VARSITY BRANDS INC
Form 10-Q
November 14, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTER ENDED SEPTEMBER 30, 2002

Commission file number: 0-19298

VARSITY BRANDS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	22-2890400
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6745 LENOX CENTER COURT, SUITE 300, MEMPHIS, TN
38115 (Address of principal executive offices)
(Zip code)

(901) 387-4300
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year,
if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1935 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

9,522,250 Common Shares as of November 12, 2002

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VARSITY BRANDS, INC.

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SPECIAL CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

This report contains certain statements which are "forward-looking" statements under the federal securities laws that are based on the beliefs of management as well as assumptions made by and information currently available to management. Forward-looking statements appear throughout Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations" concerning the Company's seasonal patterns of working capital and revenue and operating results in its business. Certain factors could cause actual results to differ materially from those in the forward-looking statements including without limitation, (i) continuation of historical seasonal patterns of demand for the Company's products and the Company's ability to meet the demand; (ii) actions by competitors, including without limitation new product introductions; (iii) the loss of domestic or foreign suppliers; (iv) changes in business strategy or new product lines and the Company's ability to successfully implement these; (v) moderation of uniform and accessories revenue growth; and (vi) changes in interest rates and general economic conditions. These "forward-looking statements" are based on currently available information and plans. They are inherently uncertain, and investors must recognize that events could turn out to be significantly different from the Company's expectations.

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Part I. FINANCIAL INFORMATION; Item 1. FINANCIAL STATEMENTS

VARSITY BRANDS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(IN THOUSANDS)

	September 30, 2002	December 31, 2001	September 30, 2001
ASSETS			
Current assets:			
Cash and cash equivalents	$ 10,631	$ 14,397	$ 26,299
Accounts receivable, trade less allowance for doubtful accounts ($578, $429 and $394, respectively)	26,941	12,161	27,710
Inventories	9,543	7,863	9,148

Prepaid expenses	1,948	3,937	1,636
Other receivables	23	3,555	3,205
Deferred taxes	1,483	2,383	2,040
Assets held for disposal	--	--	5,830
Total current assets	50,569	44,296	75,868
Property, plant and equipment, less accumulated depreciation ($5,290, $4,929 and $8,616, respectively)	3,588	4,387	4,129
Goodwill, less accumulated amortization ($9,595, $9,595 and $9,123, respectively)	66,596	66,596	67,067
Intangibles and deferred charges, less accumulated amortization ($3,371, $3,048 and $2,950, respectively)	2,085	2,793	3,775
Other assets	623	559	614
	$123,461	$118,631	$151,453
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	$ 8,894	$ 5,891	$ 11,289
Accrued liabililties	6,588	8,258	8,907
Customer deposits	3,817	5,132	3,275
Current portion of long-term debt	1,375	1,375	--
Total current liabilities	20,674	20,656	23,471
Long-term debt	72,160	80,410	112,500
Deferred taxes	188	188	--
Contingent liabilities	--	--	--
Stockholders' equity:			
Preferred stock	--	--	--
Common stock	95	95	95
Additional paid-in capital	37,499	37,306	37,306
Accumulated deficit	(7,155)	(20,024)	(21,919)
	30,439	17,377	15,482
	$123,461	$118,631	$151,453

See notes to condensed consolidated financial statements.

VARSITY BRANDS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(IN THOUSANDS, EXCEPT FOR PER SHARE AMOUNTS)

THREE MONTHS ENDED NINE MONTHS ENDED

	SEPTEMBER 30,		SEPTEMBER 30,	
	2002	2001	2002	2001
Net revenues:				
Uniforms and accessories	$32,913	$32,049	$80,614	$ 76,030
Camps and events	28,283	28,077	56,645	54,766
Net revenues	61,196	60,126	137,259	130,796
Cost of revenues:				
Uniforms and accessories	16,422	16,390	41,888	40,383
Camps and events	19,509	19,248	38,241	36,698
Cost of revenues	35,931	35,638	80,129	77,081
Gross profit	25,265	24,488	57,130	53,715
Selling, general and administrative expenses	12,612	12,697	37,362	36,551
Income from operations	12,653	11,791	19,768	17,164
Other expense				
Interest expense, net	1,975	2,990	6,149	7,536
Total other expense	1,975	2,990	6,149	7,536
Income from continuing operations before income taxes, discontinued operations and extraordinary items	10,678	8,801	13,619	9,628
Income taxes	690	2,948	890	3,225
Income from continuing operations	9,988	5,853	12,729	6,403
Discontinued operations:				
Income (loss) from operations of discontinued businesses	--	--	--	(1,358)
Gain (loss) on disposal of businesses	--	1,379	--	(16,921)
Income (loss) from operations before extraordinary items	9,988	7,232	12,729	(11,876)
Extraordinary item - gain on retirement of bonds, net of tax	--	1,486	140	1,486
Net income (loss)	$ 9,988	$ 8,718	$12,869	$(10,390)

