry s price points. *K2* skates are attractive and of high quality and have innovative features such as a soft mesh and leather upper designed for improved comfort, with a rigid plastic cuff for support. K2 s skates incorporate several innovations, including K2 s soft boot skate with no laces. The patented product line is designed for performance as well as superior comfort and support. K2 also sells women s-specific skates and adjustable-size, soft boot skates for children.

K2 in-line skates are manufactured to its specifications and are primarily assembled by a third party vendor in China. They are sold to specialty retail shops and sporting goods chains in the U.S. by independent sales representatives and in Europe and Japan through independent and Company-owned distributors.

Mountain and BMX bikes. K2 distributes high quality full-suspension mountain bikes, front suspension mountain bikes, road bikes and BMX bikes and accessories under the *K2* name in the U.S. and internationally. K2 s mountain bikes provide performance and comfort with shock absorbing elements for front and rear wheels or front wheels only, which improves climbing ability and decreases rider fatigue and off-road vibration.

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The bikes are manufactured and assembled by third party vendors. The bikes are marketed by an in-house marketing staff and are sold by independent sales representatives to independent bicycle dealers and other K2 retailers in the U.S. and through distributors internationally.

Paintball products. Brass Eagle designs and distributes throughout the world a full line of paintball markers with a variety of performance characteristics. There are three primary classifications of paintball markers: pump action, semi-automatic and ultra high performance paintball markers. Brass Eagle currently offers all three types of paintball markers under its *Brass Eagle, JT, Worr Games Products*, *Autococker* and *Viewloader* brand names to the mass merchant, sporting goods and specialty markets, as appropriate. To assist in its marketing efforts, Brass Eagle , JT and Worr Games Products sponsor key professional paintball teams. Paintball markers are generally sourced by Brass Eagle in Asia from third party suppliers, while the ultra high performance markers, such as the *Autococker* brand, are machined and assembled at the Worr Games Products facility in Corona, California. *Brass Eagle, JT, Worr Games Products and Viewloader products* are sold directly by Brass Eagle and through independent sales representatives to mass merchandisers, sporting goods retailers and to specialty shops and paintball venues in North America, as well as through independent distributors in Europe, and to other customers around the world.

Paintballs are made of a gelatinous material: the paint is non-toxic, biodegradable and washable. Paintballs are manufactured using an encapsulation process principally in K2 s manufacturing facilities in the U.S., requiring special equipment and certain technical knowledge. Brass Eagle sells its paintballs in multiple colors in packages ranging in size from 100 to 2,000 balls.

Brass Eagle markets a broad product line of paintball accessories complementary to its paintball markers and paintballs. These accessory products include goggle systems, paintball loaders, cleaning squeegees and refillable CO2 tanks. Goggle systems, a requirement for safe paintball play, are a primary component of Brass Eagle s accessory product line. The goggle systems are designed to provide full face, eye and ear protection.

During 2004, one customer accounted for more than 10% of the net sales of the Action Sports segment. The loss of this customer could have a material adverse affect on the Action Sports segment.

Team Sports

Net sales for Team Sports products were $250.4 million in 2004, $116.9 million in 2003 and $19.3 million in 2002. The following table lists K2 s principal Team Sports products and brand names under which they are sold.

Product	Brand Name
Baseballs, softballs, bats, gloves, softballs, basketballs, footballs, soccer balls, volleyballs, team sports apparel and accessories	*Rawlings, Worth* and *Miken*
Corporate casuals	*Hilton*

Baseball and softball. K2 believes that Rawlings is a leading supplier of baseball equipment in North America and, through its licensee, in Japan. *Rawlings* products in this area include baseball gloves, baseballs, softballs, batters helmets, catchers and umpires protective equipment, aluminum and wood baseball bats, batters gloves and miscellaneous accessories. Rawlings is a major supplier to professional, collegiate, interscholastic and amateur organizations worldwide and is also the official baseball supplier to Major League Baseball, Minor League Baseball and NCAA, as well as the official helmet supplier to Major League Baseball. In addition, *Rawlings* products are endorsed by college coaches, sports organizations and numerous athletes, including more than 350 Major League Baseball players. *Rawlings* products are manufactured principally in Asia and Costa Rica. Our marketing efforts are supported by endorsements from several major professional athletes, including Álex Rodríguez, Randy Johnson, Tracy McGrady and Michael Vick.

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Worth and Miken are leading suppliers of softball products with market leading positions in collegiate and amateur slow pitch and fast pitch softball. *Worth* products are widely used in NCAA Division I fast pitch softball programs. *Worth* is the official softball of all Canadian major associations and the official softball and softball bat of the U.S. Specialty Sports Association. *Worth and Miken* products include aluminum, exterior shell technology and 100% composite softball bats, softballs, softball gloves and miscellaneous accessories. *Worth* and *Miken* products are manufactured principally in the U.S.

Rawlings, Worth and *Miken* products are sold directly by K2 and through independent sales representatives to mass merchandisers and sporting goods retailers in the U.S. as well as through independent distributors in Europe and Japan.

Basketball, football, soccer and volleyball. Rawlings sells 30 different models of basketballs, including full-grain, composite and synthetic leather and rubber basketballs for men and women in both the youth and adult markets. Rawlings recently introduced its patented *Ten* basketball which uses ten panels to improve handling, grip, control and shooting. Rawlings is the official supplier of basketballs to the National Association of Intercollegiate Athletics and the National Junior College Athletic Association Championships.

Team sports apparel. Rawlings has been selling team uniforms for approximately 100 years. Rawlings believes it has growth opportunities in its current team apparel business.

Corporate casuals. K2 manufactures and distributes shirts, jackets and other apparel under the *Hilton* brand name. The products are sold in the United States to corporate buyers or advertising specialty distributors, embroiderers and screen printers who in turn sell imprinted items, including garments, principally to corporate buyers. *Hilton* apparel, which is sourced from offshore vendors, is sold through catalogs, by a direct sales force and by independent sales representatives.

K2 Licensing & Promotions manufactures and markets souvenir and promotional products to national and regional retailers; professional sports franchises and concessionaires across the nation; and entertainment destinations such as theme parks, resorts and restaurants. The Company currently holds several sports and entertainment licenses including Major League Baseball (MLB), the National Football League (NFL), over a hundred National Collegiate Athletic Association (NCAA) colleges and universities and Marvel s Spider-Man.

During 2004, one customer accounted for more than 10% of the net sales of the Team Sports segment. The loss of this customer could have a material adverse affect on the Team Sports segment.

Footwear and Apparel

Following the 2004 acquisitions of Marmot and Ex Officio, K2 created a new footwear and apparel segment consisting of the *Marmot, Ex Officio, Adio, Hawk and Planet Earth* product lines. The years ended 2002 and 2003 reflect the operations of the *Adio*, *Hawk* and *Planet Earth* product lines.

Net sales for footwear and apparel products were $110.7 million in 2004, $30.6 million in 2003 and $16.3 million in 2002. The following table lists K2 s principal footwear and apparel products and the brand names under which they are sold.

Product	**Brand Name**
Technical apparel and equipment	*Marmot*
Outdoor and adventure travel apparel	*Ex Officio* and *Buzz Off*
Skateboard shoes	*Adio* and *Hawk*
Skateboard apparel	*Adio* and *Planet Earth*
Snowboard apparel	*Planet Earth* and *Holden*

Marmot. On June 30, 2004, K2 completed the acquisition of Marmot. Marmot, founded in 1971, is a leader in the premium technical outdoor apparel and equipment market. Marmot s product lines include performance jackets, technical rainwear, expedition garments, fleeces, softshells, skiwear outerwear and accessories, gloves, and expedition quality tents, packs and sleeping bags. Marmot, a leading company in premium-priced, high performance outdoor apparel and equipment, designs, manufactures, markets and distributes technical apparel and equipment including outerwear, rainwear, skiwear, gloves, sleeping bags, backpacks, tents and related accessories sold under the *Marmot* brand name. Outdoor professionals and enthusiasts associate the *Marmot* brand with high-performance, high-technology apparel and equipment. Marmot has been the gear of choice on thousands of the most challenging expeditions and pursuits, including numerous treks to the highest summits on all seven continents. Marmot has continued to strengthen its brand image by heavily investing in product development, which has produced a steady stream of new and innovative products. Marmot products are sold to specialty retail shops and sporting goods chains in the U.S., Canada and Europe by independent sales representatives and elsewhere through independent distributors. Marmot products are manufactured to its specifications by third party vendors in Asia.

Ex Officio. On May 12, 2004, K2 completed the acquisition of substantially all of the assets of Ex Officio, a leader in the design, manufacture, sale and distribution of men and women s apparel for the outdoor and adventure travel apparel for men and women. Ex Officio s products are characterized by technical features, performance fabrics, and outdoor styles, and are used in a variety of activities including fishing, kayaking, trekking, exploring, and other leisure activities. *Ex Officio* products include the only EPA-approved line of insect-repellent clothing, which are sold in conjunction with *Buzz Off* brand insect repellent under a licensing agreement. Ex Officio products are sold to specialty sporting goods chains in the U.S. by independent sales representatives and in Europe and elsewhere through independent distributors. Ex Officio products are also sold via the internet. Ex Officio products are manufactured to its specifications by third-party vendors in Asia.

Skateboard and snowboard apparel and skateboard shoes. Skateboard and snowboard apparel and skateboard shoes are sold to specialty retailers in the U.S., Canada, Europe and Japan. Suppliers, primarily located in Asia, manufacture these products to K2 s specifications. Independent sales representatives sell the products to retailers in the U.S. and Canadian markets and through Company-owned and independent distributors in Europe and Asia. K2 s skateboard shoes are designed with significant assistance from a group of well-known professional skateboarders. With favorable demographic trends, skateboarding has been enjoying a significant resurgence in popularity, principally among pre-teen and early teen boys. Skateboard shoes are marketed under the *Adio* and *Hawk* brand names, and models are named after the specific skateboarder who aided in the design. The *Hawk* brand of shoes has been designed and introduced in cooperation with Tony Hawk, the best known professional skateboarder in the world.

During 2004, two customers each accounted for more than 10% of the net sales of the Footwear and Apparel segment. The loss of one or both of these customers could have a material adverse affect on the Footwear and Apparel segment.

Competition

K2 s competition varies among its business lines. The sporting goods products, recreational products, footwear and apparel markets are generally highly competitive, with competition centering on product innovation, performance and styling, price, marketing and delivery. Competition in these products (other than for active wear) consists of a relatively small number of large producers, some of whom have greater financial and other resources than K2. A relatively large number of companies compete for sales of active wear. While K2 believes its well-recognized brand names, low cost China manufacturing and sourcing base, established distribution channels and reputation for developing and introducing innovative products have been key factors in the successful introduction and growth of its sporting goods and other recreational products, there are no significant technological or capital barriers to entry into the markets for many sporting goods, recreational products, footwear and apparel. These markets face competition from other leisure activities, and sales of leisure products are affected by economic conditions, weather patterns and changes in consumer tastes, which are difficult to accurately predict.

K2 believes certain of its marine and outdoor products compete based on product quality, service and delivery, however, certain of K2 s marine and outdoor products are, in most instances, subject to price competition, ranging from moderate in marine antennas and monofilament line to intense for commodity-type products. Certain industrial competitors have greater financial and other resources than K2.

Manufacturing, Foreign Sourcing and Raw Materials

K2 believes that, for the products within its core categories, it is of strategic importance for it to develop the capability to source and manufacture high-quality, low cost products. As a result, K2 currently manufactures products in the People s Republic of China, including most of its fishing rods and reels, snowboards, skis (other than Völkl skis which are manufactured in Germany), shells for flotation devices, batting helmets and certain marine antennas. Additionally, K2 currently purchases in-line skates, baseball gloves, paintball markers and other products from a few vendors in China. Certain other products are sourced from various vendors in Asia, Latin America and Europe. The remaining products are manufactured by K2 in the United States, Costa Rica, and Europe.

K2 has not experienced any substantial difficulty in obtaining raw materials, parts or finished goods inventory for its businesses, although the cost of certain raw materials has fluctuated. Certain components and finished products, however, are manufactured or assembled abroad and therefore could be subject to interruption as a result of local unrest, currency exchange fluctuations, increased tariffs, trade difficulties and other factors. Timely supply of sporting goods products from K2 s factories and suppliers in the People s Republic of China is dependent on uninterrupted trade with China. Should there be an interruption in trade with China, it could have a significant adverse impact on K2 s business, results of operations or financial position. Additionally, the gross margins on K2 s products manufactured or sourced in the U.S., Europe or in Asia and distributed in the U.S. and Europe will depend on the relative exchange rates between the U.S. dollar, the Chinese yuan and the Euro.

Seasonality and Cyclicality; Backlog

Sales of K2 s sporting goods are generally highly seasonal and in many instances are dependent on weather conditions. This seasonality causes K2 s financial results to vary from quarter to quarter, and K2 s sales and earnings are usually lower in the first and second quarters. In addition, the nature of K2 s baseball, softball, paintball, ski, snowboard, in-line skate, apparel, fishing and water sports products businesses requires that, in anticipation of the selling season for these products, it make relatively large investments in inventory. The primary selling season, in the case of baseball and softball, runs from January through April, paintball runs from September through November, skis, snowboards and winter apparel runs from July through December, in-line skates runs primarily from October through May and fishing tackle and water sports products runs primarily from January through June. Relatively large investments in receivables consequently exist during and after such seasons. The rapid delivery requirements of K2 s customers for its sporting goods products and other recreational products also result in investment in significant amounts of inventory. K2 believes another factor in its level of inventory investment is the shift by certain of its sporting goods customers from substantial purchases of pre-season inventories to deferral of deliveries until the products retail seasons and ordering based on rates of sale.

Sales of sporting goods and other recreational products depend largely on general economic conditions including the amount of discretionary income available for leisure activities, consumer confidence and favorable weather conditions. Sales of footwear and apparel often depend on fashion trends that can be difficult to predict. Sales of K2 s monofilament products are dependent to varying degrees upon economic conditions in the container and paper industries, and are subject to threat from vertical integration and consolidation among its customers.

Because of the nature of many of K2 s businesses, backlog is generally not significant.

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Customers

K2 believes that its customer relationships are excellent. Net sales to Wal-Mart Stores, Inc. and its affiliates accounted for approximately 16% of K2 s consolidated net sales for 2004, compared to 15% in 2003 and 9% in 2002.

Research and Development

Consistent with K2 s business strategy of continuing to develop innovative brand name products and improving the quality, cost and delivery of products, K2 maintains decentralized research and development departments at several of its manufacturing centers, which are engaged in product development and the search for new applications and manufacturing processes. Expenditures for research and development activities totaled approximately $14.5 million in 2004, $9.6 million in 2003 and $8.5 million in 2002.

