

BRIEF CASES

4050

REV: JUNE 20, 2011

TIMOTHY A. LUEHRMAN JOEL L. HEILPRIN

Mercury Athletic Footwear: Valuing the Opportunity

In March 2007, John Liedtke, the head of business development for Active Gear, Inc., a privately held footwear company, was contemplating an acquisition opportunity. West Coast Fashions, Inc. (WCF), a large designer and marketer of men's and women's branded apparel had recently announced plans for a strategic reorganization. The plan called for a divestiture of certain non-core assets and a renewed focus on WCF's higher-end business, business-casual, and formal-wear apparel businesses. One of the divisions WCF intended to shed was Mercury Athletic, its footwear division. Liedtke knew that acquiring Mercury would roughly double Active Gear's revenue, increase its leverage with contract manufacturers, and expand its presence with key retailers and distributors. He also expected that Active Gear's bankers would quickly approach the company about a possible bid for Mercury; consequently, he wanted to complete his own rough evaluation of the opportunity before hearing the bankers' pitch.

Athletic and Casual Footwear Industry

Footwear was a mature, highly competitive industry marked by low growth, but fairly stable profit margins. Despite the industry's overall stability, the performance of individual firms could be quite volatile as they vied with one another to anticipate and exploit fashion trends. The market for athletic and casual shoes remained fragmented, despite the presence of a small number of global footwear brands. In the casual segment, companies competed on the basis of style, price, and general quality. In the athletic segment, competition revolved around brand image, specialized engineering for performance, and price.

Within the fashion-sensitive part of the industry, product lifecycles tended to be short, sometimes lasting only a season. Consequently, active management of inventory and production lead times were critical success factors. Although a few firms sold their products in company-owned retail stores, the large majority of athletic and casual footwear was sold through department stores, independent specialty retailers, sporting goods stores, boutiques, and wholesalers. In 2007, many

HBS Professor Timothy A. Luehrman and Illinois Institute of Technology Adjunct Finance Professor Joel L. Heilprin prepared this case specifically for the Harvard Business School Brief Case Collection. Though inspired by real events, the case does not represent a specific situation at an existing company, and any resemblance to actual persons or entities is unintended. Cases are developed solely as the basis for

class discussion and are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Copyright © 2009 President and Fellows of Harvard College. To order copies or request permission to reproduce materials, call 1-800-545-7685, write Harvard Business Publishing, Boston, MA 02163, or go to http://www.hbsp.harvard.edu. This publication may not be digitized, photocopied, or otherwise reproduced, posted, or transmitted, without the permission of Harvard Business School.

companies were actively engaged in attempts to sell directly to customers via web-based e-commerce platforms. So far, successes in this venue had been small in both size and number.

New footwear was produced on a cycle that required 8 to 10 months to complete a new design, associated samples, and production specifications. Another 4 to 6 months were required for manufacturing start-up before new orders could be filled. Despite significant import taxes and tariffs in the United States and European Union, the great majority of North American and European footwear companies used independent contract manufacturers to produce their shoes. Most of these independent manufacturers were located in China.¹

Active Gear, Inc.

Active Gear (AGI) was founded in 1965 to produce and market high-quality specialty shoes for golf and tennis players. The company's products were among the first to incorporate sculpted cushioned insoles and a selection of high-performance tread patterns designed for specific surfaces and/or playing conditions. AGI began selling its shoes primarily in golf and tennis pro shops and a few specialty sporting goods stores. As its products became more established, AGI moved into larger department and retail stores. The company also exported its shoes to Europe and, to a lesser extent, Japan. Sales outside the United States were made through a network of wholesalers, which the company still employed in 2007.

Beginning in the 1970s, Active Gear moved into casual and recreational footwear aimed at what had become its core customer demographic: affluent urban and suburban family members aged 25 to 45. AGI was among the first companies to offer fashionable walking, hiking, and boating footwear. By the early 1980s, the Active Gear brand and logo were associated with a lifestyle that was prosperous, active, and fashion-conscious.