Income from continuing operations

per share				
Basic	$ 1.05	$ 0.62	$ 1.34	$ 0.68
Diluted	$ 0.89	$ 0.53	$ 1.16	$ 0.61
Income (loss) per share:				
Basic	$ 1.05	$ 0.92	$ 1.36	$ (1.10)
Diluted	$ 0.89	$ 0.79	$ 1.17	$ (1.10)
Weighted average number common and common equivalent shares outstanding:				
Basic	9,488	9,452	9,464	9,452
Diluted	11,382	11,149	11,203	11,048

See notes to condensed consolidated financial statements.

VARSITY BRANDS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)
(IN THOUSANDS)

	Common Stock		Additional paid-in Capital	Retained Earnings (Accumulated deficit)	Total Stock-holders' Equity
	Shares	Amount			
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001					
Balance, January 1, 2001	9,452	$ 95	$ 37,306	$(11,529)	$25,872
Net loss for the period		--	--	(10,390)	(10,390)
	9,452	$ 95	$ 37,306	$(21,919)	$15,482
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002					
Balance, January 1, 2002	9,452	$ 95	$ 37,306	$(20,024)	$17,377
Issuance of common stock for stock option exercise	60	--	193	--	193
Net income for the period		--	--	12,869	12,869
	9,512	$ 95	$ 37,499	$ (7,155)	$30,439

See notes to condensed consolidated financial statements.

VARSITY BRANDS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	THREE MONTHS ENDED SEPTEMBER 30, 2002	2001	NINE MONTHS END SEPTEMBER 30, 2002	200
Cash flows from operating activities:				
Net income (loss)	$ 9,988	$ 8,718	$12,869	$(10
Adjustments to reconcile net income (loss) to net cash provided by (used in) continuing operations:				
Loss from operations of discontinued businesses	--	--	--	1,
(Gain) loss on sale of businesses	--	(1,379)	--	16,
Extraordinary gain	--	(1,486)	(140)	(1,
Depreciation and amortization:				
Amortization of debt issue costs	122	173	375	
Other depreciation and amortization	467	1,041	1,456	2,
Provision for losses on accounts receivable	280	150	386	
Deferred taxes	690	--	900	(2,
Changes in assets and liabilities, net of assets held for disposal:				
(Increase) decrease in:				
Accounts receivable, trade	7,028	6,603	(15,166)	(13,
Inventories	4,578	4,236	(1,680)	(1,
Prepaid expenses	2,627	2,586	1,989	1,
Other receivables	103	(750)	3,532	(1,
Other assets	9	(54)	(64)	(
Increase (decrease) in:				
Accounts payable	(7,314)	(5,431)	3,003	7,
Accrued liabilities	(2,012)	313	(1,670)	1,
Customer deposits	(9,283)	(10,751)	(1,315)	(2,
Net cash provided by (used in) continuing operations	7,283	3,969	4,475	(
Cash flows from discontinued operations and extraordinary item				
Net change in assets held for disposal	--	1,159	--	(9,
Costs associated with bond redemption	--	(270)	(51)	(
Net cash provided by (used by) discontinued operations and extraordinary item	--	889	(51)	(9,
Cash flows from investing activities:				
Capital expenditures	(204)	(344)	(522)	(1,
Other assets	--	(360)	--	(
Net proceeds received from the sale of businesses	--	--	--	61,
Net cash provided by (used in) investing activities	(204)	(704)	(522)	60,
Cash flows from financing activities:				
Net repayments under line-of-credit agreement	--	--	--	(16,
Redemption of senior bonds	--	(7,050)	(7,858)	(7,
Debt issue costs	--	(223)	(3)	(
Proceeds from issuance of common stock	193	--	193	
Net cash provided by (used) by financing activities	193	(7,273)	(7,668)	(23,
Net increase (decrease) in cash	7,272	(3,119)	(3,766)	26,

Cash, beginning	3,359	29,418	14,397	----
Cash, ending	$10,631	$26,299	$10,631	$26,

See notes to consolidated financial statements.