Environmental Factors

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

Environmental and related remediation costs are difficult to quantify for a number of reasons including the number of parties involved, the difficulty in determining the extent of the contamination, the length of time remediation may require, the complexity of environmental regulation and the continuing advancement of remediation technology. K2 accrues for liabilities of this nature when it is probable a liability has been incurred and the amount can be reasonably estimated. At December 31, 2004 and December 31, 2003, K2 had recorded an estimated liability of approximately $800,000 and $980,000, respectively, for environmental liabilities. The estimates are based on K2 s share of the costs to remediate as provided by the PRP s consultants and in ongoing discussions with the EPA or other environmental agencies. The ultimate outcome of these matters cannot be predicted with certainty, however, and taking into consideration reserves provided, management does not believe these matters will have a material adverse effect on K2 s financial statements.

Employees

K2 had approximately 4,700 and 3,500 employees at December 31, 2004 and 2003, respectively. K2 believes its relations with its employees generally have been good.

Patents and Intellectual Property Rights

While product innovation is a highly important factor and many of K2 s innovations have been patented, K2 does not believe the loss of any one patent would have a material effect on its financial position, cash flows or results of operations. Certain of its brand names, such as *Rawlings, Worth, Shakespeare*, *Ugly Stik*, *Pflueger, Adio, Stearns, Mad Dog, K2*, *Völkl*, *Marker*, *Marmot*, *Ex Officio*, *Ride, Morrow*, *Liquid, 5150, TUBBS, Atlas, Brass Eagle, Viewloader, JT, Worr Games* and *Adio* are believed by K2 to be well-recognized by consumers and therefore important in the sales of these products. Rawlings®, Worth®, Miken®, deBeer®, Gait, Ten, Hilton®, Shakespeare®, Pflueger®, Ugly Stik®, All Star, Brass Eagle®, Viewloader®, Autococker®, Stearns®, Sospenders®, Mad Dog®, K2®, Völkl ®, Ride®, Morrow®, 5150®, Liquid®, Velvet, Recon, Marmot®, Ex Officio®, Marker®, Planet Earth®, Adio®, Hawk® skateboard shoes, Holden, Tubbs®, Atlas®, Little Bear®, JT®, Worr Games®, and Dana Designs®, are protected trademarks or registered trademarks of K2 or its subsidiaries in the United States and other countries worldwide. Olin® and Buzz Off are trademarks licensed to K2 or its subsidiaries from third parties.

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

Executive Officers of K2

Name	Position	Age
Richard J. Heckmann	Chairman of the Board and Chief Executive Officer	61
J. Wayne Merck	President and Chief Operating Officer	44
John J. Rangel	President K2 Inc. European Operations	50
Dudley W. Mendenhall	Senior Vice President and Chief Financial Officer	50
Monte H. Baier	Vice President, General Counsel and Secretary	36
David Y. Satoda	Vice President and Director of Taxes	39
Brian R. Anderson	Director of Business Development	51
Thomas R. Hillebrandt	Corporate Controller and Chief Accounting Officer	43
Diana C. Crawford	Director of Financial Reporting	36

Mr. Heckmann has been Chief Executive Officer of K2 since October 2002 and Chairman of the Board of Directors of K2 since April 2000. Mr. Heckmann has been a director of MPS Group, Inc. since April 2003 and served as a director of Philadelphia Suburban Corporation from August 2000 through February 2002, United Rentals, Inc. from October 1997 through May 2002, Waste Management Inc. from January 1994 through January 1999 and Station Casinos, Inc. from April 1999 through March 2001. Mr. Heckmann retired as Chairman of Vivendi Water, an international water products group of Vivendi S.A., a worldwide utility and communications company with headquarters in France, in June 2001. Mr. Heckmann was Chairman, President and Chief Executive Officer of U.S. Filter Corporation, a worldwide provider of water and wastewater treatment systems and services, from 1990 to 1999. Vivendi acquired US Filter on April 29, 1999. He has served as the associate administrator for finance and investment of the Small Business Administration in Washington, DC and was the founder and Chairman of the board of Tower Scientific Corporation.

Mr. Merck has been President and Chief Operating Officer of K2 since November 2003. Prior to that, he was Executive Vice President and Chief Operating Officer of K2 from October 2002. He served as Executive Vice President of Operations of K2 from July 2000, Vice President of K2 from January 1996 and President of Shakespeare Composites & Electronics, a division of Shakespeare, a wholly-owned subsidiary of K2 from June 1996. Mr. Merck served as President of K2 s former business, Anthony Pools, from February 1994 to June 1996.

Mr. Rangel, has been President K2 Inc. European Operations of K2 since August 2004. Prior to that, he served as Senior Vice President Finance and Chief Financial Officer since April 2003, Senior Vice President-Finance of K2 since 1988, and Corporate Controller from 1985 to 1988.

Mr. Mendenhall is Senior Vice President and Chief Financial Officer of K2. Prior to joining K2 in April 2003, he was Managing Director of Ernst & Young s west coast Corporate Finance Group from March 2001. From January 1990 through March 2001, Mr. Mendenhall held a number of executive positions at Bank of America: from January 1996 to March 2001, as Managing Director and Group Head of the entertainment and media industry group in Los Angeles and New York; from June 1993 to December 1995, as Managing Director of the Corporate Finance Group; and from January 1990 to June 1993, as Managing Director of the Leveraged Finance Group.

Mr. Baier is Vice President, General Counsel and Secretary of K2. Prior to joining K2 in April 2003, he was Associate General Counsel at Asia Global Crossing from April 2000. From 1995 through April 2000, Mr. Baier was as an Associate in the New York law firm of Simpson Thacher

& Bartlett. Mr. Baier received a juris doctor degree from the New York University School of Law.

Mr. Satoda has been a Vice President of K2 Inc. since May 2001 and Director of Taxes since joining K2 in August 2000. Prior to that time, Mr. Satoda was a Senior Manager with Ernst & Young LLP, an international auditing and tax consulting firm for more than five years.

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Mr. Anderson has been Director of Business Development since February 2005. Prior to holding that position, Mr. Anderson was the Director of Financial Accounting for K2 since he joined the company in March 2003. Prior to that, Mr. Anderson served as the Corporate Controller of US Filter Corporation, a provider of water and waste treatment systems and services since May 2000 and served as Assistant Corporate Controller from January 1997 through May 2000.

Mr. Hillebrandt has been Corporate Controller and Chief Accounting Officer of K2 since May 2004. Prior to joining K2, he was Senior Vice President and Chief Financial Officer of Fotoball USA, a publicly held souvenir and promotional products company, since July 2001 and was Vice President and Chief Financial Officer of Fotoball from July 2000 through May 2001. Fotoball was acquired by K2 in January 2004. From August 1998 through July 2000, Mr. Hillebrandt served as the Vice President and Chief Financial Officer of ChatSpace, Inc., a privately held Internet software and services company.

Ms. Crawford has been Director of Financial Reporting of K2 since May 2004. Ms. Crawford was Corporate Controller of K2 from July 1999 through May 2004 and Secretary from December 2000 through May 2003. Prior to joining K2, she was Controller of Kent H. Landsberg Company from 1996 to 1999 and an Audit Manager with Ernst & Young LLP from 1990 to 1996.

Officers of K2 are elected for one year by the directors at their first meeting after the annual meeting of shareholders and hold office until their successors are elected and qualified.

Available Information

K2 s website is http://www.k2inc.net. K2 makes available, free of charge, on or through the website, its annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with the Securities and Exchange Commission. In addition, copies of the written charters for the committees of the Board of Directors, K2 s Principles of Corporate Governance, K2 s Code of Business Conduct and Ethics are also available on this website and can be found under the Investor Information and Corporate Governance links. Copies are also available in print, free of charge, by writing to Investor Relations, K2 Inc., 5818 El Camino Real, Carlsbad, California 92008. This website address is intended to be an inactive textual reference only, and none of the information contained on the website is part of this report or is incorporated in this report by reference.

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ITEM 2. PROPERTIES

The table below provides information with respect to the principal production and distribution facilities utilized by K2 for operations as of December 31, 2004.

Location	Type of Facility	Owned Facilities No. of Locations	Owned Facilities Square Footage	Leased Facilities No. of Locations	Leased Facilities Square Footage
Marine Outdoor					
Minnesota	Distribution and production	1	278,000	5	234,000
South Carolina	Distribution and production	2	400,000	3	181,000
Texas	Production			1	19,000
Foreign	Distribution and production	2	48,000	7	2,330,000
		5	726,000	16	2,764,000
Action Sports					
Arkansas	Distribution	1	14,000		
California	Distribution and production			2	100,000
Illinois	Distribution	1	6,000		
Missouri	Distribution and production			2	302,000
New Hampshire	Distribution			1	180,000
Vermont	Distribution and production			2	32,000
Washington	Distribution and production	1	165,000	1	146,000
Foreign	Distribution and production	3	228,000	31	629,000
		6	413,000	39	1,389,000
Team Sports					
Alabama	Distribution	1	12,000		
California	Distribution and production			4	103,000
Minnesota	Distribution and production			5	34,000
Missouri	Distribution and production			3	467,000
New York	Production	2	80,000	1	10,000
Pennsylvania	Distribution			1	7,000
Tennessee	Distribution and production	4	294,000		
Foreign	Distribution and production	1	70,000	1	23,000
		8	456,000	15	644,000
Footwear and Apparel					
California	Distribution and production			3	127,000
Utah	Distribution and production			1	30,000
Washington	Distribution and production			3	53,000
Foreign	Distribution			3	8,000
				10	218,000

In March 2005, the corporate headquarters of K2 relocated to approximately 53,000 square feet of leased office space in Carlsbad, California. The terms of K2 s leases range from one to nineteen years, and many are renewable for additional periods. The termination of any lease expiring during 2005 would not have a material adverse effect on K2 s operations.

K2 believes, in general, its plants and equipment are adequately maintained, in good operating condition and are adequate for K2 s present needs. K2 regularly upgrades and modernizes its facilities and equipment and expands its facilities to meet production and distribution requirements.

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ITEM 3. LEGAL PROCEEDINGS

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

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

Environmental and related remediation costs are difficult to quantify for a number of reasons including the number of parties involved, the difficulty in determining the extent of the contamination, the length of time remediation may require, the complexity of environmental regulation and the continuing advancement of remediation technology. K2 accrues for liabilities of this nature when it is probable a liability has been incurred and the amount can be reasonably estimated. At December 31, 2004 and December 31, 2003, K2 had recorded an estimated liability of approximately $800,000 and $980,000, respectively, for environmental liabilities. The estimates are based on K2 s share of the costs to remediate as provided by the PRP s consultants and in ongoing discussions with the EPA or other environmental agencies. The ultimate outcome of these matters cannot be predicted with certainty, however, and taking into consideration the recorded reserves, management does not believe these matters will have a material adverse effect on K2 s financial statements or its operations going forward.

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

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON STOCK, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Principal Markets and Holders

K2 s common stock is listed on the New York Stock Exchange and the Pacific Stock Exchange under the symbol KTO. At February 28, 2005, there were 2,743 holders of record of common stock of K2.

Common Stock Prices

The following table sets forth, for the quarters indicated, the reported high, low and closing sales prices of K2 s Common Stock, as reported by the New York Stock Exchange during K2 s two most recent fiscal years.

	Stock Prices		
	High	**Low**	**Close**
2004			
Fourth	$ 17.25	$ 14.29	$ 15.88
Third	15.23	12.74	14.31
Second	16.92	13.60	15.70
First	18.50	15.13	16.03
2003			
Fourth	$ 18.15	$ 13.43	$ 15.55
Third	18.09	12.30	14.85
Second	12.75	7.45	12.25
First	10.06	7.72	7.72

Equity Compensation Plan Information

Information regarding K2 s equity compensation plans, including both stockholder approved plans and non-stockholder approved plans, is set forth in the section entitled Equity Compensation Plan Information in K2 s Notice of Annual Meeting of Shareholders and Proxy Statement, to be filed within 120 days after K2 s fiscal year end of December 31, 2004 (the Proxy Statement), which information is incorporated herein by reference.

Recent Sales of Unregistered Securities; Uses of Proceeds from Registered Securities

On July 7, 2004, K2 completed the acquisition of Völkl and Marker. The aggregate purchase price was valued at approximately $97.5 million (excluding merger costs of approximately $3.7 million). The transaction consideration consisted of $68.6 million in cash and the issuance of 1,821,073 shares of K2 Inc. common stock. The shares were sold to the shareholders of Völkl and Marker pursuant to Regulation S of the Securities Act of 1933, as amended.

Dividends

K2 has paid no cash dividends since May 1999. K2 s credit facility limits K2 s cash dividends to $1.0 million per year. As of December 31, 2004, $1.0 million of retained earnings were available to pay such dividends, however, K2 does not anticipate paying any cash dividends in the foreseeable future. See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Sources of Capital, and Note 6 of Notes to Consolidated Financial Statements for further description of K2 s credit facilities.

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Issuer Purchases of Equity Securities

K2 has an ongoing authorization, as amended, from the Board of Directors to repurchase shares of K2 s common stock in the open market or negotiated transactions. The Company s authorization is for up to $50 million of shares of common stock. K2 does not generally purchase stock during the quiet periods it has established in advance of its quarterly earnings release. K2 did not make any repurchases of its stock during 2004.

Transfer Agent, Registrar and Dividend Disbursing Agent for Common Stock

Computershare Trust Co., Inc.