After years of steady if unspectacular growth, AGI's 2006 revenue and operating income were \$470.3 million and \$60.4 million, respectively, with 42% of revenue from athletic shoes and the balance from casual footwear. [Historical income statements and balance sheets for AGI are presented in **Exhibits 1** and **2**.] The firm's athletic shoes had evolved from high-performance footwear to athletic fashion wear with a classic image. The company's traditional casual shoes also offered classic styling, but were aimed at a broader, more mainstream market.

AGI's casual footwear was sold by more than 5,700 North American department, specialty, and general retail stores via a network of wholesalers and independent distributors. Sales of athletic footwear were made through independent sales representatives to a limited number of sporting goods stores, pro shops, and specialty athletic footwear retailers. A small percentage of both casual and athletic shoes were sold through Active Gear's website.

By focusing on a smaller portfolio of classic products with longer lifecycles, Active Gear was able to maintain relatively simple production and supply chains. This in turn allowed the firm to avoid the worst of the industry's cycles of inventory write-downs and missed profit opportunities. AGI's simplified approach to brand and inventory management also contributed to its strong operating margins. **Table 1** shows AGI's Days Sales in Inventory compared to Mercury and other selected footwear producers.

 $^{^1}$ U.S. import taxes ranged from 8.5% to 10.0% for leather footwear, and 6.0% to 20.0% for synthetic footwear. Duties in the EU averaged 7.0% to 8.0% for leather and 16.5% for synthetic footwear.

Table 1

Casual & Athletic Shoe Companies	Days Sales in Inventory
D&B Shoe Company	61.3
Marina Wilderness	39.5
General Shoe Corp.	73.2
Kinsley Coulter Products	31.1
Victory Athletic	50.0
Surfside Footwear	60.0
Alpine Company	42.9
Heartland Outdoor Footwear	58.1
Templeton Athletic	42.5
Average	50.9
Active Gear	42.5
Mercury Athletic	61.1

Like most footwear makers, AGI outsourced production to a network of contract manufacturers located in China. To ensure quality and on-time delivery, AGI conducted a rigorous screening and certification program for all of its manufacturers. The company also maintained a staff of 85 full-time professionals who monitored contract manufacturing on-site from the initial sourcing of materials all the way through final inspection.

Financial Policy & Performance

Active Gear was among the most profitable firms in the footwear industry (Exhibit 3 presents recent data for selected publicly traded footwear producers). However, the company was much smaller than many competitors, and AGI's executives felt its small size was becoming a competitive disadvantage. A recent wave of consolidation among Chinese contract manufacturers created pressure to boost capacity utilization; this was expected to favor larger firms who could offer the manufacturers longer production runs. Active Gear had recently increased its supplier concentration—reducing the number of its contract manufacturers—in an effort to improve its negotiating position. Until recently, AGI's largest supplier accounted for no more than 12% of its volume; by 2006 this figure was approximately 20%, and the two next-largest firms together accounted for 22%.

On the customer side, the rise of "big box" retailers threatened AGI's growth. To protect the company's brand image, Active Gear did not sell through discount retailers. While this policy helped preserve operating margins, it was believed to have hurt sales growth. During 2000-2006 AGI grew its revenue at a compound average rate of only 6% per year compared with nearly 10% for the group shown in **Exhibit 3**. During the past three years AGI grew even more slowly—at an average annual rate of only 2.2%. Continuing pressure from suppliers and competitors caused some deterioration of basic performance metrics, such as return on net operating assets, return on equity, and asset turnover, during 2004–2006 (see Exhibit 1).

Mercury Athletic Footwear

Mercury Athletic Footwear designed and distributed branded athletic and casual footwear, principally to the youth market. Its 2006 revenue and EBITDA were \$431.1 million and \$51.8 million, respectively. Exhibit 4 presents recent income statements and balance sheets for Mercury.

West Coast Fashions had purchased Mercury from its founder, Daniel Fiore, in late 2003. Fiore had started Mercury 35 years earlier, but developed health problems that forced him to sell the business. At the time of the transaction, WCF was in a period of rapid expansion, driven by an aggressive acquisition strategy; it planned to extend the Mercury brand by creating a complementary line of apparel. WCF executives also believed that its larger, more established network of distributors would substantially widen Mercury's distribution with department stores and large discount retailers and boost sales for both shoes and apparel.