VARSITY BRANDS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The condensed consolidated financial statements represent Varsity Brands, Inc. ("Varsity" or the "Company") and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. These statements are unaudited and, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) necessary for fair presentation of the Company's condensed consolidated financial position and the condensed consolidated results of its operations and cash flows at September 30, 2002 and 2001 and for the periods then ended. Certain information and footnote disclosures made in the Company's last Annual Report on Form 10-K have been condensed or omitted for these interim statements. Accordingly, these condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2001. Operating results for the nine months ended September 30, 2002 are not necessarily indicative of the results to be expected during the remainder of 2002.

2. DISPOSITION OF ASSETS

In June 2001, the Company sold its Riddell Group Division to an affiliate of Lincolnshire Management, Inc. ("Lincolnshire"), a private-equity fund. The purchase price, which was determined by an arms-length negotiation, was approximately $67.5 million.

The sale was made pursuant to a stock purchase agreement dated April 27, 2001 between the Company and Lincolnshire. The Riddell Group Division included: (i) all of the Company's team sports business, excluding Umbro branded team soccer products, (ii) the Company's licensing segment, which allows third-parties to market certain products using the Riddell and MacGregor trademarks, and (iii) the Company's retail segment, including the New York Executive Office, which managed the retail and licensing segments, and marketed a line of sports collectibles and athletic equipment, principally to retailers in the United States, and to a limited extent internationally. In conjunction with the sale of the Riddell Group Division, the Company recognized a decline in value in its net minority investment in a company that made game uniforms on behalf of the Riddell Group Division. The Company had previously accounted for its investment in the game uniform company using the equity method of accounting. As a result of the sale of the Riddell Group Division and the write-down in the value of its minority investment in the game uniform company, the Company recorded a loss on the sale of the Riddell Group Division of $20.5 million ($16.9 million after tax) in the second quarter of 2001.

The net operating results of the Riddell Group Division for the periods ending September 30, 2001 are presented as income from operations of discontinued

businesses in the Condensed Consolidated Statements of Operations. Revenues generated by the Riddell Group Division for the nine-month and three-month periods ended September 30, 2001 were $42.4 million and $0.0 million, respectively.

In September 2001, the Company settled the litigation that it had brought earlier that year against Umbro Worldwide, Ltd. ("Umbro Worldwide") involving the licensing agreement between the Company and Umbro Worldwide. The license agreement allowed Varsity to sell Umbro branded soccer apparel, equipment and footwear to soccer specialty stores and others in the team channel of distribution, principally in the United States.

In connection with the settlement the Company voluntarily terminated its license effective November 30, 2001 in exchange for a lump sum payment to the Company of $5.5 million and Umbro Worldwide's agreement to make certain payments to the Company in the future, including the purchase, for $2.6 million, of certain inventory from the Company. As a result of the early termination of the Umbro license, the Company recognized a gain of approximately $4.9 million ($2.9 million after tax) during the fourth quarter of 2001.

The net operating results of the Umbro Division for the periods ended September 30, 2001 are presented in income from discontinued operations of discontinued businesses in the Condensed Consolidated Statements of Operations. Revenues generated by the Umbro division for the nine-month and three-month periods ended September 30, 2001 were $8.6 million and $3.9 million, respectively.

3. EARNINGS PER SHARE

Basic earnings (loss) per share amounts have been computed by dividing earnings (loss) by the weighted average number of outstanding common shares. Diluted earnings (loss) per share is computed by adjusting earnings for the effect of the assumed conversion of dilutive securities and dividing the result by the weighted average number of common share and common equivalent shares to dilutive securities. A reconciliation between the numerators and denominators for these calculations follows:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2002	2001	2002	2001
NET INCOME				
EARNINGS (LOSS) - NUMERATOR				
Net income (loss)	$ 9,988	$ 8,718	$12,869	$(10,390)