350 Indiana Street

Suite 800

Golden, Colorado 80401

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ITEM 6. SELECTED FINANCIAL DATA

	Year Ended December 31				
	2004	2003	2002	2001 (a)	2000
	(Thousands, except per share figures)				
Statement of Operations Data:					
Net sales	$ 1,200,727	$ 718,539	$ 582,159	$ 589,519	$ 665,562
Cost of products sold	800,678	498,620	411,620	429,338	462,242
Gross profit	400,049	219,919	170,539	160,181	203,320
Selling expenses	197,134	116,509	86,394	103,688	108,274
General and administrative expenses	121,895	71,358	56,862	55,212	56,223
Operating income	81,020	32,052	27,283	1,281	38,823
Interest expense	21,449	9,950	8,966	13,631	14,814
Debt extinguishment costs (b)		6,745			
Other income, net (c)	(246)	(2,218)	(253)	(375)	(191)
Income (loss) from continuing operations before provision (credit) for income taxes	59,817	17,575	18,570	(11,975)	24,200
Provision (credit) for income taxes	20,876	6,151	6,500	(4,271)	7,502
Income (loss) from continuing operations	38,941	11,424	12,070	(7,704)	16,698
Discontinued operations, net of taxes					(119)
Net Income (loss)	$ 38,941	$ 11,424	$ 12,070	$ (7,704)	$ 16,579
Basic earnings (loss) per share of Common Stock:					
Continuing operations	$ 0.97	$ 0.46	$ 0.67	$ (0.43)	$ 0.93
Discontinued operations					(0.01)
Net income (loss)	$ 0.97	$ 0.46	$ 0.67	$ (0.43)	$ 0.92
Diluted earnings (loss) per share of Common Stock:					
Continuing operations	$ 0.86	$ 0.44	$ 0.67	$ (0.43)	$ 0.93
Discontinued operations					(0.01)
Net income (loss)	$ 0.86	$ 0.44	$ 0.67	$ (0.43)	$ 0.92
Dividends:					
Cash per share of Common Stock	$	$	$	$	$
Basic shares outstanding of Common Stock	40,285	24,958	17,941	17,940	17,949
Diluted shares outstanding of Common Stock (d)	49,345	28,750	17,994	17,940	18,040
Balance Sheet Data: (e)					
Total current assets	$ 773,156	$ 525,532	$ 323,924	$ 307,175	$ 305,132
Total assets	1,456,365	871,871	438,410	423,400	424,110
Total current liabilities	349,175	254,761	115,302	99,422	121,742
Long-term obligations	349,347	133,261	73,007	97,828	69,836
Total debt plus off-balance sheet financing facility (f)	415,911	216,138	96,120	160,557	173,292
Shareholders equity	682,866	434,040	231,296	214,657	227,248

(a) Operating income and net loss include downsizing costs totaling $18.0 million ($11.7 million net of taxes) of which $15.7 million was charged to cost of products sold and $2.3 million was charged to general and administrative expenses.
(b) For 2003, amount includes $4.7 million of a make-whole premium and $2.0 million for the write-off of capitalized debt costs.

(c) For 2004 and 2003, other income includes a $0.2 million and $2.2 million gain related to the sale of the composite utility and decorative light pole product lines. See Note 3 to Notes Consolidated Financial Statements.

(d) For 2004 and 2003, diluted shares of common stock outstanding include the dilutive impact of stock options and warrants and the assumed conversion of convertible subordinated debentures. See Note 13 to Notes to Consolidated Financial Statements.

(e) For 2003 and 2004, the increase in balance sheet data, including total current assets, total assets, total current liabilities, long-term obligations, total debt plus off-balance sheet financing facility and shareholders equity was primarily attributable to K2 s acquisition activities during 2004 and 2003. See Note 2 to Notes to Consolidated Financial Statements.

(f) Years 2001 and 2000 include debt related to an accounts receivable securitization facility that qualified for off-balance sheet treatment.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in connection with the other sections of this Annual Report on Form 10-K, including Part I, Item 1: Business ; Part II, Item 6: Selected Financial Data ; and Part II, Item 8: Financial Statements and Supplementary Data. The various sections of this MD&A contain a number of forward-looking statements, all of which are based on K2 s current expectations and could be affected by the uncertainties and risk factors described throughout this filing and particularly in the Factors That Could Affect Future Results section. K2 s actual results may differ materially, and these forward-looking statements do not reflect the potential impact of any future divestitures, mergers, acquisitions or other business combinations.

K2 Inc. is a premier, branded consumer products company with a portfolio of leading brands including *Shakespeare*, *Pflueger* and *Stearns* in the Marine and Outdoor segment; *Rawlings*, *Worth* and *K2 Licensing & Promotions* in the Team Sports segment; *K2*, *Völkl*, *Marker*, *Ride* and *Brass Eagle* in the Action Sports segment; and *Adio*, *Marmot* and *Ex Officio* in the Footwear and Apparel segment. K2 s diversified mix of products is used primarily in team and individual sports activities such as fishing, watersports activities, baseball, softball, alpine skiing, snowboarding, in-line skating and mountain biking. The Marine and Outdoor segment represented $336.9 million, or 28.1%, of K2 s 2004 consolidated net sales, the Action Sports segment represented $502.7 million, or 41.9% of 2004 consolidated net sales, the Team Sports segment had net sales of $250.4 million, or 20.8% of 2004 consolidated net sales and the Footwear and Apparel segment had net sales of $110.7 million, or 9.2% of 2004 consolidated net sales.

Overview

K2 believes that in 2004 there were two continuing major trends in the sporting goods industry. First, the sporting goods market experienced little or no growth in wholesale sales. Second, there was a growing influence of large format sporting goods retailers and retailer buying groups as well as the consolidation of certain sporting goods retailers worldwide, all of which has resulted in a consolidation of sporting goods suppliers. Based on these market trends, K2 believes that the most successful sporting goods suppliers will be those with greater financial and other resources, including those with the ability to produce or source high-quality, low cost products and deliver these products on a timely basis, to invest in product development projects and the ability to access distribution channels with a broad array of products and brands. In addition, as the influence of large sporting goods retailers grows, K2 believes that these retailers will prefer to rely on fewer and larger sporting goods suppliers to help them manage the supply of products and the allocation of shelf space.

As a result of these market trends, K2 has embarked upon a program to leverage its existing operations and to complement and diversify its product offerings within the sporting goods and recreational products industries. K2 intends to implement its internal growth strategy by continuing to improve operating efficiencies, extending its product offerings through new product launches and maximizing its extensive distribution channels. In addition, K2 will seek strategic acquisitions of other sporting goods companies with well-established brands and with complementary distribution channels.

K2 has begun to see results from its efforts reflected in its financial performance. Net sales for 2004 improved 67.1% to $1.2 billion from $718.5 million in 2003, which was up 23.4% from $582.2 million in 2002, primarily due to the acquisitions K2 completed during 2003 and 2004, as well as organic growth from most of K2 s existing brands. Gross profit percentage improved to 33.3% in 2004 from 30.6% in 2003 and 29.3% in 2002 primarily as the result of a more favorable product mix resulting from K2 s recent acquisitions, fewer close-out sales and continued reduced product costs associated with the China manufacturing facility. Operating income for 2004 increased to $81.0 million, or 6.7% of net sales, from $32.1 million, or 4.5% of net sales, in 2003 and $27.3 million, or 4.7% of net sales, in 2002 primarily as the result of higher sales volume and an improvement in gross profit percentage, partially offset by higher selling and general and administrative expenses.

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During 2004 and 2003, K2 made significant progress towards achieving its strategic objectives as follows:

- K2 completed nine acquisitions during 2004, including the following:
  - Acquisition in a stock-for-stock exchange offer/merger transaction of Fotoball USA, Inc. (later renamed K2 Licensing & Promotions, Inc.), a marketer and manufacturer of souvenir and promotional products, principally for team sports;
  - Acquisition of substantially all of the assets of Worr and All-Cad, businesses engaged in the design, manufacturing, selling and distribution of paintball markers and paintball-related products and accessories;
  - Acquisition of substantially all of the assets of IPI Innovations, Inc., a business engaged in the design, manufacturing, selling and distribution of gun and bow mounting systems, and other products and accessories for all-terrain vehicles;
  - Acquisition of Ex Officio, a division of The Orvis Company, Inc. a business engaged in the design, manufacture, selling and distribution of high-end travel, adventure and outdoor clothing and accessories;
  - Acquisition of Marmot, a leader in the premium technical outdoor apparel and equipment market;
  - Acquisitions of Völkl and Marker: Völkl is a well established and recognized brand in the worldwide alpine ski market and Marker has gained worldwide recognition for its patented ski-bindings; and
  - Acquisition of substantially all of the assets of Miken Composites LLC, a business engaged in the design, manufacturing, selling and distribution of composite softball bats and softball-related products and accessories.
- K2 completed seven acquisitions during 2003, including the following:
  - Acquisition in a stock-for-stock exchange offer/merger transaction of Rawlings, a leading marketer and manufacturer of baseball equipment;
  - Acquisition of all of the outstanding capital stock of Worth, a leading marketer and manufacturer of softball equipment; and
  - Acquisition in a stock-for-stock exchange offer/merger transaction of Brass Eagle, a worldwide leader in the design, manufacture, marketing, and distribution of paintball products, including paintball markers, paintballs, and accessories.
- The newly acquired brands along with K2 s existing brands have allowed K2 to aggregate its brand strength in complementary distribution channels in a consolidating industry characterized by large format sporting goods retailers and retail buying groups.
- The newly acquired brands have helped K2 strengthen its customer relationships.

Since 2003, K2 has entered several new sports markets such as baseball, softball, paintball, lacrosse, snowshoeing and apparel, which provides K2 with additional platforms for future growth opportunities.

K2 has continued to leverage its China manufacturing and Asian product sourcing capabilities. During 2003 and 2004, K2 increased the capacity of its China operations and increased the size of its sourcing group to accommodate the product needs of its acquisitions and existing companies.

K2 introduced a number of new products during 2003 and 2004 in the sporting goods markets as a means to drive organic growth.

K2 continued to focus on cost reduction initiatives by relocating the manufacturing of K2 branded products to K2 s China facilities.

K2 established the K2 Merchandising group to improve the marketing of K2 products and strengthen K2 s relationships with its retailers.

K2 completed a restructuring of its debt and equity through the private placement of $200.0 million of senior notes in July 2004, the replacement of K2 s revolving credit facility with an amended and restated revolving credit facility of $250.0 million in July 2004, and the public offering of $99.2 million of common stock. These new sources of capital replaced higher interest borrowings and provided K2 more opportunity and flexibility to make progress towards its strategic objectives.

Matters Affecting Comparability

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

Acquisitions. K2 s operating results for 2004 include the operating results for its acquisitions completed during 2004 and 2003. Approximately $452.7 million of the $482.2 million increase in net sales, when compared to 2003, are attributable to K2 s acquisitions during 2004 and 2003 as discussed below.

K2 s operating results for 2003 also include the operating results for its acquisitions completed during 2003. Approximately $113.9 million of the $136.3 million increase in net sales, when compared to 2002, are attributable to K2 s acquisitions during 2003 as discussed below.

Divestiture. On May 27, 2003, K2 completed the sale of the assets of its composite utility and decorative light poles and related product lines (the Division) to a subsidiary of Genlyte Thomas Group LLC. The Division was sold for approximately $20.1 million in cash and the assumption of certain liabilities by the buyer. During 2004 and 2003, K2 recorded a gain on sale of the Division of $0.2 million and $2.2 million, respectively, which included a reserve in respect of the estimated costs of disposal and amounts related to the retention of certain liabilities by K2.

Debt Extinguishment Costs. K2 s operating results for 2003 include approximately $6.7 million of debt extinguishment costs in conjunction with K2 s debt refinancing activities in March 2003. K2 expensed approximately $2.0 million ($1.3 million, or $0.05 per diluted share, after tax) of capitalized debt costs related to the payoff of the amounts outstanding under its existing debt facilities, and an additional $4.7 million ($3.1 million, or $0.11 per diluted share, after tax) was paid in cash and expensed for a make-whole premium related to the prepayment of K2 s $200 million of senior notes.

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Consolidated Results of Operations

The following table sets forth certain ratios and relationships calculated from the Consolidated Statements of Income for the years ended December 31, 2004, 2003 and 2002:

				2004 vs. 2003 Increase/ (Decrease)		2003 vs. 2002 Increase/ (Decrease)	
(In thousands, except per share data)	**2004**	**2003**	**2002**	**$**	**%**	**$**	**%**
Net sales	$ 1,200.7	$ 718.5	$ 582.2	$ 482.2	67.1%	$ 136.3	23.4%
Gross profit	400.0	219.9	170.5	180.1	81.9%	49.4	29.0%
Operating income	81.0	32.1	27.3	48.9	152.3%	4.8	17.6%
Net income (a)	38.9	11.4	12.1	27.5	241.2%	(0.7)	(5.8)%
Diluted earnings per share	$ 0.86	$ 0.44	$ 0.67	$ 0.42	95.5%	$ (0.23)	(34.3)%
Expressed as a percentage of net sales:							
Gross margin (b)	33.3%	30.6%	29.3%				
Selling, general and administrative expense	26.6%	26.2%	24.6%				
Operating margin (c)	6.7%	4.5%	4.7%				

(a) Net income for 2003 includes $6.7 million ($4.4 million net of taxes) for debt extinguishment costs as discussed in **Note 7, Borrowings and Other Financial Instruments,** in the Notes to Consolidated Financial Statements and in **Matters Affecting Comparability** above.

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

(c) Operating margin is defined as operating profit divided by net sales as presented in the Consolidated Statements of Income.

Downsizing and Restructuring Activities

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

Review of Operations: Comparison of 2004 to 2003

Net sales increased to $1.2 billion from $718.5 million in the prior year. Net income for 2004 was $38.9 million, or $0.86 per diluted share, as compared to net income of $11.4 million, or $0.44 per diluted share, in the prior year. Net income for 2003 included $4.4 million, or $0.15 per diluted share, in after-tax charges for early extinguishment of debt.

Net sales. In the Marine and Outdoor segment, net sales for 2004 totaled $336.9 million as compared with $324.0 million in 2003. The 2003 year included $12.6 million of net sales related to *Shakespeare s* composite utility and decorative light poles and related product lines (the Division). K2 sold the assets of the Division in May 2003. The overall improvement in net sales during 2004 (excluding the 2003 net sales of the Division) resulted from increased sales of *Shakespeare* fishing tackle products of $10.7 million, new sales of all-terrain vehicle accessory products of $5.3 million resulting from K2 s acquisition of IPI during the second quarter of 2004, higher sales of *Stearns* products of $6.8 million and increased sales of *Shakespeare* monofilament products of $2.8 million. Sales of *Shakespeare* fishing tackle products improved, reflecting growth in sales of *Pflueger*

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reels, marine antennas and the addition of *All-Star* rods in mid-2004. Increased sales of *Stearns* outdoor products reflected higher demand for rain gear and children s flotation products. Sales of monofilament products improved, reflecting demand for new products in the European market.

In the Action Sports segment, net sales for 2004 were $502.7 million as compared with $247.0 million in the prior year. The increase is the result of $101.7 million and $8.3 million in net sales of paintball products and snowshoes, respectively (companies acquired in the 2003 fourth quarter), $136.4 million in net sales resulting from the acquisitions of Völkl and Marker in July 2004, and from higher sales of snowboard products of $13.0 million and *K2* skis of $18.9 million. Partially offsetting these increases was a decline in sales of in-line skates and scooters of $23.9 million. The increase in snowboard sales resulted mainly from the popularity of the *Ride* brand, while ski sales benefited from the popularity of *K2* skis in the domestic and European markets. The decline in in-line skates sales is the result of sluggish worldwide retail sales for the industry, caused by soft consumer demand.