Mercury's performance since the acquisition was mixed, but disappointing on the whole. WCF did exploit its own distribution network to expand Mercury's sales. However, the new Mercury Athletic line of branded apparel never gained much traction with consumers. The most loyal purchasers of Mercury's footwear were 15 to 25 years old, with an active interest in extreme sports. These customers were either uninterested in branded apparel, or the specific apparel offered by Mercury simply did not appeal to their tastes. Further, WCF's efforts to establish the apparel line included price cuts and promotions that hurt operating margins. In late 2006, WCF's board concluded that Mercury's size, customers, and brand image did not fit with WCF's and had determined to sell the business in the context of a broader reorganization. Mercury's managers were eager to abandon the apparel line and return to an exclusive focus on footwear.

Mercury Products

Mercury competed in four main segments: men's and women's athletic and casual footwear. During the 1990s, Mercury's athletic shoes became popular among extreme sports enthusiasts and within the associated X-Games subculture. As a result, the company's brand acquired an iconoclastic nonconformist image that the company tried to exploit by adding a line of active casual footwear targeted at the same demographic.

Traditionally the company had promoted the Mercury brand without emphasizing individual products. In support of this strategy, Mercury closely monitored styles and images that evolved from a global youth culture that included alternative music, television, film, and clothing. The company also sponsored, or co-sponsored, certain athletic and cultural events with demonstrated appeal to its target demographic. Such events included skateboarding, snowboarding, and BMX competitions, as well as alternative music festivals and concerts.

Mercury's price points were predominantly mid-range, but the company also had a few brands in higher and lower price ranges. Mercury's shoes were sold throughout North America in a wide range of retail, athletic, department, and specialty stores, and via catalogs and the Internet. No single geographic region accounted for more than 10% of sales.

Production & Operations

Mercury sourced substantially all of its production from independent contractors in Asia. The company had developed an operational infrastructure intended to help it adapt quickly to changes in customer tastes and corresponding product specifications. The company had relatively little capital spending and focused its resources instead on market research and product design. It sourced the majority of its raw materials from foreign suppliers, and had 73 professional and technical personnel in China alone to oversee the quality, production, packaging, and shipping of all its footwear.

Although Mercury was a wholly owned subsidiary of WCF, it operated with considerable autonomy. It maintained its own financial statements, databases, resource management systems, and distribution facilities. As of December 31, 2006, the company had 1,123 full- and part-time employees.

Financial Performance

Following the acquisition by WCF, Mercury's financial performance had been disappointing. The growing popularity of extreme sports, along with WCF's large distribution network, supported top line growth of 20% during 2006 and at a compounded annual rate of 10.5% from the date of the acquisition. However, when Fiore sold the company to WCF, Mercury's EBITDA margin had been steady for years between 14.0-14.5%. In contrast, during 2004-2006 Mercury's EBITDA margin averaged 11.6%.

Several factors contributed to the diminished profitability. First, some of Mercury's sales growth resulted from lower prices. In particular, Mercury had discounted part of its line to get product on the shelves of large discount retailers. These pricing concessions explained part of the financial performance displayed in Table 2. However, a related problem, discussed further below, was Mercury's unsuccessful entry into women's casual footwear. Finally, the firm's rapid sales increase, proliferation of brands, and underperforming women's lines strained its infrastructure and eroded operating efficiency. In 2006 Mercury's DSI² was more than 10 days longer than the industry average, and the company's return on net operating assets was only 12.9%, compared with an industry average of approximately 20%.3

Table 2

Mercury Operating Metrics	2004	2005	2006
Return on net assets	17.0%	8.6%	11.1%
Return on equity	18.5%	9.6%	12.1%
Asset turnover	2.4x	1.4x	1.6x

Performance data for each of Mercury's product segments are presented in Exhibit 5.