Effect of assumed conversion of convertible debt, when dilutive - interest savings	94	105	282	--
Numerator for diluted				

per share computation	$10,082	$ 8,823	$13,151	$(10,390)
SHARES - DENOMINATOR				
Weighted average number of outstanding common shares	9,488	9,452	9,464	9,452
Weighted average common equivalent shares:				
Options, assumed exercise of dilutive options, net of treasury shares which could have been purchased from the proceeds of the assumed exercise based on average market prices	197	--	42	--
Convertible debt, assumed conversion when dilutive	1,697	1,697	1,697	--
Denominator for diluted per share computation	11,382	11,149	11,203	9,452
INCOME FROM CONTINUING OPERATIONS				
INCOME FROM CONTINUING OPERATIONS - NUMERATOR				
Income from continuing operations	$ 9,988	$ 5,853	$12,729	$ 6,403
Effect of assumed conversion of convertible debt, when dilutive - interest savings	94	105	282	315
Numerator for diluted per share computation	$10,082	$ 5,958	$13,011	$ 6,718
SHARES - DENOMINATOR				
Weighted average number of outstanding common shares	9,488	9,452	9,464	9,452

Weighted average common equivalent shares:				
Options, assumed exercise of dilutive options, net of treasury shares which could have been purchased from the proceeds of the assumed exercise based on average market prices	197	--	42	--
Convertible debt, assumed conversion when dilutive	1,697	1,697	1,697	1,596

Denominator for diluted per share computation	11,382	11,149	11,203	11,048

For the nine months ended September 30, 2001, potentially dilutive securities, which include convertible debt and common stock options, were not dilutive and were excluded from the computation of diluted earnings per share.

4. RECEIVABLES

Accounts receivable include unbilled shipments of approximately $1,704,000, $610,000 and $1,636,000 at September 30, 2002, December 31, 2001 and September 30, 2001, respectively. It is the Company's policy to record revenues when the related goods have been shipped. Unbilled shipments represent receivables for shipments that have not yet been invoiced. These amounts relate principally to partial shipments to customers who are not invoiced until their order is shipped in its entirety or customers with orders containing other terms that require a deferral in the issuance of the invoice. Management believes that substantially all of these unbilled receivables will be invoiced within the current sales season.

5. INVENTORIES

Inventories consist of the following:

(In thousands)	September 30, 2002	December 31, 2001	September 30, 2001
Finished goods	$6,111	$5,904	$6,893
Raw materials	3,432	1,959	2,255
	$9,543	$7,863	$9,148

6. SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest was $3,530,000 and $6,780,000 for the three-month periods ended September 30, 2002 and 2001, respectively, and $7,914,000 and $14,349,000 for the nine-month periods ended September 30, 2002 and 2001, respectively. During the nine months ended September 30, 2001, the Company received an income tax refund of approximately $1,500,000 related to a carry back of net operating losses of its Varsity Spirit Corporation subsidiary for periods preceding the 1997 acquisition of Varsity Spirit Corporation. This tax refund had been recorded as a receivable at the time of the acquisition. Other income tax payments, or refunds, were not significant for the three and nine month periods ended September 30, 2002.

7. INCOME TAXES

Operating results from continuing operations for the three-month and nine-month periods ended September 30, 2002 reflect a tax expense based on the anticipated effective annual tax rate for 2002. The anticipated effective annual tax rate is estimated based on remaining net operating loss carryforwards and anticipated income and non-deductible expenses for the year. The actual tax rate for the year could vary substantially from the anticipated rate due to the use of these estimates.

Operating results from continuing operations for the nine month period ended September 30, 2001 reflect a tax expense based on the anticipated effective annual tax rate for 2001.

8. SEGMENT INFORMATION

Net revenues and income or loss from operations for the Company's two reportable segments are as follows:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001	2002	2001
	(In thousands)		(In thousands)	
Net revenues:				
Uniforms and accessories	$32,913	$32,049	$ 80,614	$ 76,030
Camps and events	28,283	28,077	56,645	54,766
Consolidated total	$61,196	$60,126	$137,259	$130,796
Income from operations				
Uniforms and accessories	$ 8,434	$ 7,314	$ 15,325	$ 12,798
Camps and events	4,582	4,920	5,794	5,872
Corporate and unallocated expenses	(363)	(443)	(1,351)	(1,506)
Consolidated total	$12,653	$11,791	$ 19,768	$ 17,164

9. ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 was effective January 1, 2002. Under the new rules, goodwill and indefinite lived intangible assets will no longer be amortized, but will be reviewed annually for impairment. Intangible assets that are not deemed to have an indefinite life will continue to be amortized over their useful lives.