In the Team Sports segment, net sales for 2004 were $250.4 million as compared with $116.9 million in 2003. The increase from 2003 is primarily due to the acquisitions of Rawlings at the end of the 2003 first quarter, Worth at the end of the 2003 third quarter and K2 Licensing & Promotions in January 2004, resulting in additional net sales of $93.5 million, $27.8 million and $29.2 million, respectively.

In the Footwear and Apparel segment, net sales for 2004 were $110.7 million as compared with $30.6 million in 2003. The increase in net sales from 2003 is the result of the acquisitions of Ex Officio and Marmot in 2004 which had combined sales of $64.2 million for K2 in 2004 as well as higher sales of skateboard shoes and apparel of $15.9 million. The increase in sales of skateboard shoes and apparel reflects the strong sell through of the *Adio* shoe brand and an expanded retail distribution network.

K2 s international operations (operating locations outside of the U.S.) represented $329.6 million, or 27.5% of K2 s consolidated net sales for 2004 as compared to $208.9 million, or 29.1% of K2 s consolidated net sales for 2003. The increase in net sales from international operations was due to the acquisitions of Völkl and Marker during 2004 which had net sales from international operations of $97.3 million, improved ski and snowboard sales of $18.5 million and $6.9 million of higher sales of *Shakespeare* monofilament products in Europe, and a $16.2 million increase as the result of stronger foreign currencies relative to the U.S. dollar as compared to 2003. These improvements were partially offset by lower 2004 sales of in-line skates of $14.7 million.

Gross profit. Gross profit for 2004 was $400.0 million, or 33.3% of net sales, as compared with $219.9 million, or 30.6% of net sales in 2003. The improvement in gross profit dollars for 2004 was attributable to the increase in 2004 sales volume and an increase in gross profit as a percentage of net sales. The improvement in the gross profit percentage was due to a more favorable product mix as compared to 2003 resulting from K2 s recent acquisitions, fewer close-out sales in the current year as compared to the prior year, as well as continued reduced products costs associated with the China manufacturing facility. These improvements were partially offset by increased raw material costs.

Costs and expenses. Selling expenses for 2004 increased to $197.1 million, or 16.4% of net sales, as compared with $116.5 million, or 16.2% of net sales, in 2003. The increase in selling expenses was attributable to the increase in sales volume for 2004 as compared to the prior year and recent acquisitions made by K2 which resulted in additional selling expenses of $65.2 million. In addition, translated selling expenses for international locations were $3.0 million higher as a result of stronger foreign currencies relative to the U.S. dollar as compared to 2003.

General and administrative expenses for 2004 were $121.9 million, or 10.2% of net sales, compared with $71.4 million, or 9.9% of net sales, in 2003. The increase in general and administrative expenses in dollars for 2004 was primarily attributable to higher sales volume during the 2004 period and recent acquisitions made by K2 which resulted in additional general and administrative expenses of $35.3 million. In addition, K2 incurred

higher amortization costs on intangible assets of $1.6 million as the result of K2 s acquisition activities in 2003 and 2004, and $2.1 million in higher external professional fees related to K2 s compliance with section 404 of the Sarbanes-Oxley Act. In addition, translated general and administrative expenses for international locations were $1.2 million higher as a result of stronger foreign currencies relative to the U.S. dollar as compared to 2003.

Research and development expenses increased $4.9 million, or 51.0%, to $14.5 million from $9.6 million in 2003 as the result of K2 s acquisitions during 2003 and 2004, which resulted in the inclusion of additional research and development expenses totaling $3.6 million beginning with the date of each acquisition. The remaining increase in research and development expenses was attributable to additional costs spent in the development of new products.

Operating income. Operating income for 2004 increased to $81.0 million, or 6.7% of net sales, as compared to operating income of $32.1 million, or 4.5% of net sales, in 2003. The increase in operating income reflects higher sales volume and an improvement in gross profit percentage, partially offset by higher selling and general and administrative expenses. The improvement in operating income as a percentage of net sales was due to higher gross profits as a percentage of net sales.

K2 s international operations (for operating locations outside of the U.S.) represented $38.6 million, or 47.7% of K2 s operating income, for 2004 as compared with $13.8 million, or 43.0% of K2 s operating income for 2003. The increase in operating income from international operations during 2004 was attributable to the acquisitions of Völkl and Marker in 2004, and improved sales of skis, snowboards and monofilament products, partially offset by lower sales of in-line skates.

Interest expense. Interest expense for 2004 increased to $21.4 million, compared with $10.0 million in 2003. The increase in interest expense for 2004 was primarily attributable to higher average borrowing levels during the entire year resulting from K2 s acquisitions during 2003 and 2004. Borrowings on average were higher during 2004 due to borrowings made to fund acquisitions and the seasonal working capital requirements of the businesses acquired during 2004 and 2003.

Other income, net. Other income was $0.2 million for 2004 as compared to $2.2 million in 2003. Other income generally includes gains or losses on disposals of fixed assets and other miscellaneous income and expenses. In 2004 and 2003, other income included a $0.2 million and $2.2 million gain, respectively, on the sale of the composite utility and decorative light poles and related product lines.

Income taxes. The effective income tax rate for 2004 was 34.9% and for 2003 was 35.0%.

Segment information. Total segment operating profit (before interest expense, corporate expenses, the gain on the sale of the composite utility and decorative light poles and related product lines, debt extinguishment costs and income taxes) improved to $95.1 million in 2004 from $37.9 million in 2003. See Note 14, Segment Information for the calculation of segment operating profit.

In the Marine and Outdoor segment, operating profit was $42.4 million in 2004 as compared with an operating profit of $44.4 million in 2003. The 2003 year included $0.8 million of operating income related to *Shakespeare s* composite utility and decorative light poles and related product lines (the Division). K2 sold the assets of the Division in May 2003. The remaining decline in operating profit was attributable to lower gross margins on sales of monofilament products due to an increase in raw material costs and an increase in sales of lower margin products. The acquisitions made by K2 during 2004 in this segment did not have a significant impact on operating profit during 2004.

In the Action Sports segment, operating profit was $39.3 million in 2004 as compared to an operating profit of $4.7 million in 2003. The improvement in operating profit was attributable to the acquisitions of Völkl and Marker in July 2004 and Brass Eagle in December 2003, which resulted in increased in sales volume during 2004

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and higher gross margins. Partially offsetting these improvements was a $3.6 million increase in amortization expense of intangible assets and of the increase to fair market value of acquired inventories, which were a direct result of K2 s acquisitions in this segment during 2003 and 2004. K2 s other acquisition in this segment during 2004 did not have a significant impact on operating profit during 2004. The operating profit for 2004 includes the results of the acquisitions of Völkl and Marker in July 2004. Both Völkl and Marker are highly seasonal businesses that are profitable in the third and fourth quarters and normally generate losses in the first and second quarters of the year.

In the Team Sports segment, an operating profit of $2.4 million was reported in 2004 as compared to an operating loss of $12.1 million in 2003. The improvement in operating profit was attributable to a full year of operating results of Rawlings and Worth' which were acquired by K2 in March 2003 and September 2003, respectively. In addition the acquisition of K2 Licensing & Promotions in January 2004 contributed to the improvement in operating profit. Partially offsetting these improvements was a $1.1 million increase in amortization expense of intangible assets which was a direct result of K2 s acquisitions in this segment during 2003 and 2004. K2 s other acquisition in this segment during 2004 did not have a significant impact on operating profit during 2004.

In the Footwear and Apparel segment, operating profit was $11.0 million in 2004 as compared to an operating profit of $0.9 million in 2003. The improvement in operating profit was attributable to the acquisitions of Marmot in June 2004 and Ex Officio in May 2004, which resulted in increases sales volume and higher gross margins during 2004. In addition, operating profit generated by skateboard shoes and apparel improved due to increased sales volume and improved gross margins as the result of fewer close-out sales. Partially offsetting these improvements was a $1.5 million increase in amortization expense of intangible assets which was a direct result of K2 s acquisitions in this segment during 2004. The operating profit for 2004 includes the results of the acquisitions of Marmot in June 2004. Marmot is a highly seasonal business that is profitable in the third and fourth quarters and normally generates losses in the first and second quarters of the year.

Review of Operations: Comparison of 2003 to 2002

Net sales increased to $718.5 million from $582.2 million in the prior year. Net income for 2003 was $11.4 million, or $0.44 per diluted share, as compared to net income of $12.1 million, or $0.67 per diluted share, in the prior year. Net income for 2003 included $4.4 million, or $0.15 per diluted share, in after-tax charges for early extinguishment of debt.

Net sales. In the Marine and Outdoor segment, net sales for 2003 totaled $324.0 million as compared with $328.7 million in 2002. The overall decline in sales was attributable to the sale of the assets of the composite utility and decorative light poles and related product lines in May 2003 resulting in lower sales of $20.2 million, partially offset by increased sales of *Stearns* outdoor products of $6.2 million and S*hakespeare* cutting line and monofilament products of $10.5 million. Increased sales of *Stearns* outdoor products reflected new product introductions, and higher demand for rain gear and children s flotation products. These improvements were offset by a $2.7 million decline in sales of *Shakespeare* fishing tackle products due to lower sales in the European markets.

In the Action Sports segment, net sales for 2003 were $247.0 million as compared with $217.9 million in the prior year. The sales improvement was attributable to increased sales of snowboard products of $5.0 million, skis of $4.1 million, in-line skates of $6.3 million and the combined sales contribution of $14.7 million from K2 s acquisitions during 2003. The increase in snowboard sales resulted mainly from the popularity of the *Ride* brand, while ski sales benefited from the popularity of *K2 s* skis in the domestic and European markets. Increased in-line skate sales were the result of strong demand in the European and Asian markets.

In the Team Sports segment, net sales for 2003 were $116.9 million as compared with $19.3 million in 2002. The increase in sales was attributable to K2 s acquisition activities during 2003 which contributed sales of $99.2 million during 2003. Sales of *Hilton* apparel declined by

$1.6 million as the business was restructured during the year and integrated into the Rawlings operations.

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In the Footwear and Apparel segment, net sales for 2003 were $30.6 million as compared with $16.3 million in 2002. The increase in skateboard shoes and apparel reflected the strong sell through of the *Adio* shoe brand and an expanded retail distribution network.

K2 s international operations (operating locations outside of the U.S.) represented $208.9 million, or 29.1% of K2 s consolidated net sales for the twelve months ended December 31, 2003 as compared to $189.5 million, or 32.5% of K2 s consolidated net sales for the twelve months ended December 31, 2002. The increase in net sales from international operations was due to increased sales in the European and Asian markets of in-line skates of $12.7 million and higher combined ski and snowboard sales of $6.6 million.

Gross profit. Gross profit for 2003 was $219.9 million, or 30.6% of net sales, as compared with $170.5 million, or 29.3% of net sales in 2002. The improvement in gross profit dollars for the year was attributable to the increase in sales volume and the improvement in gross profit as a percentage of net sales. The improvement in gross profit percentage as a percentage of net sales was due to fewer close-out sales of in-line skates in 2003 as compared to 2002, continued shifting of product manufacturing and sourcing to K2 s China manufacturing facility and an increase in the sales of higher margin products, particularly related to K2 s acquisitions during 2003.

Costs and expenses. Selling expenses for 2003 increased to $116.5 million, or 16.2% of net sales as compared with $86.4 million, or 14.8% of net sales, in 2002. The dollar and percentage increase in selling expenses was attributable to K2 s acquisitions during 2003, which resulted in increased volume-related selling expenses of $24.4 million without a corresponding full year benefit of net sales, and K2 s additional investment in advertising and marketing of its brands during 2003.

General and administrative expenses for 2003 were $71.4 million, or 9.9% of net sales, compared with $56.9 million, or 9.8% of net sales, in 2002. The dollar and percentage increase in 2003 was attributable to K2 s acquisitions during 2003, which resulted in increased expenses of $9.6 million without a corresponding full year benefit of net sales, higher pension expenses of $2.1 million and the impact of stronger foreign currencies on translated expenses as compared to 2002.

Research and development expenses increased $1.1 million, or 12.9%, to $9.6 million from $8.5 million in 2002 as the result of K2 s acquisitions during 2003, which resulted in the inclusion of additional research and development expenses beginning with the date of each acquisition.

Operating income. Operating income for 2003 increased to $32.1 million or 4.5% of net sales, as compared to operating income of $27.3 million, or 4.7% of net sales, in 2002. The increase in operating income reflects higher sales volume and an improvement in gross profit percentage, partially offset by higher selling and general and administrative expenses. The decline in operating income as a percentage of net sales was due to higher selling, general and administrative expenses as a percentage of net sales, partially offset by higher gross profits as a percentage of net sales.

K2 s international operations (for operating locations outside of the U.S.) represented $13.8 million, or 42.9% of K2 s operating income, for the twelve months ended December 31, 2003 as compared with $8.5 million, or 31.1% of K2 s operating income, for the twelve months ended December 31, 2002. The improvement in operating income from international operations during 2003 was due to the increase in sales volume in the European and Asian markets and improved margins from fewer close out sales.

Interest expense. Interest expense for 2003 increased to $10.0 million, compared with $9.0 million in 2002. The increase in interest expense for 2003 was primarily attributable to higher average borrowing levels during the year resulting from K2 s acquisitions during 2003, as well as approximately $0.4 million of amortization expense associated with the warrants issued on K2 s $25 million convertible subordinated debentures. These increases were partially offset by lower average interest rates on borrowings.

Debt Extinguishment Costs. In conjunction with K2 s debt refinancing activities in March 2003, K2 expensed approximately $2.0 million ($1.3 million, or $0.05 per diluted share, after tax) of capitalized debt costs related to the payoff of the amounts outstanding under its existing debt facilities, and an additional $4.7 million ($3.1 million, or $0.11 per diluted share, after tax) was paid in cash and expensed for a make-whole premium related to the prepayment of K2 s Senior Notes.

Other income, net. Other income increased to $2.2 million from $0.3 million in 2002. Other income generally includes gains or losses on disposals of fixed assets and other miscellaneous income and expenses. In 2003, other income also included a $2.2 million gain on the sale of the composite utility and decorative light poles and related product lines.

Income taxes. The effective income tax rate for 2003 and 2002 was 35.0%.

Segment information. Total segment operating profit (before interest expense, corporate expenses, the gain on the sale of the composite utility and decorative light poles and related product lines, debt extinguishment costs and income taxes) improved to $37.9 million in 2003 from $30.6 million in 2002.

In the Marine and Outdoor segment, operating profit was $44.4 million in 2003 as compared with an operating profit of $42.8 million in 2002. The improvement in operating profit was attributable to reduced product costs from the China manufacturing facility and an increase in sales of higher margin products. The improvements in operating profit were partially offset by decreased operating profits resulting from the sale of the assets of the composite utility and decorative light poles and related product lines in May 2003. The acquisition made by K2 during 2003 in this segment did not have a significant impact on operating profit during 2003.