Men's Athletic Footwear

Men's athletic footwear was by far the company's largest segment and constituted its core business. Revenue for this segment grew more than 40% over the prior year, and at an average compounded rate of 29% between 2004 and 2006. Mercury's managers attributed the growth primarily to increased sales through large discount retailers, which began handling Mercury's products nationwide in the second quarter of 2005.

In addition to robust sales growth, men's athletic footwear enjoyed operating margins that were consistently higher than rival firms'. On the one hand, loyal customers associated with extreme sports paid medium to high prices for Mercury footwear. On the other, Mercury's shoes were relatively inexpensive to produce: simple designs in combination with basic materials reduced complexity and cost in manufacturing. Operating margins for men's athletic footwear had been approximately 14% historically. A slight decline in 2005 was due to roll-out costs associated with introducing the line to discount retailers.

Men's Casual Footwear

Sales of men's casual footwear peaked in 2004, and had declined since then at an average rate of 6.25% per year. Mercury attributed much of the decline to a combination of cannibalization and

² DSI or days sales inventory is computed here as end-of-year inventory / (revenue /360).

³ Return on net operating assets equals net operating profit after tax / end-of-period net operating assets. Asset turnover is computed as revenue divided by end-of-period net operating assets.

unfortunate shipping problems. The firm introduced a new fashion line for the 2005 holiday season that was received enthusiastically by retailers, who placed strong orders. When bad weather and strikes by dockworkers delayed deliveries, Mercury's holiday sales were disappointing: stores had trimmed their orders for Mercury's existing men's casual products to make room for the new line, which showed up late. When sales failed to recover satisfactorily in 2006, Mercury took steps to upgrade parts of the line and boost support of the casual segment generally. As a result, Mercury expected 2007 and following years to show steady improvement.

Despite its small size and recent sales declines, the men's casual segment consistently posted Mercury's highest profit margins. High profitability was attributed to a marketing and distribution strategy in which casual products were sold exclusively through specialty shops with proven ability to reach the youth demographic. In addition to supporting prices, the exclusivity reinforced the brand's image. Finally, this set of retailers tended to be quite fragmented, and most lacked a national footprint, which allowed Mercury to obtain very favorable terms.

Women's Athletic Footwear

In contrast to the relative strength of the men's lines, Mercury's lines for women had subpar performance. Women's athletic footwear turned in solid sales growth, averaging 13.5% per year during 2004–2006. However, as with the men's line, much of this growth was due to the recent introduction of Mercury's shoes to large discount retailers. An equally important driver was the growing participation of women in extreme sports.

Operating margins for women's athletic footwear averaged just over 10%, which was below the industry mean of 11.9%. Mercury's managers felt the primary reason for lower margins was the high cost of building brand image and awareness among women. Prior to the acquisition by WCF, Mercury had done almost no marketing specifically targeted at female consumers. Since then, targeted advertising and promotional programs had improved the brand's standing among women, and Mercury's managers anticipated better margins in the immediate future.

Women's Casual Footwear

Women's casual footwear was Mercury's worst-performing line of shoes. WCF had expected that its expertise in marketing upscale women's apparel would naturally boost the line of women's casual footwear that Mercury introduced just after the acquisition. The new line was launched with heavy promotion in 2004, but sales began to falter in 2005, as soon as promotional support was reduced. During 2004–2006 sales dropped alarmingly, which led to multiple rounds of inventory write-downs. These in turn further eroded margins and led to operating losses. By the end of 2006, the line was considered all but dead and Mercury's managers were not eager to try the experiment again.

Valuing Mercury Athletic

To perform a preliminary valuation, Liedtke developed a base case set of financial projections based on forecasts of revenue and operating income for each of Mercury's four main segments as shown in **Exhibit 6**. Liedtke's base case assumed that women's casual footwear would be wound down within one year following an acquisition, as he doubted that WCF would be willing to sell Mercury without it. He further assumed that Mercury's historical corporate overhead-to-revenue ratio would conform to historical averages. To accompany the operating projections, Liedtke prepared projections for certain balance sheet accounts for Mercury, shown in **Exhibit 7**; these corresponded to operating assets and liabilities that Liedtke expected would be required to support his operating projections. He did not prepare projections for debt or equity accounts since Mercury

likely would not have its own balance sheet and capital structure following an acquisition by AGI. To estimate a discount rate, Liedtke planned to assume the same degree of leverage for Mercury that AGI currently used, which he estimated to be 20%, measured as debt divided by the market value of AGI's invested capital. Given current credit market conditions, he expected this degree of leverage to imply a cost of debt of 6.0%.4 Finally, his analysis would assume a 40% tax rate, equal to AGI's anticipated marginal tax rate.