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The adoption of SFAS No. 142 requires that an initial impairment assessment be performed on all goodwill and indefinite lived intangible assets. The Company completed its initial evaluation of its goodwill in accordance with the provisions of SFAS No. 142 as of January 1, 2002 and has determined that, at present, goodwill was not impaired and there is no change in its carrying value or corresponding charge to the Company's earnings. Fair values were derived using cash flow analysis. The assumptions used in this cash flow analysis were consistent with the Company's internal planning. The adoption of the new standard will benefit earnings beginning in 2002 by approximately $1.9 million in reduced goodwill amortization. The Company will continue to evaluate the carrying value of its goodwill in accordance with SFAS No. 142.

The Financial Accounting Standards Board has issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 will be effective January 1, 2003. The new rules apply to all entities that have legal obligations associated with the retirement of a tangible long-lived asset. The entity should recognize a liability for an asset retirement obligation if (a) the entity has a duty or responsibility to settle an asset retirement obligation, (b) the entity has little or no discretion to avoid the future transfer or use of the assets, and (c) the transaction or other event obligating the entity has occurred. The Company does not believe this pronouncement will have a material impact on its financial statements.

Effective January 1, 2002, the Financial Accounting Standards Board issued SFAS No. 144, "Impairment or Disposal of Long-Lived Assets." Under the provisions of SFAS No. 144, an entity should recognize an impairment loss if the carrying amount of a long-lived asset or asset group if it is not recoverable and exceeds its fair value. An entity must test an asset or asset group for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. SFAS No. 144 also includes criteria for classifying a long-lived asset or asset group as held for sale. Assets held for sale must be shown at the lower of its carrying amount or fair value less cost to sell. The Company does not believe SFAS No. 144 will have a material impact on its financial statements.

Effective January 1, 2002, the Financial Accounting Standards Board issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses the accounting and reporting for costs associated with exit or disposal activities. This Statement requires that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred.

10. SUBSEQUENT EVENTS

On November 1, 2002, the Company's convertible debt holder elected to receive their scheduled $1,375,000 debt repayment. The debt holder did not elect to exercise their right to convert this repayment into equity.

11. RECLASSIFICATION OF PRIOR PERIODS

Certain prior period balances have been reclassified to conform to current year presentation.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Overview and seasonality

In June 2001, the Company sold its Riddell Group Division ("RGD") to an affiliate of Lincolnshire Management, Inc., a private-equity fund. In conjunction with this sale, the Company wrote down its net minority investment in an entity that provided game uniforms to RGD. As a result of these two transactions, the Company recorded a loss of $20.5 million ($16.9 million after tax). In September 2001, the Company settled the litigation that had been brought earlier that year against Umbro Worldwide, Ltd. ("Umbro Worldwide") involving its licensing agreement between the Company and Umbro Worldwide. In connection with the settlement and in exchange for an upfront payment and Umbro Worldwide's agreement to make certain additional payments to the Company, the Company voluntarily agreed to terminate its license effective November 30, 2001. The Company recorded the transaction during the fourth quarter of 2001, establishing the reserves necessary to record the purchase of inventory by Umbro Worldwide. In April 2002, the Company received a Settlement Agreement from Umbro Worldwide in which the final selling price of the Umbro-related inventory was set at $2.6 million. RGD's and Umbro's operating results are shown as income from operations of discontinued businesses in the Condensed Consolidated Statements of Operations.

RGD included: (i) all of the Company's Team Sports business, excluding Umbro branded team soccer products, (ii) the Company's licensing segment, which allowed third-parties to market certain products using the Riddell and MacGregor trademarks, and (iii) the Company's retail segment, which marketed a line of sports collectibles and athletic equipment to retailers.

The Umbro operations that were discontinued as a result of the termination of the license with Umbro Worldwide included sales of Umbro branded soccer apparel, equipment and footwear to soccer specialty stores and others within the team channel of distribution, primarily in the United States.