In the Action Sports segment, an operating profit of $4.7 million was reported in 2003 as compared with an operating loss of $5.5 million in 2002. The improvement in operating profit was attributable to the increase in sales volume (excluding the impact of acquisitions) during 2003, improved gross margins as the result of fewer close-out sales, reduced product costs from the China manufacturing facility and an increase in sales of higher margin products. The acquisitions made by K2 during 2003 in this segment did not have a significant impact on operating profit during 2003.

In the Team Sports segment, an operating loss of $12.1 million was reported in 2003 as compared to an operating loss of $4.4 million in 2002. The increase in the loss was attributable to a decline in corporate apparel sales as the business was restructured during 2003, and due to lower gross margins on corporate apparel sales as the result of certain inventory reduction efforts. In addition, the operating loss increased $4.5 million due to higher selling, general and administrative expenses from the newly acquired companies in the segment without the impact of the highest seasonal sell-ins and gross profits due to the timing of the acquisitions during 2003.

In the Footwear and Apparel segment, an operating profit of $0.9 million was reported in 2003 as compared to an operating loss of $2.3 million in 2002. The improvement in operating profit was attributable to the increase in sales volume during 2003 and improved gross margins as the result of fewer close-out sales.

Liquidity and Sources of Capital

Cash Flow Activity

K2 s operating activities provided $13.3 million of cash in 2004 as compared to $34.1 million during 2003. The decline in cash from operations during 2004 was primarily attributable to an increase in accounts receivable during the 2004 period of $102.7 million as compared to the prior year s decrease of $24.0 million, partially offset by higher net income in 2004 of $27.5 million as compared to 2003, higher depreciation and amortization expense during 2004 of $13.7 million, a decrease in inventories during 2004 of $8.4 million as compared to an increase during 2003 of $20.3 million, and an increase in accrued liabilities of $27.0 million during 2004 as compared to a decrease during 2003 of $2.7 million. The improvement in net income for 2004 was primarily attributable to K2 s higher sales volume and higher gross margins. The increase in depreciation and amortization expenses during 2004 was attributable to higher depreciation expenses on fixed assets, higher amortization costs of intangible assets and an higher amortization costs of the increase to fair market value of acquired inventories, all of which resulted from K2 s acquisition activities during 2003 and 2004. The increase in accounts receivable and accrued liabilities and the reduction in inventories in 2004 was attributable to the seasonal working capital requirements of the businesses acquired by K2 during 2004.

Net cash used for investing activities was $216.3 million in the current year as compared to $42.5 million of cash used by investing activities in the prior year. The increase in cash used in investing activities was due to an increase in capital expenditures of $15.5 million, and an increase in cash used to acquire new businesses of $136.9 million. In addition, the 2003 period had $20.1 million of cash proceeds from the sale of the Division. The increase in capital expenditures during 2004 was attributable to the increase in the size of K2 s overall business as the result of acquisitions completed by K2 during 2003 and 2004. There were no material commitments for capital expenditures at December 31, 2004.

Net cash provided by financing activities in 2004 was $207.4 million as compared with $18.4 million during 2003. The increase in cash provided by financing activities during 2004 was due to $200.0 million of gross proceeds received from the issuance of senior notes and $93.6 million of net proceeds received from the issuance of equity compared to the issuance of $100.0 million in convertible subordinated debentures during 2003.

Capital Structure and Resources

K2 s principal long-term borrowing facility is a $250 million revolving credit facility (Facility), secured by all of K2 s assets in the United States, Canada and England. Total availability under the Facility is determined by a borrowing formula based on eligible trade receivables and inventory and defined advance rates. The Facility is expandable to $350 million and has a $100 million limit for the issuance of letters of credit. The Facility expires on July 1, 2009. At December 31, 2004, there were $60.2 million of borrowings outstanding under the Facility, $18.5 million of outstanding letter of credit issuances (consisting of $16.3 million of standby letters of credit and $2.2 million of trade letters of credit which expire over the next 12 months) and $170.2 million of available borrowing capacity. At December 31, 2004, K2 also had outstanding $25.0 million of 7.25% convertible subordinated debentures due March 2010, $75.0 million of 5.00% convertible senior debentures due June 2010 and $200.0 million of senior notes due July 2014. At December 31, 2004, K2 had $55.1 million outstanding under various foreign lending arrangements.

The Facility limits K2 s ability to pay cash dividends and to make stock repurchases to $1.0 million per each fiscal year, of which the full amount was available as of December 31, 2004. K2 is currently negotiating with its lenders under the Facility to obtain an amendment to this Stock repurchase restriction.

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Long-term Financial Obligations and Other Commercial Commitments

The following summarizes the outstanding borrowings, contractual obligations and long-term liabilities of K2 at December 31, 2004 and the effects such obligations are expected to have on liquidity and cash flow in future periods.

Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
			(Thousands)		
Long-term debt (1)	$ 385,886	$ 4,619	$ 6,694	$ 65,789	$ 308,784
Operating leases (2)	68,186	16,610	21,427	13,360	16,789
Licensing arrangements (3)	23,466	16,919	6,210	337	
Endorsement and sponsorship arrangements (4)	11,696	7,969	3,327	390	10
Pension contributions (5)	5,700	5,700			
Amounts due related to acquisitions (6)	3,779	3,779			
Total contractual cash obligations	$ 498,713	$ 55,596	$ 37,658	$ 79,876	$ 325,583

(1) Includes principal payments contractually outstanding under K2 s lending arrangements. See Note 6 to Notes to Consolidated Financial Statements, for additional information on K2 s long-term debt obligations.
(2) See Note 9 to Notes to Consolidated Financial Statements for additional information on K2 s operating leases.
(3) In the ordinary course of business, K2 enters into licensing arrangements whereby future minimum payments are due. These amounts represent the contractual minimum payments due under these agreements.
(4) In the ordinary course of business, K2 enters into endorsement and sponsorship contracts with athletes whereby future minimum payments are due. These amounts represent the contractual minimum payments due under these agreements.
(5) These amounts include estimated contributions for K2 s pension plans. See Note 9 to Notes to Consolidated Financial Statements, for additional information on K2 s pension plans.
(6) These amounts include payments to be made during 2005 related to K2 s completed acquisitions.

K2 believes that the credit available under the Facility, together with cash flow from operations, will be sufficient for K2 s business needs during 2005. K2 s ability to arrange debt financing from other sources, should such additional financing become necessary, could be limited by the fact that substantially all of K2 s assets in the United States, Canada and England are subject to security interests pursuant to the Facility. In addition, K2 s Senior Notes places limitations on the incurrence of indebtedness by K2.

Off-Balance Sheet Arrangements

K2 did not enter into any off-balance sheet arrangements during 2004 or 2003, nor did K2 have any off-balance sheet arrangements outstanding at December 31, 2004 or 2003.

Environmental Matters

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

Environmental and related remediation costs are difficult to quantify for a number of reasons including the number of parties involved, the difficulty in determining the extent of the contamination, the length of time remediation may require, the complexity of environmental regulation and the continuing advancement of

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remediation technology. K2 accrues for liabilities of this nature when it is probable a liability has been incurred and the amount can be reasonably estimated. At December 31, 2004 and December 31, 2003, K2 had recorded an estimated liability of approximately $800,000 and $980,000, respectively, for environmental liabilities. The estimates are based on K2 s share of the costs to remediate as provided by the PRP s consultants and in ongoing discussions with the EPA or other environmental agencies. The ultimate outcome of these matters cannot be predicted with certainty, however, and taking into consideration the recorded reserves, management does not believe these matters will have a material adverse effect on K2 s financial statements.

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 151, *Inventory Costs, an Amendment of ARB No. 43, Chapter 4*. SFAS No. 151 retains the general principle of ARB No. 43, Chapter 4, *Inventory Pricing*, that inventories are presumed to be stated at cost; however, it amends ARB No. 43 to clarify that abnormal amounts of idle facilities, freight, handling costs and spoilage should be recognized as current period expenses. Also, SFAS No. 151 requires fixed overhead costs be allocated to inventories based on normal production capacity. The guidance in SAFS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. K2 does not believe the implementation of SFAS 151 will have a material impact on its financial statements.

In December 2004, the FASB issued SFAS No. 123 (R) *Share-Based Payment.* SFAS No. 123 (R) requires that companies recognize compensation expense equal to the fair value of stock options or other share based payments. The standard is effective for K2 beginning in the 2005 third quarter. The impact on K2 s net income will include the remaining amortization of the fair value of existing options currently disclosed as pro-forma expense in Note 1 in the Notes to Consolidated Financial Statements, and is contingent upon the number of future options granted, the selected transition method and the selection of either the Black-Scholes or the binominal lattice model for valuing options.

Critical Accounting Policies

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

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

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

Revenue Recognition

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

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Warranty

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

Accounts Receivable and Allowances

Accounts receivable are the result of K2 s worldwide sales activities. Although K2 s credit risk is spread across a large number of customers within a wide geographic area, periodic concentrations within a specific industry occur due to the seasonality of its businesses. At December 31, 2004 and 2003, K2 s receivables from sporting goods retailers who sell skis, bindings, skates, snowboards and bikes amounted to 52% and 41%, respectively, of total receivables. K2 generally does not require collateral but performs periodic credit evaluations to manage its credit risk.

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

Inventories

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

Long-Lived and Finite Lived Intangible Assets

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

Long-lived assets, such as property, plant and equipment and purchased intangible assets with finite lives, are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* K2 assesses the fair value of the assets based on the future cash flow the assets are expected to generate and recognizes an impairment loss when estimated undiscounted future cash flow expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When an impairment is identified, K2 reduces the carrying amount of the asset to its estimated fair value based on a discounted cash flow approach or, when available and appropriate, comparable market values. K2 determined there were no indicators of material impairment of long-lived assets as of December 31, 2004.

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

Indefinite Lived Intangible Assets

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

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

In performing the fiscal 2004 annual test for the Marine and Outdoor segment, K2 assumed a sales growth rate of 5%; gross profit margins of 37%; an income tax rate of 35%; and a discount rate of 12%. For the Action Sports segment, K2 assumed a sales growth rate of 5%; gross profit margins of 34%; an income tax rate of 35%; and a discount rate of 12%. For the Team Sports segment, K2 assumed a sales growth rate of 3%; gross profit margins ranging from 34% to 36%; an income tax rate of 35%; and a discount rate of 12%. For the Footwear and Apparel segment, K2 assumed a sales growth rate of 5%; gross profit margins of 40%; an income tax rate of 35%; and a discount rate of 12%. K2 did not recognize any goodwill impairment as a result of performing this annual test.

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

change, economic conditions, or changes to K2 s business operations. Such changes may result in impairment charges recorded in future periods.

Income Taxes

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

Pensions

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

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

The impact on future benefit costs is the elimination of the service cost and an $8.0 million reduction of the projected benefit obligation for future pay increases. This plan change has further resulted in an estimated reduction in net periodic pension costs for the 2005 year of $2.8 million.

K2 also has a pension plan which covered certain employees of the Simplex Building Products division which K2 sold in 2000. This plan is referred to as the Simplex UAW Pension Plan. The disclosures that follow include this plan.

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

December 31, 2004, K2 made contributions totaling $3.5 million to the plans.

Due to the lower discount rate and declines in the stock market during 2002, actual asset returns on K2 s pension assets did not meet K2 s original assumption of 2003 expected returns. This resulted in 2003 pension expense being higher than 2002 pension expense by approximately $2.1 million. Pension expense for the 2004 year was approximately $0.1 million lower than the 2003 year. The 2004 decrease in pension expense was attributable to: the plan freeze on August 31, 2004 resulting in a reduction in expense of approximately $0.6 million; better than expected 2003 asset returns resulting in a reduction to expense of approximately $0.3 million; all of which were offset by an increase in pension expense of approximately $0.8 million due to changes in assumptions regarding the discount rate, expected return on assets, mortality rates, administrative expenses and changes in participant demographics. For 2005, pension expense is estimated to be approximately $0.6 million, a reduction of $2.7 million from the 2004 year. This decrease in overall expense is expected to result from the following: a $0.2 million decrease in expense due to better than expected asset returns during 2004; a $2.8 million decrease in expense due to the freezing of the plan during 2004; all of which are expected to be offset by a $0.3 million increase in pension expense due to the decrease in the discount rate from 6.25% to 5.75% at December 31, 2004. K2 estimates a required cash contribution of approximately $5.7 million to the plans in 2005.

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

Foreign Currency Translation

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

Other Contingencies

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

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Impact of Inflation and Changing Prices

The inflation rate, as measured by the U.S. Consumer Price Index, has been relatively low in the last few years, and therefore, pricing decisions by K2 have largely been influenced by competitive market conditions. Depreciation expense is based on the historical cost to K2 of its fixed assets, and therefore, is considerably less than it would be if it were based on current replacement cost. While buildings, machinery and equipment acquired in prior years will ultimately have to be replaced at significantly higher prices, it is expected this will be a gradual process over many years.

Factors That Could Affect Future Results

Because of the following factors, as well as other factors affecting our business, financial position, results of operations and prospects, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

K2 s strategic plan, involving growth through the acquisition of other companies, may not succeed.

K2 s strategic plan involves rapid growth through the acquisition of other companies. Such growth involves a number of risks, including:

- the difficulties related to combining previously separate businesses into a single unit;
- the substantial diversion of management s attention from day-to-day operations;
- the assumption of liabilities of an acquired business, including unforeseen liabilities;
- the failure to realize anticipated benefits, such as cost savings and revenue enhancements;
- the dilution of existing stockholders and convertible note holders due to the issuance of equity securities, utilization of cash reserves, or incurrence of debt in order to fund the acquisitions;
- the potentially substantial transaction costs associated with acquisitions;
- the difficulties related to assimilating the products, personnel and systems of an acquired business and to integrating distribution and other operational capabilities; and
- the difficulties in applying K2 s internal controls to an acquired business.

If K2 fails to maintain an effective system of internal controls, it may not be able to accurately report its financial results or prevent fraud, which could harm K2 s brands and operating results.