As a result of the sale of RGD and the discontinuance of the Umbro license, the Company's continuing financial results consist of operations within the school spirit industry, including: (i) the design, market and manufacture of cheerleader and dance team uniforms and accessories, (ii) the operation of cheerleading and dance team camps throughout the United States, (iii) the production of nationally televised cheerleading and dance team championships and other special events and (iv) the operation of studio dance competitions and conventions.

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Operations for the three-month period ended September 30, 2002 resulted in a net income of $10.0 million, or $0.89 per share on a diluted basis, as compared to a net income of $8.7 million, or $0.79 per share on a diluted basis, for the third quarter of 2001. The primary reasons for the increase in net income is increased gross margins realized on uniform and accessories sales combined with a decrease in net interest expense offset by an extraordinary gain realized on the early retirement of senior bonds in the third quarter of 2001.

Operating income before interest, taxes, discontinued operations and extraordinary items for the third quarter of 2002 increased $0.9 million, or 7.3%, to $12.7 million from $11.8 million in the third quarter of 2001. For the nine-month period, operating income before taxes, interest, discontinued operations and extraordinary items increased $2.6 million, or 15.2%, in 2002 to $19.8 million from $17.2 million in 2001. The Company benefited from increases in revenues and gross margins and decreases in selling, general and administrative expenses as a percentage of sales, as described in more detail in the discussion which follows this overview.

The Company's operations are highly seasonal. In recent years, the Company's operations have been profitable in the second and third quarters, with the third quarter typically the strongest, while losses have typically been incurred in the first and fourth quarters. The factors influencing this seasonal pattern were discussed in the Company's last Annual Report on Form 10-K.

The operating results of RGD and the Umbro Division are reported as income from operations of discontinued businesses in the Condensed Consolidated Statements of Operations. The following management's discussion and analysis of financial condition reflects changes occurring in the Company's income from continuing operations, exclusive of the discontinued operations of RGD and the Umbro division.

Revenues

Revenues for the three-month period ended September 30, 2002 increased by

$1.1 million, or 1.8%, to $61.2 million from $60.1 million in the third quarter of 2001. For the nine-month period ended September 30, 2002, revenues increased by $6.5 million, or 4.9%, to $137.3 million from $130.8 million in the first nine months of 2001.

Revenues from the sale of uniforms and accessories increased by $0.9 million, or 2.7%, to $32.9 million in the third quarter of 2002 from $32.0 million for the third quarter of 2001. For the nine-month period, uniform and accessories revenues increased by $4.6 million, or 6.0%, to $80.6 million from $76.0 million in 2001. The revenue increase in the third quarter was attributable to overall increases in all product categories. Revenue increases for the nine-month period ended September 30, 2002 are also partially due to increases in uniform sales and product sales at the Company's national championships combined with increased sales of dance and recital wear to the studio dance market.

Revenues from camps and events increased by $0.2 million, or 0.7%, to $28.3 million in the third quarter of 2002 from $28.1 million in the third quarter of 2001. For the nine-month period, camps and events revenues increased $1.8 million, or 3.4%, to $56.6 million in 2002 from $54.8 million in 2001. The increase in revenues for the three-month period is attributable to an 1.2% increase in summer camp revenue and a change in the timing of the Co. Dance National Finals from June 2001 to July 2002. These increases are offset by significant decreases in the Company's group tour business, caused by groups either delaying or cancelling their 2002 tours as a result of the events of September 11. The increase in revenues for the nine-month period is also attributable to an increase in the number of participants at the Company's regional and national cheerleading and dance team championships and at the Company's studio dance competitions and conventions, as compared to the prior year. Exclusive of the effects of September 11 on the group tour business, the Company's camps and events segment experienced revenue increases of 2.8% and 6.9%, respectively, for the three and nine month periods ended September 30, 2002.

Gross Profit

Gross profit for the third quarter of 2002 increased by 3.2% to $25.3 million from $24.5 million in the third quarter of 2001 and for the nine-month period increased by 6.4% to $57.1 million in 2002 from $53.7 million in 2001. Gross margin rates increased by 0.6 percentage points to 41.3% in the third quarter of 2002 from 40.7% in the third quarter of 2001. For the nine-month period, gross margin rates increased to 41.6% in 2002 from 41.1% in 2001.

Gross margin rates for the uniforms and accessories segment increased to 50.1% in the third quarter of 2002 from 48.9% in the third quarter of 2001. For the nine-month period the segment's margin rates increased to 48.0% in 2002 from 46.9% in 2001. These increases are a result of the shift in product mix from lower margin campwear and accessories to higher margin manufactured uniforms and special event merchandise combined with manufacturing efficiencies realized through improvements made in the Company's uniform manufacturing process.

Gross margin rates for the camps and events segment decreased slightly to 31.0% in the third quarter of 2002 from 31.4% in the third quarter of 2001. For the nine-month period the segment's margin rates decreased to 32.5% in 2002 from 33.0% in 2001. The decrease in the gross margin rate for the third quarter is primarily attributable to higher housing, personnel and program support expenses associated with higher anticipated revenue growth for the Company's summer camp operations. The overall decrease for the nine-month period is primarily due to increased venue and production costs at the Company's special events held during the first quarter of 2002, combined with higher personnel and program support expenses associated with higher anticipated revenue growth for the Company's summer camp operations.

Selling, General and Administrative

Selling, general and administrative expenses decreased as a percentage of revenues to 20.6% in the third quarter of 2002 from 21.1% in the third quarter of 2001. For the nine-month period, selling, general and administrative expense rates decreased to 27.2% in 2002 from 27.9% in 2001. The improvement is principally due to economies of scale realized by spreading fixed and certain variable administrative expenses over a greater revenue base combined with a reduction in amortization expense as a result of adopting the standards of Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets."

Selling, general and administrative expenses as a percentage of revenues with respect to the uniforms and accessories segment decreased to 24.1% in the third quarter of 2002 from 26.4% in the third quarter of 2001. For the nine-month period the segment's selling, general and administrative expense rate decreased to 28.4% in 2002 from 30.3% in 2001. These gains were due to improved economies of scale and reductions in amortization expense as discussed in the preceding paragraph.

Selling, general and administrative expense ratios for the camps and events segment increased to 16.6% in the third quarter of 2002 from 14.6% in the third quarter of 2001. For the nine-month period the segment's selling, general and administrative expense rate increased to 23.2% in 2002 from 22.4% in 2001. The increases in the three-month and nine-month expense ratios are attributable to the segment's slight revenue gains during these periods as compared to changes in the Company's adminstrative expenditures. Specifically, the Company has realized a significant decrease in group tour revenues as a result of the September 11 tragedy, while group tour administrative expenditures have remained relatively flat on a comparative basis. These increases are partially offset by reductions in amortization expense as discussed in the above paragraph.

Interest Expense

Interest expense for the nine-month period ended September 30, 2001 has been reduced by $3.1 million, as a result of an allocation of interest expense to the discontinued operations of RGD.

Interest expense, decreased to $2.0 million in the third quarter of 2002 from $3.0 million in the third quarter of 2001. For the nine-month period ended September 30, 2002, interest expense decreased by $1.4 million to $6.1 million from $7.5 million in the first nine-months of 2001. Total interest expense for the nine-month period decreased by $4.5 million due to lower interest on the senior notes and the revolving line of credit resulting from lower outstanding indebtedness in 2002 as compared to 2001. The net interest expense for the nine-month period ended September 30, 2001 included approximately $250,000 of interest received as part of a federal income tax refund. The refund, which included approximately $1.5 million in taxes, related to a carryback of net operating losses of the Company's Varsity Spirit Corporation subsidiary for periods preceding the 1997 acquisition of Varsity Spirit Corporation and had been recorded as a receivable at the time of acquisition.

As a result of the sale of RGD, the Company used a portion of the proceeds received, approximately $32.7 million, to paydown all of the indebtedness then outstanding on its line of credit agreement. (See "Liquidity and Capital Resources" below.)

During 2001, the Company used a portion of the net proceeds received from the sale of RGD to repurchase $40.7 million of its 10.5% Senior Notes for a total cost, including commissions, of $32.0 million.

In April 2002, the Company repurchased $8.25 million of its 10.5% Senior Notes for a total cost, including commissions, of $7.9 million resulting in an extraordinary gain of $0.1 million, net of taxes.

Income Taxes

Operating results from continuing operations for the three-month and nine-month periods ended September 30, 2002 include an income tax expense based on the anticipated effective annual tax rate for 2002. The anticipated effective annual tax rate is estimated based on the expected utilization of remaining net operating loss carryforwards and anticipated income and non-deductible expenses for the year. The actual tax rate for the year could vary substantially from the anticipated rate due to the use of these estimates.