Effective internal controls are necessary for K2 to provide reliable and accurate financial reports and effectively prevent fraud. K2 has devoted significant resources and time to comply with the new internal control over financial reporting requirements of the Sarbanes-Oxley Act of 2002. In addition, Section 404 under the Sarbanes-Oxley Act of 2002 requires that K2 assess and its auditors attest to the design and operating effectiveness of K2 s controls over financial reporting. K2 s compliance with the annual internal control report requirement for each fiscal year will depend on the effectiveness of its financial reporting and data systems and controls across its operating subsidiaries. Furthermore, an important part of K2 s growth strategy has been, and will likely continue to be, the acquisition of complementary businesses, and K2 expects these systems and controls to become increasingly complex to the extent that it integrates acquisitions and its business grows. To effectively manage this growth, K2 will need to continue to improve its operational, financial and management controls and its reporting systems and procedures. K2 cannot be certain that these measures will ensure that it designs, implements and maintains adequate controls over its financial processes and reporting in the future, especially in light of likely future acquisitions of companies that may not be in compliance with Section 404 of the Sarbanes-Oxley Act of 2002. Any failure to implement required new or improved controls, difficulties encountered in their implementation or operation, or difficulties in the assimilation of acquired businesses into

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K2 s control system could harm K2 s operating results or cause it to fail to meet its financial reporting obligations. Inferior internal controls could also cause investors to lose confidence in K2 s reported financial information, which could have a negative effect on the trading price of its stock and its access to capital.

Current and future financings may place a significant debt burden on K2.

K2 has incurred substantial indebtedness. As of December 31, 2004, K2 had $415.9 million of outstanding debt, including $60.2 million of borrowings under its $250.0 million revolving credit facility, $55.1 million outstanding under foreign lending arrangements, outstanding convertible debentures of $100.0 million in the aggregate and $200.0 million outstanding in senior notes. In addition, as of December 31, 2004, K2 had available borrowings under its revolving credit facility of $170.2 million. K2 s substantial indebtedness, as well as potential future financings, could, among other things:

- adversely affect K2 s ability to expand its business, market its products and make investments and capital expenditures;
- adversely affect the cost and availability of funds from commercial lenders, debt financing transactions and other sources;
- adversely affect the ability of K2 to pursue its acquisition strategy; and
- create competitive disadvantages compared to other companies with lower debt levels.

K2 faces intense competition and potential competition from companies with greater resources, and, if it is unable to compete effectively with these companies, its business could be harmed.

The markets for sporting goods and recreational products in which K2 competes are generally highly competitive, especially as to product innovation, performance and styling, price, marketing and delivery. Competition regarding these products, other than active wear, consists of a relatively small number of large producers, some of whom have greater financial and other resources than K2. In addition, many of K2 s competitors offer sports and recreational equipment not currently sold by K2 and may be able to leverage these broader product offerings to adversely affect K2 s competitive market position. Further, there are no significant technological or capital barriers to entry into the markets for many sporting goods and recreational products. The sales of leisure products are also affected by changes in the economy and consumer tastes, and sporting goods and recreational products face competition from other leisure activities.

K2 s marine and outdoor products are, in most instances, subject to price competition, ranging from moderate in marine antennas and monofilament line to intense for commodity-type products. Many of K2 s marine and outdoor competitors have greater financial and other resources than K2.

Certain K2 businesses are highly seasonal

Certain K2 businesses are highly seasonal. Historically, certain of K2 s businesses, such as fishing tackle and water sports products, baseball and softball, skis and snowboards, winter apparel, bikes, and in-line skates have experienced seasonal swings in their businesses depending on their respective products. This seasonality impacts K2 s working capital requirements and hence overall financing needs. In addition, K2 s borrowing capacity under the revolving credit facility is impacted by the seasonal change in receivables and inventory.

Purchasing decisions made by a small number of large format sporting goods retailers can have a significant impact on K2 s results.

Although the sporting goods manufacturing industry is highly fragmented, many of the retail customers that purchase sporting goods are highly concentrated. Large format sporting goods retailers are important to K2 s results of operations, and Wal-Mart accounted for approximately 16% of K2 s net sales for the year ended December 31, 2004. Due to their size, these retailers may demand better prices and terms from K2, and these demands may have an adverse impact on K2 s margins. In addition, if any of these large format sporting goods retailers were to decide to materially reduce the amounts or types of K2 products that they purchase, such decision would have a material adverse impact on K2 s business, financial condition, results of operations and prospects.

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K2 s failure to keep pace with rapid change in marketing strategies, product design, styles and tastes could harm its business.

Consumer demand for recreational products is strongly influenced by matters of taste and style. K2 cannot assure you that K2 will successfully develop new products to address new or shifting consumer demand. An unexpected change in consumer tastes or product demand could seriously harm K2 s business. K2 s inability to timely and successfully respond to developments and changing styles could hurt its competitive position or render its products noncompetitive.

K2 cannot assure you that demand for its products will remain constant. The sales of leisure products are affected by changes in the economy and consumer tastes, both of which are difficult to predict. Continued adverse developments affecting economies throughout the world, including a general tightening of the availability of credit, increasing energy costs, declining consumer confidence and significant declines in the stock market could lead to a further reduction in discretionary spending for K2 s products.

The weak financial conditions of some of K2 s customers may adversely impact K2 s business.

A large portion of K2 s sales are to sporting goods retailers. Many of K2 s smaller retailers and some larger retailers are not strongly capitalized. Adverse conditions in the sporting goods retail industry can adversely impact the ability of retailers to purchase K2 products, or could lead retailers to request credit terms that would adversely affect K2 s cash flow and involve significant risks of nonpayment.

K2 s financial results vary from quarter to quarter, which could hurt K2 s business and the market price of its stock.

Various factors affect K2 s quarterly operating results and some of them are not within K2 s control. They include, among others:

- weather and snow conditions;
- the timing and introduction of new products;
- the mix of products sold;
- the timing of significant orders from and shipments to customers;
- product pricing and discounts;
- the timing of its acquisitions of other companies and businesses; and

general economic conditions.

These and other factors are likely to cause financial results of K2 to fluctuate from quarter to quarter. The trading price of K2 common stock could decline dramatically. Based on the foregoing, K2 believes that quarter-to-quarter comparisons of its results of operations may not be meaningful. Therefore, purchasers of K2 common stock should not view K2 s historical results of operations as reliable indications of its future performance.

K2 may not be able to attract or retain the management employees necessary to remain competitive in its industry; the loss of one or more of K2 s key personnel, including Mr. Richard J. Heckmann, Chairman and Chief Executive Officer of K2, could have a material adverse effect on K2 s business, financial condition, results of operations and prospects.

K2 s continued success depends on the retention, recruitment and continued contributions of K2 s key management, finance, marketing and staff personnel, many of whom would be difficult or impossible to replace. The competition for qualified personnel is intense. K2 cannot assure you that it will be able to retain its current personnel or recruit the key personnel it requires. Specifically, Mr. Richard J. Heckmann, K2 s Chairman and Chief Executive Officer, has been fundamental to developing K2 s growth strategy and, without his services, K2 s implementation of its growth strategy might fail. The loss of services of members of K2 s key personnel, including Mr. Heckmann, could have a material adverse effect on K2 s business, financial condition, results of operations and prospects.

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International operations, unfavorable political developments, natural disasters and weak foreign economies may seriously harm K2 s financial condition.

K2 s business is dependent on international trade, both for sales of finished goods and low-cost manufacturing and sourcing of products. K2 s three principal markets are North America, Europe and Asia. K2 s revenues from international operations were approximately 27.5% of K2 s sales for the year ended December 31, 2004. K2 expects that its revenues from international operations will continue to account for a significant portion of its total revenues. Any political developments adversely affecting trade with Europe or Asia (especially China) or a natural disaster to any of K2 s facilities therein could severely impact K2 results of operations. K2 s international operations are subject to a variety of risks, including:

- recessions in foreign economies;
- the adoption and expansion of trade restrictions;
- limitations on repatriation of earnings;
- reduced protection of intellectual property rights in some countries;
- longer receivables collection periods and greater difficulty in collecting accounts receivable;
- difficulties in managing foreign operations;
- social, political and economic instability;
- unexpected changes in regulatory requirements;
- acts of war and terrorism;
- ability to finance foreign operations;
- changes in consumer tastes and trends;
- natural disasters;
- tariffs and other trade barriers; and

U.S. government licensing requirements for export.

In addition, K2 will continue to outsource a number of its supply contracts to entities in foreign nations and will continue to be highly reliant on overseas manufacturing. Specifically, K2 maintains significant manufacturing capacity in China and Costa Rica. Political or economic developments adversely affecting the operation of these facilities could result in late deliveries, lower sales and earnings, and unanticipated costs.

Significant price volatility or interruptions in supply of K2 s raw materials may result in increased costs that it may be unable to pass on to customers, which could reduce profitability.

The prices of the raw materials, such as resin-based products, steel and aluminum, that K2 purchases from third parties are cyclical and volatile. K2 purchases a substantial portion of these raw materials from third party suppliers, and the cost of these raw materials represents a substantial portion of our cost of products sold. In recent periods, K2 has experienced significantly higher crude oil prices, which have resulted in increased prices for resin-based products. In addition, the fluctuations of supply and demand for raw materials have led to increased price volatility.

Although K2 frequently enters into supply agreements to acquire these raw materials, these agreements typically provide for market based pricing and provide K2 only limited protection against price volatility. While K2 attempts to match cost increases with corresponding product price increases, K2 is not always able to raise product prices immediately or at all. Timing differences between raw material prices, which may change daily, and contract product prices, which in many cases are negotiated only monthly or less often, have had and may

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continue to have a negative effect on profitability. If any of K2 s suppliers is unable to meet its obligations under present supply agreements, K2 may be forced to pay higher prices to obtain the necessary raw materials from other sources, and K2 may not be able to increase prices for finished products to recoup the higher raw materials cost. In addition, if any of the raw materials that K2 uses becomes unavailable within the geographic area from which they are now sourced, then K2 may not be able to obtain cost-effective substitutes. Any underlying cost increase that K2 is not able to pass on to customers or any interruption in supply of raw materials could increase K2 s costs or decrease revenues, which could reduce profitability.

Changes in currency exchange rates could affect K2 s revenues.

A significant portion of K2 s production and approximately 25.1% of K2 s sales for the year ended December 31, 2004 are denominated in foreign currencies and are subject to exchange rate fluctuation risk. Although K2 engages in some hedging activities to reduce foreign exchange transaction risk, changes in the exchange rates between the U.S. dollar and the currencies of Europe and Asia could make K2 products less competitive in foreign markets, and could reduce the sales and earnings represented by foreign currencies. Additionally, such fluctuation could result in an increase in cost of products sold in foreign markets reducing margins and earnings.

Acts of war or terrorism may have an adverse effect on K2 s business.

Acts of war or terrorism may have an adverse effect on the economy generally, and more specifically on K2 s business, financial condition, results of operations and prospects. Among various other risks, such occurrences have the potential to significantly decrease consumer spending on leisure products and activities, adversely impact K2 s ability to consummate future debt or equity financings and negatively affect K2 s ability to manufacture, source and deliver low-cost goods in a timely manner.

K2 is subject to and may incur liabilities under various environmental laws.

K2 is subject to federal, state, local and foreign laws and regulations that govern activities that may have adverse environmental effects, such as discharges to air and water, as well as handling and disposal of and exposure to hazardous substances. In that regard, K2 has been and could be subject to claims and inquiries related to alleged substances in K2 s products that may be subject to notice requirements or exposure limitations, particularly in California, which may result in fines and penalties. K2 is also subject to laws and regulations that impose liability for cost and damages resulting from past disposals or other releases of hazardous substances. For example, K2 may incur liability under the Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended, and similar laws, some of which impose strict, and in some cases, joint and several, liability for the cleanup of contamination resulting from past disposals of waste, including disposal at off-site locations. K2 is currently aware of one matter involving off-site waste disposal liability in South Carolina and another matter involving an offsite waste disposal facility in Michigan. At December 31, 2004 and December 31, 2003, K2 had recorded an estimated liability of approximately $800,000 and $980,000, respectively, for environmental matters. In addition, K2 has acquired and intends to continue to acquire pre-existing businesses, such as Rawlings, Völkl, Marker and Marmot, that have historical and ongoing operations, and K2 has limited information about the environmental condition of the properties of such companies. It is possible that soil and groundwater contamination may exist on these or other of K2 s properties resulting from current or former operations. Although K2 is not aware of any issues arising under current environmental laws that would be reasonably likely to have a material adverse effect on K2 s business, financial condition, results of operations, or prospects, K2 cannot assure you that such matters will not have such an impact.

Unfavorable weather can adversely affect K2 s sales.

Sales of K2 s recreational products are strongly influenced by the weather. For example, poor snow conditions in the winter or summer conditions unfavorable to outdoor sports can adversely affect sales of important K2 products.

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K2 is subject to and may incur liabilities under various tax laws.

K2 is subject to income taxes in the United States and numerous foreign jurisdictions. In the ordinary course of our business, there are transactions and calculations where the ultimate tax determination is uncertain. In addition, changes in tax law and regulations, as well as adverse judicial rulings, could adversely affect the income tax provision. The Company believes that it has adequately provided for income tax issues not yet resolved with federal, state, and foreign tax authorities. Although not probable, the most adverse resolution of such issues could affect the income tax provision in the period in which that determination is made.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

Fluctuations in foreign currency exchange rates can affect K2 s earnings and cash flows. K2 manages its exposures to changes in foreign currency exchange rates on certain firm purchase commitments and anticipated, but not yet committed purchases, by entering into some foreign currency forward contracts. K2 s risk management objective is to reduce its exposure to the effects of changes in exchange rates on the cost of products sold over annual time horizons. Foreign currency exchange rate movements also affect K2 s competitive position, as exchange rate changes may affect business practices and/or pricing strategies of non-U.S. based competitors and may affect the profitability and pricing strategies of K2 as well. K2 s foreign currency risk policies entail entering into foreign currency derivative instruments only to manage risk of currency fluctuations over a given period of time, not for speculative investments. At December 31, 2004, K2 had foreign exchange contracts with maturities of within one year to exchange various foreign currencies to dollars in the aggregate amount of $81.6 million.

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

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

As of December 31, 2004, K2 had $300.0 million in principal amount of fixed rate debt represented by the $100 million of convertible subordinated debentures and $200 million of senior notes, and $115.9 million of variable rate debt represented by borrowings under the revolving credit facility and foreign lending arrangements (at a weighted average interest rate of 4.62% at December 31, 2004). Based on the balance outstanding under the variable rate facilities as of December 31, 2004, an immediate change of one percentage point in the applicable interest rate would have caused an increase or decrease in interest expense of approximately $1.2 million on an annual basis. At December 31, 2004, up to $170.2 million of variable rate borrowings were available under K2 s $250 million revolving bank credit facility. K2 may use derivative financial instruments, where appropriate, to manage its interest rate risks. However, as a matter of policy, K2 does not enter into derivative or other financial investments for trading or speculative purposes. At December 31, 2004, K2 had no such derivative financial instruments outstanding.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

K2 INC.

CONSOLIDATED STATEMENTS OF INCOME

	Year ended December 31		
	2004	2003	2002
	(Thousands, except per share figures)		
Net sales	$ 1,200,727	$ 718,539	$ 582,159
Cost of products sold	800,678	498,620	411,620
Gross profit	400,049	219,919	170,539
Selling expenses	197,134	116,509	86,394
General and administrative expenses	121,895	71,358	56,862
Operating income	81,020	32,052	27,283
Interest expense	21,449	9,950	8,966
Debt extinguishment costs		6,745	
Other income, net	(246)	(2,218)	(253)
Income before provision for income taxes	59,817	17,575	18,570
Provision for income taxes	20,876	6,151	6,500
Net income	$ 38,941	$ 11,424	$ 12,070
Basic earnings per share of Common Stock:	$ 0.97	$ 0.46	$ 0.67
Diluted earnings per share of Common Stock:	$ 0.86	$ 0.44	$ 0.67
Basic shares outstanding of Common Stock	40,285	24,958	17,941
Diluted shares outstanding of Common Stock	49,345	28,750	17,994

See notes to consolidated financial statements

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K2 INC.

CONSOLIDATED BALANCE SHEETS

	At December 31	
	2004	**2003**
	(Thousands, except number of shares)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 25,633	$ 21,256
Accounts receivable, net	369,914	224,818
Inventories, net	325,125	237,152
Deferred income taxes	29,709	29,223
Prepaid expenses and other current assets	22,775	13,083
Total current assets	773,156	525,532
Property, Plant and Equipment		
Land and land improvements	6,794	3,037
Buildings and leasehold improvements	55,900	35,289
Machinery and equipment	204,651	162,472
Construction in progress	5,614	3,940
	272,959	204,738
Less allowance for depreciation and amortization	131,995	113,716
	140,964	91,022
Other Assets		
Goodwill	349,760	147,047
Tradenames	137,329	61,394
Other intangible assets, net	21,276	20,406
Deferred income taxes	7,506	10,800
Other	26,374	15,670
Total Assets	$ 1,456,365	$ 871,871
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Bank loans	$ 31,490	$ 10,751
Accounts payable	103,158	77,304
Income taxes payable	28,386	8,305
Accrued payroll and related	67,443	33,040
Other accruals	83,624	53,235
Current portion of long-term debt	35,074	72,126
Total current liabilities	349,175	254,761
Long-term pension liabilities	16,854	11,173
Long-term debt	250,812	35,194

Deferred income taxes	58,123	38,636
Convertible subordinated debentures	98,535	98,067
Commitments and Contingencies		
Shareholders Equity		
Preferred Stock, $1 par value, authorized 12,500,000 shares, none issued		
Common Stock, $1 par value, authorized 110,000,000 in 2004 and 60,000,000 shares is 2003, issued and outstanding shares 47,543,108 in 2004 and 34,146,798 in 2003	47,543	34,147
Additional paid-in capital	502,322	313,142
Retained earnings	146,558	107,617
Employee Stock Ownership Plan and stock option loans		(1,214)
Treasury shares at cost, 747,234 in 2004 and 2003	(9,107)	(9,107)
Accumulated other comprehensive loss	(4,450)	(10,545)
Total Shareholders Equity	682,866	434,040
Total Liabilities and Shareholders Equity	$ 1,456,365	$ 871,871

See notes to consolidated financial statements

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K2 INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

	Common Stock	Additional Paid-in Capital	Retained Earnings	Employee Stock Ownership Plan and Stock Option Loans	Treasury Shares, at Cost	Accumulated Other Comprehensive Loss	Total
				(Thousands)			
Balance at December 31, 2001	18,676	$ 143,346	$ 84,123	$ (1,582)	$ (9,107)	$ (20,799)	$ 214,657
Net income for the year 2002			12,070				12,070
Translation adjustments						9,719	9,719
Change in additional minimum pension liability, net of $2,639 in taxes						(4,904)	(4,904)
Net unrealized loss on derivative instruments, net of $253 in taxes						(470)	(470)
Comprehensive income							16,415
Exercise of stock options	3	19					22
Stock option loan repayments				53			53
Employee Stock Ownership Plan, amortization, loan and partial loan repayment				149			149
Balance at December 31, 2002	18,679	143,365	96,193	(1,380)	(9,107)	(16,454)	231,296
Net income for the year 2003			11,424				11,424
Translation adjustments						7,947	7,947
Change in additional minimum pension liability, net of $189 in taxes						(351)	(351)
Net unrealized loss on derivative instruments, net of $908 in taxes						(1,687)	(1,687)
Comprehensive income							17,333
Shares issued in connection with acquisitions	14,250	156,284					170,534
Value of warrants issued in connection with issuance of convertible subordinated debentures		2,303					2,303
Exercise of stock options	1,218	7,990					9,208
Income tax benefit on stock option exercises		3,200					3,200
Employee Stock Ownership Plan, amortization, loan and partial loan repayment				166			166
Balance at December 31, 2003	34,147	313,142	107,617	(1,214)	(9,107)	(10,545)	434,040
Net income for the year 2004			38,941				38,941
Translation adjustments						10,276	10,276
Change in additional minimum pension liability, net of $2,838 in taxes						(5,270)	(5,270)
Net unrealized gain on derivative instruments, net of $575 in taxes						1,089	1,089
Comprehensive income							45,036
Shares issued in connection with acquisitions	6,313	95,327					101,640
Shares issued in connection with equity offering, net	6,400	87,180					93,580
Exercise of stock options and warrants	683	4,368					5,051
Income tax benefit on stock option exercises		2,100					2,100
Amortization of restricted stock awards		199					199
				1,214			1,214

Employee Stock Ownership Plan, amortization and loan repayment							
Other items		6					6
Balance at December 31, 2004	$ 47,543	$ 502,322	$ 146,558	$ 0	$ (9,107)	$ (4,450)	$ 682,866

See notes to consolidated financial statements

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K2 INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31		
	2004	2003	2002
		(Thousands)	
Operating Activities			
Net income	$ 38,941	$ 11,424	$ 12,070
Adjustments to reconcile net income to net cash provided by operating activities:			
Gain on sale of operating division	(206)	(2,222)	
Depreciation and amortization of property, plant and equipment	23,721	15,518	13,237
Amortization of intangibles and increase in fair value of inventories from acquisitions	8,561	2,879	688
Amortization of deferred debt and warrant costs	3,073	3,249	632
Deferred taxes and income taxes receivable	4,750	2,980	(2,135)
Increase (decrease) in long-term pension liabilities	5,681	(1,380)	8,828
Changes in operating assets and liabilities:			
Accounts receivable, net	(102,688)	24,037	12,682
Repurchase of previously securitized receivables			(51,827)
Inventories, net	8,411	(20,348)	28,215
Prepaid expenses and other current assets	1,661	(2,579)	1,218
Accounts payable	(5,599)	3,329	432
Payroll and other accrued liabilities	26,964	(2,745)	(2,776)
Net cash provided by operations	13,270	34,142	21,264
Investing Activities			
Property, plant and equipment expenditures	(36,297)	(20,759)	(8,281)
Disposals of property, plant and equipment	1,245	400	147
Purchases of businesses, net of cash acquired	(175,838)	(38,902)	(1,100)
Proceeds received from sale of operating division		20,132	
Other items, net	(5,389)	(3,361)	370
Net cash used in investing activities	(216,279)	(42,490)	(8,864)
Financing Activities			
Issuance of senior notes	200,000		
Issuance of convertible subordinated debentures		100,000	
Borrowings under long-term debt	738,366	523,673	65,750
Payments of long-term debt	(788,489)	(584,811)	(105,307)
Net borrowings under (payments on) accounts receivable purchase facility		(25,702)	25,702
Net increase (decrease) in short-term bank loans	(32,531)	4,490	1,245
Net proceeds from equity issuance	93,580		
Debt issuance costs	(8,591)	(8,257)	
Proceeds received from exercise of stock options and warrants	5,051	8,983	22
Net cash provided by (used in) financing activities	207,386	18,376	(12,588)
Net increase (decrease) in cash and cash equivalents	4,377	10,028	(188)
Cash and cash equivalents at beginning of year	21,256	11,228	11,416

Cash and cash equivalents at end of year	$ 25,633	$ 21,256	$ 11,228

See notes to consolidated financial statements

K2 INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004

Note 1 Summary of Significant Accounting Policies

Organization

K2 is a premier, branded consumer products company with a portfolio of leading brands including *Shakespeare*, *Pflueger* and *Stearns* in the Marine and Outdoor segment; *Rawlings*, *Worth*, and *K2 Licensing & Promotions* in the Team Sports segment; *K2*, *Völkl*, *Marker*, *Ride* and *Brass Eagle* in the Action Sports segment; and *Adio*, *Marmot* and *Ex Officio* in the Footwear and Apparel segment. The Marine and Outdoor segment represented $336.9 million, or 28.1%, of K2 s 2004 consolidated net sales, the Action Sports segment represented $502.7 million, or 41.9% of 2004 consolidated net sales, the Team Sports segment had sales of $250.4 million, or 20.8% of 2004 consolidated net sales and K2 s Footwear and Apparel segment had net sales of $110.7 million, or 9.2% of 2004 consolidated net sales.

Principles of Consolidation

The consolidated financial statements include the accounts of K2 and its subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Fiscal Periods

K2 maintains its books using a 52/53 week year ending on the last Sunday of December. For purposes of the consolidated financial statements, the year end is stated as of December 31. The years ended December 31, 2004, 2003 and 2002 consisted of 52 weeks.

Revenue Recognition

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

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions affecting the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual amounts could differ from those estimates.

Foreign Currency Translation

The functional currency for most foreign operations is the local currency. The financial statements of foreign subsidiaries have been translated into U.S. dollars. Asset and liability accounts have been translated using the exchange rate in effect at the balance sheet date. Revenue and expense accounts have been translated using the average exchange rate for the year. The gains and losses associated with the translation of the financial statements resulting from the changes in exchange rates from year to year have been reported in the other comprehensive income or loss account in shareholders equity. To the extent assets and liabilities of the foreign

K2 INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2004

Note 1 Summary of Significant Accounting Policies (Continued)

operations are realized or the foreign operations pay back intercompany debt, amounts previously reported in other comprehensive income or loss account would be included in net income or loss in the period in which the transaction occurs. Transaction gains or losses, other than those related to intercompany accounts and investments deemed to be of a long-term nature, are included in net income or loss in the period in which they occur.

Cash and Cash Equivalents

Short-term investments (including any debt securities) that are part of K2 s cash management portfolio are classified as cash equivalents carried at amortized cost. These investments are liquid, are of limited credit risk and have original maturities of three months or less when purchased. The carrying amount of cash equivalents approximates market.

Accounts Receivable and Allowances

Although K2 s credit risk is spread across a large number of customers within a wide geographic area, periodic concentrations within a specific industry occur due to the seasonality of its businesses. At December 31, 2004 and 2003, K2 s receivables from sporting goods retailers who sell skis, bindings, skates, snowboards and bikes amounted to 52% and 41%, respectively, of total receivables. K2 generally does not require collateral but performs periodic credit evaluations to manage its credit risk.

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

Accounts receivable are net of allowances for doubtful accounts and estimated sales returns of $14,895,000 and $7,558,000 at December 31, 2004 and 2003, respectively.

Inventories

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

Long-Lived and Finite Lived Intangible Assets

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

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K2 INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2004

Note 1 Summary of Significant Accounting Policies (Continued)

Property, plant and equipment are recorded at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets, ranging from 2 to 30 years. At December 31, 2004, the weighted average useful life for buildings and leasehold improvements was 19.9 years and for machinery and equipment was 9.0 years.

Long-lived assets, such as property, plant and equipment and purchased intangible assets with finite lives, are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. K2 assesses the fair value of the assets based on the future cash flow the assets are expected to generate and recognizes an impairment loss when estimated undiscounted future cash flow expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When an impairment is identified, K2 reduces the carrying amount of the asset to its estimated fair value based on a discounted cash flow approach or, when available and appropriate, comparable market values. K2 determined there were no indicators of material impairment of long-lived assets as of December 31, 2004.

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

Indefinite Lived Intangible Assets

Effective January 1, 2002, K2 adopted standards on Business Combinations, and Goodwill and Other Intangible Assets. In accordance with these standards, goodwill and intangible assets with indefinite lives are no longer amortized but instead are measured for impairment at least annually, or when events indicate that a likely impairment exists. As required by the standards, the impairment tests for goodwill and other indefinite-lived intangible assets are assessed for impairment using fair value measurement techniques. Specifically, goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a K2 reporting unit with the net book value (or carrying amount), including goodwill. If the fair value of the reporting unit exceeds the carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit exceeds the fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit s goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. The impairment test for other intangible assets consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

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K2 INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2004

Note 1 Summary of Significant Accounting Policies (Continued)

Warranty

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

The following activity related to product warranty liabilities:

	For the year ended December 31		
	2004	2003	2002
		(Thousands)	
Balance at January 1	$ 5,526	$ 2,954	$ 2,237
Charged to costs and expenses	8,394	4,677	5,043
Increase to reserve resulting from acquisitions	2,618	3,498	
Amounts charged to reserve	(6,847)	(5,603)	(4,326)
Balance at December 31	$ 9,691	$ 5,526	$ 2,954

Income Taxes

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

Pensions

As described in Note 9, K2 sponsors trusteed noncontributory defined benefit pension plans covering most of its domestic employees. Pension costs and liabilities are actuarially calculated. These calculations are based on assumptions related to the discount rate, projected compensation increases and expected return on assets.

Stock-Based Compensation and Other Equity Instruments

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

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K2 INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2004

Note 1 Summary of Significant Accounting Policies (Continued)

value at the grant date for K2 s stock options under SFAS No. 123 using the Black Scholes option pricing model, pro forma net income and pro forma net income per share, including the following weighted average assumptions used in these calculations, would have been as follows:

	December 31		
	2004	2003	2002
	(Thousands, except per share date, percentages and years)		
Net income as reported	$ 38,941	$ 11,424	$ 12,070
Less: Total stock-based compensation expense determined under fair value based method for all awards, net of taxes	2,157	586	1,399
Net income, adjusted	$ 36,784	$ 10,838	$ 10,671
Earnings per share:			
Basic as reported	$ 0.97	$ 0.46	$ 0.67
Basic pro forma	$ 0.91	$ 0.43	$ 0.59
Diluted as reported	$ 0.86	$ 0.44	$ 0.67
Diluted pro forma	$ 0.82	$ 0.42	$ 0.59
Risk free interest rate	3.55%	2.71%	4.58%
Expected life of options	5 years	5 years	5 years
Expected volatility	43.3%	49.8%	36.3%
Expected dividend yield			

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), *Share Based Payment*, which will require K2 to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award the requisite service period. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. The grant-date fair value of employee share options and similar instruments will be estimated using option-pricing models adjusted for the unique characteristics of those instruments. SFAS No. 123 (Revised 2004) eliminates the use of APB Opinion No. 25. SFAS No. 123 (Revised 2004) will become effective for K2 beginning in the 2005 third quarter. Based on K2 s current methodology in determining compensation expense related to stock options, the impact of the adoption of this amendment to current and prior year earnings is reflected in the table above. K2 is also currently evaluating the impact the adoption of this amendment will have on future cash flows.