Operating results from continuing operations for the nine-month period ended September 30, 2001 reflected a tax expense based on the anticipated effective annual tax rate for 2001.

Liquidity and Capital Resources

The seasonality of the Company's working capital needs is impacted by three key factors. First, a significant portion of the Company's products are shipped during the late spring, summer and early fall period, with the related receivables being paid when the school year begins during the following July to October period. Second, the Company incurs costs related to the Company's summer camp business during the first and second quarters as the Company prepares for the upcoming camp season, while camp revenues are mostly collected in the June to August period. Lastly, the Company's debt structure impacts working capital requirements, as the semi-annual interest payments on the Company's 10.5% Senior Notes come due each January and July.

To finance these seasonal working capital demands, the Company maintains a credit facility in the form of a $15 million revolving line of credit. Historically, the outstanding balance on the credit facility usually follows the seasonal cycles described above, increasing during the early part of the operating cycle in the first and second quarters of each year and then decreasing from the middle of the third quarter and into the fourth quarter as collections are used to reduce the outstanding balance. Such seasonality should continue in the future.

There were no outstanding balances due under the credit facility as of September 30, 2002 and 2001.

In April 2002, in accordance with the terms of the Company's debt instruments, including the Indenture in respect of its 10.5% Senior Notes, the

Company used $7.9 million aggregate net proceeds received in the Umbro settlement to repurchase $8.25 million aggregate principal amount of its Senior Notes. As a result of this transaction, the Company recognized an extraordinary gain, before related income taxes, of $0.2 million. Had the Company not used the proceeds from the Umbro settlement to repurchase the Senior Notes, the Company may have had to offer to repurchase a portion of the Senior Notes at par.

The Company's current debt service obligations are significant and, accordingly, the Company's ability to meet its debt service and other obligations will depend on the Company's future performance and is subject to financial, economic and other factors, some of which are beyond the Company's control. Furthermore, due to the seasonality of the Company's working capital demands described above, year-over-year growth in the Company's business and working capital requirements could lead to higher debt levels in future periods. Management believes operating cash flow together with funds available from the Company's credit facility will be sufficient to fund the Company's current debt service, seasonal capital expenditures and other working capital requirements. However, many factors, including growth and expansion of the Company's business, could necessitate the need for increased lines of credit or other changes in the Company's credit facilities in the future.

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Item 4. CONTROLS AND PROCEDURES

Within the 90-day period prior to the filing of this Quarterly Report on Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures. Based upon the evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to timely alert them to material information required to be included in the Company's Exchange Act filings. In addition, there have been no changes in internal controls, or in other factors that could significantly affect internal controls subsequent to the date the Chief Executive Officer and Chief Financial Officer completed their evaluation.

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Part II OTHER INFORMATION

Item 1. Legal Proceedings

The Company from time to time becomes involved in various claims and lawsuits incidental to its business. None of these matters are expected to have a material adverse effect on the Company's consolidated financial statements.

Item 2. Changes in Securities

None

Item 3. Defaults upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibit index:

99.3 Second Amendment to Second Amended and Restated Loan Guaranty and Security Agreement between Bank America N.A. and Varsity Brands, Inc.

99.4 John M. Nichols Employment Agreement dated as of November 1, 2002

99.5 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

99.6 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K:

None

SIGNATURES

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

VARSITY BRANDS, INC.

Date: November 14, 2002 By: /s/ Jeffrey G. Webb

President and
Chief Executive Officer

Date: November 14, 2002 By: /s/ John M. Nichols

Chief Financial Officer and
Principal Accounting Officer

CERTIFICATIONS PURSUANT TO
SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002

CERTIFICATION

I, Jeffrey G. Webb, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Varsity Brands, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in the quarterly report;

4. The registrants's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

    (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

    (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

    (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

    (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: November 14, 2002

/s/ Jeffrey G. Webb
President
Chief Executive Officer

CERTIFICATION

I, John M. Nichols, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Varsity Brands, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in the quarterly report;

4. The registrants's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

(c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: November 14, 2002

/s/ John M. Nichols
Senior Vice President
Chief Financial Officer