During 2004, 2003 and 2002, stock options granted were 1,192,400, 617,900 and 40,000, respectively. Using the Black Scholes option pricing model and the assumptions as noted above, the options granted each had a weighted average fair value of $7.98, $4.79 and $4.33, respectively.

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

K2 INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2004

Note 1 Summary of Significant Accounting Policies (Continued)

Shipping and Handling Costs

K2 reports freight billed to customers (freight recovery) as a component of net sales and related freight costs are reflected primarily in selling expenses. The amount of freight costs reflected in selling expenses for the years ended December 31, 2004, 2003 and 2002 amounted to $16,941,000, $11,654,000 and $11,563,000, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2004, 2003 and 2002 amounted to $25,340,000, $18,124,000 and $17,064,000, respectively.

Other Income, net

Other income generally includes gains or losses on disposals of fixed assets and other miscellaneous income and expenses. During 2004 and 2003, other income also includes a gain of $0.2 million and $2.2 million, respectively, related to the sale of the composite utility and decorative light poles and related product lines. For further discussion, see Note 3 to Notes to Consolidated Financial Statements.

Comprehensive Income (loss)

Comprehensive income (loss) includes all changes in shareholders equity except those resulting from investments by, and distributions to, shareholders. Accordingly, K2 s comprehensive income (loss) includes net income (loss) and foreign currency adjustments that arise from the translation of the financial statements of K2 s foreign subsidiaries, minimum pension liability and fair value gains and losses on certain derivative instruments.

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 151, *Inventory Costs, an Amendment of ARB No. 43, Chapter 4*. SFAS No. 151 retains the general principle of ARB No. 43, Chapter 4, Inventory Pricing, that inventories are presumed to be stated at cost; however, it amends ARB No. 43 to clarify that abnormal amounts of idle facilities, freight, handling costs and spoilage should be recognized as current period expenses. Also, SFAS No. 151 requires fixed overhead costs be allocated to inventories based on normal production capacity. The guidance in SAFS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. K2 does not believe the implementation of SFAS 151 will have a material impact on its financial statements.

In December 2004, the FASB issued SFAS No. 123 (Revised) *Share-Based Payment.* SFAS No. 123 (Revised) requires that companies recognize compensation expense equal to the fair value of stock options or other share based payments. The standard is effective for K2 beginning in the 2005 third quarter. The impact on K2 s net income will include the remaining amortization of the fair value of existing options currently disclosed as pro-forma expense in Note 1 and is contingent upon the number of future options granted, the selected transition method and the selection of either the Black-Scholes or the binominal lattice model for valuing options.

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K2 INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2004

Note 1 Summary of Significant Accounting Policies (Continued)

Reclassifications

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

Note 2 Acquisitions

2004 First Quarter Acquisition Activity:

Fotoball USA, Inc.

On January 23, 2004, K2 completed the acquisition of Fotoball USA, Inc. (Fotoball), a marketer and manufacturer of souvenir and promotional products, principally for team sports, in a stock-for-stock exchange offer/merger transaction. Under the terms of the merger, each outstanding share of Fotoball common stock was converted into 0.2757 shares of common stock of K2 for a total of approximately 1.0 million shares of K2 s common stock. The transaction was valued at approximately $17.1 million plus merger costs of approximately $1.0 million. The purchase price included fully vested K2 stock options issued in exchange for Fotoball stock options outstanding at the time of the acquisition with a value of approximately $1.5 million. The value of the K2 stock options issued in exchange for the Fotoball stock options outstanding was based on a Black-Scholes estimate using the following assumptions: risk free interest rate of 3.00%, volatility of K2 stock of 0.478 and expected life of 4.00 years. The results of the operations of Fotoball were included in the consolidated financial statements of K2 beginning with the date of the merger. Subsequent to the completion of the merger, K2 changed the name of Fotoball to K2 Licensing & Promotions, Inc.

The Fotoball acquisition was accounted for under the purchase method of accounting, and accordingly the purchased assets and assumed liabilities are recorded at their estimated fair values at the date of the merger. The purchase price allocation resulted in an excess of the purchase price over net tangible assets acquired of $17.1 million. Based on a independent third party valuation completed by K2, net intangible assets acquired/(liabilities assumed) were allocated to: non-compete agreements of $0.1 million with an average life of 2.5 years; customer relationships of $1.2 million with an average life of 5.8 years; licensing agreements of ($1.0) million with an average life of 2.3 years;

tradenames with indefinite lives not subject to amortization of $1.1 million; and goodwill not subject to amortization of $15.7 million.

2004 Second Quarter Acquisition Activity:

On April 19, 2004, K2 completed the acquisition of substantially all of the assets of Worr Game Products, Inc., and All-Cad Manufacturing, Inc. (collectively, Worr Games), businesses engaged in the design, manufacturing, selling and distribution of premium paintball markers. The purchase price for these assets was paid in a combination of cash and the issuance of 304,340 shares of K2 common stock. The results of the operations of Worr Games were included in the consolidated financial statements of K2 beginning with the date of the acquisition.

Also, on April 19, 2004, K2 completed the acquisition of substantially all of the assets of IPI Innovations, Inc. (IPI), a business engaged in the design, manufacturing, selling and distribution of rack mounting systems, and other products and accessories for all-terrain vehicles. The purchase price for these assets was paid in a combination of cash and the issuance of 326,101 shares of K2 common stock. The results of the operations of IPI were included in the consolidated financial statements of K2 beginning with the date of the acquisition.

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K2 INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2004

Note 2 Acquisitions

On May 12, 2004, K2 completed the acquisition of substantially all of the assets of Ex Officio, a leader in the design and manufacture, sale and distribution of men and women s apparel for the outdoor and adventure travel apparel for men and women, in an all cash transaction. Ex Officio s products are characterized by technical features, performance fabrics, and outdoor styles, and are used in a variety of activities including fishing, kayaking, trekking, exploring, and other leisure activities. Ex Officio also markets a line of insect repellent clothing under the *Buzz Off* brand. The results of the operations of Ex Officio were included in the consolidated financial statements of K2 beginning with the date of the acquisition.

The three transactions completed during the 2004 second quarter were accounted for under the purchase method of accounting, and accordingly the purchased assets and liabilities were recorded at their estimated fair values at the date of the acquisition. The combined preliminary purchase price allocation for the three acquisitions resulted in an excess of the purchase price over net tangible assets acquired of $32.8 million.

Based on independent third party valuations completed by K2, the excess amounts of the Worr Games, IPI and Ex Officio transactions were preliminarily allocated to: intangible assets/(liabilities assumed) with definite and indefinite lives including: patents of $1.1 million with an average life of 6.2 years; trademarks of $0.6 million with an average life of 8.2 years; supply agreements of ($0.7) million with an average life of 1.0 year; non-compete agreements of $1.0 million with an average life of 5.0 years; order backlog of $0.3 million with an average life of 9 months; tradename with an indefinite life not subject to amortization of $7.2 million; and goodwill not subject to amortization of $23.3 million.

2004 Third Quarter Acquisition Activity:

Marmot Mountain Ltd.

On June 30, 2004, K2 completed the acquisition of Marmot Mountain Ltd. (Marmot). Marmot, founded in 1971, is a leader in the premium technical outdoor apparel and equipment market. Marmot s product lines include performance jackets, technical rainwear, expedition garments, fleeces, softshells, skiwear outerwear and accessories, gloves, and expedition quality tents, packs and sleeping bags. The aggregate purchase price of the transaction was valued at approximately $83.6 million (excluding merger costs of approximately $3.3 million) plus the repayment of permanent and seasonal working capital debt. The transaction consideration consisted of $38.2 million in cash and the issuance of 2,840,123 shares of K2 Inc. common stock. In connection with the acquisition, K2 paid off Marmot s long-term debt of approximately $1.8 million. The results of the operations of Marmot were included in the consolidated financial statements of K2 beginning with the date of the merger.

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K2 INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2004

Note 2 Acquisitions (Continued)

The Marmot transaction was accounted for under the purchase method of accounting; and, accordingly, the purchased assets and liabilities assumed were recorded at their estimated fair values at the date of the merger. The following table summarizes the total purchase price, estimated fair values of the assets acquired and liabilities assumed, and the resulting net intangible assets acquired at the date of the acquisition:

	In thousands	
Total purchase price, including estimated merger expenses (a)		$ 86,848
Total current assets	$ 27,892	
Property, plant and equipment	1,466	
Deferred taxes and other assets	120	
Net tangible assets acquired (b)	29,478	
Total liabilities assumed (c)	34,078	
Net liabilities assumed (b) (c) = (d)		(4,600)
Net intangible assets acquired (a) (d)		$ 91,448

Based on an independent third party valuation completed by K2 during 2004, net intangible assets acquired were allocated to: non-compete agreements of $0.2 million with an average life of 2.8 years; order backlog of $1.2 million with an average life of 6 months; tradename with an indefinite life not subject to amortization of $16.6 million; and goodwill not subject to amortization of $73.4 million.

Völkl and Marker.

On July 7, 2004, K2 completed the acquisitions of Völkl Sports Holding AG (Völkl) and The CT Sports Holding AG (Marker). Founded in 1889, Völkl is a well established and recognized brand in the worldwide alpine ski market. Marker was founded in 1952, and has gained worldwide recognition for its patented ski-bindings. The aggregate purchase price of the transaction was valued at approximately $97.5 million (excluding merger costs of approximately $3.7 million). The transaction consideration consisted of $68.6 million in cash and the issuance of

1,821,073 shares of K2 Inc. common stock. The results of the operations of Völkl and Marker were included in the consolidated financial statements of K2 beginning with the date of the merger.

The Völkl and Marker transactions were accounted for under the purchase method of accounting; and, accordingly, the purchased assets and liabilities assumed were recorded at their estimated fair values at the date of the merger. The following table summarizes the total purchase price, estimated fair values of the assets acquired and liabilities assumed, and the resulting net intangible assets acquired at the date of the acquisition:

	In thousands	
Total purchase price, including estimated merger expenses (a)		$ 101,209
Total current assets	$ 94,251	
Property, plant and equipment	30,241	
Deferred taxes and other assets	1,970	
Net tangible assets acquired (b)	126,462	
Total liabilities assumed (c)	142,081	
Net liabilities assumed (b) (c) = (d)		(15,619)
Net intangible assets acquired (a) (d)		$ 116,828

K2 INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2004

Note 2 Acquisitions (Continued)

Based on an independent third party valuation completed by K2 during 2004, net intangible assets acquired were allocated to: patents of $0.2 million with an average life of 3.0 years; customer relationships of $0.3 million with an average life of 5.0 years; tradenames with indefinite lives not subject to amortization of $51.1 million; and goodwill not subject to amortization of $65.3 million.

At December 31, 2004, there was approximately $6.1 million of cash and 625,224 of K2 Inc. shares held in escrow or due for payment in 2005 relating to K2 s acquisitions. The cash and shares will be released from escrow during 2005 through 2008 subject to final agreement between the K2 and the selling parties. The cash and shares in escrow as well as future cash payments due in 2005 have been reflected in the purchase price of the related acquisition. The shares held in escrow are reflected in the calculation of diluted earnings per share for the year ended December 31, 2004.

During 2004, K2 also completed three smaller acquisitions, two in the Marine and Outdoor segment and one in the Team Sports segment, for a combined total purchase price of approximately $24.4 million. The three additional transactions completed were accounted for under the purchase method of accounting, and accordingly the purchased assets and liabilities were recorded at their estimated fair values at the date of the acquisition. The combined preliminary purchase price allocation for the three acquisitions resulted in an excess of the purchase price over net tangible assets acquired of $18.4 million. The consolidated statements of operations include the operating results of each business from the date of the acquisitions. The preliminary allocation of one of these transactions assumes the excess purchase price of the acquisition will be allocated to goodwill, and is thus not amortized. The final allocation, however, could include identifiable intangible assets with finite and indefinite lives separate from goodwill. Should there be assets with finite lives, those assets will be subject to amortization resulting in additional amortization expense.

During 2003, K2 completed seven acquisitions, including the acquisitions of Rawlings Sporting Goods Company, Inc. (Rawlings), on March 26, 2003, Worth, Inc. (Worth), on September 16, 2003 and Brass Eagle, Inc. (Brass Eagle), on December 8, 2003 as well as five smaller acquisitions.

The following summarized unaudited pro forma results of operations of K2 assume the acquisitions of Rawlings, Brass Eagle, Marmot and Völkl and Marker had occurred as of January 1, 2003, the earliest date for which information is presented below. The pro forma results also exclude the debt extinguishment costs incurred by K2 during 2003. This pro forma information does not purport to be indicative of what would have occurred had the acquisition been made as of those dates, or of results which may occur in the future. Pro forma results of operations of K2 s other acquisitions have not been presented because the effects of these additional acquisitions were not material on either an individual basis or aggregate basis to K2 s consolidated results of operations.

	For the twelve months ended December 31	
	2004	2003
	(Thousands, except per share amounts)	
Pro Forma Information (Unaudited)		
Net sales	$ 1,258,777	$ 1,104,551
Operating income	65,587	61,950
Net income	24,253	19,704
Diluted earnings per share	$ 0.51	$ 0.43

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K2 INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2004

Note 2 Acquisitions (Continued)

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

The following table summarizes the activity in 2003 and 2004:

	Employee Severance	Employee Relocation	Subtotal	Lease Termination Costs	Total
			(Thousands)		
Reserves established in conjunction with 2003 acquisitions	$ 3,051	$ 816	$ 3,867	$ 1,203	$ 5,070
Utilized in 2003:	(640)		(640)		(640)
Balance at December 31, 2003	$ 2,411	$ 816	$ 3,227	$ 1,203	$ 4,430
Reserves established in conjunction with 2004 acquisitions	6,968	40	7,008	4,034	11,042
Adjustments to reserve estimates (reflected as an adjustment of the cost of the acquired companies)	(974)		(974)		(974)
Utilized in 2004:	(1,415)	(488)	(1,903)	(40)	(1,943)
Balance at December 31, 2004	$ 6,990	$ 368	$ 7,358	$ 5,197	$ 12,555