After examining Mercury's value using the base case assumptions, Liedtke also wanted to consider the value of possible synergies. Specifically, he believed that AGI's inventory management system could be adopted by Mercury at little incremental cost and would reduce Mercury's DSI to the same level as AGI's. In addition, he thought it was possible that Mercury's women's casual footwear line could be folded into Active Gear's, rather than discontinued. In that case, he thought the combined businesses could achieve an EBIT margin of 9% and revenue growth of 3%.

HARVARD BUSINESS SCHOOL I BRIEFCASES

⁴ At the time of Liedtke's analysis, U.S. Treasury obligations with maturities of 1, 5, 10, and 20 years were yielding 4.50%, 4.69.%, 4.73%, and 4.93%, respectively.

Exhibit 1 Active Gear, Inc. Historical Income Statements, years ended December 31 (\$ in thousands)

Operating Results:	2004	2005	2006
Revenue	\$ 450,174	\$ 469,704	\$ 470,286
Less: Cost of Goods Sold	223,617	231,583	234,494
Gross Profit	226,557	238,121	235,792
Less: Selling Expenses	127,705	130,242	130,471
Less: General & Administrative Expenses	31,437	<u>33,938</u>	<u>36,535</u>
EBITDA	67,415	73,942	68,786
Less: Depreciation & Amortization	<u>7,049</u>	<u>7,343</u>	<u>8,366</u>
EBIT	60,367	66,599	60,420
Less: Net Interest Expense	5,092	5,143	5,098
Less: Other, net	<u>1,211</u>	<u>(752)</u>	<u>24</u>
ЕВТ	54,064	62,208	55,298
Less: Taxes	19,192	21,089	19,349
Net Income	\$ 34,872	\$ 41,120	\$ 35,949
Margin	s:		
Revenue Growth	1.7%	4.3%	0.1%
Gross Profit Margin	50.3%	50.7%	50.1%
EBITDA Margin	15.0%	15.7%	14.6%
EBIT Margin	13.4%	14.2%	12.8%
EBT Margin	12.0%	13.2%	11.8%
Tax Rate	35.5%	33.9%	35.0%
Net Income Margin	7.7%	8.8%	7.6%

Exhibit 2 Active Gear, Inc. Historical Balance Sheets, at December 31 (\$ in thousands)

	2004	2005	2006
Assets:			
Cash & Cash Equivalents	\$ 92,735	\$ 63,949	\$ 54,509
Accounts Receivable	46,507	50,649	61,322
Inventory	38,493	50,140	56,030
Prepaid Expenses	8,298	10,051	12,223
Deferred Taxes	8,681	8,080	6,519
Derivative Assets	0	<u>1,813</u>	_53
Total Current Assets	194,714	184,682	190,655
Property, Plant & Equipment	23,694	24,712	28,392
Intangible Assets	6,414	12,273	14,360
Goodwill	4,249	11,851	11,915
Other Assets	<u>2,982</u>	<u>3,079</u>	<u>3,249</u>
Total Assets	\$ 232,053	\$ 236,596	\$ 248,571
Liabilities & Owners' Equity:			
Accounts Payable	\$ 15,711	\$ 29,188	\$ 33,009
Accrued Expenses	37,211	30,553	36,718
Taxes Payable	10,421	13,263	10,162
Derivative Liabilities	0	0	0
Other	<u>4,514</u>	0	<u>878</u>
Total Current Liabilities	\$ 67,858	\$ 73,004	\$ 80,767
Long Term Debt	178,173	150,240	140,047
Deferred Compensation	3,763	4,814	3,919
Deferred Taxes	2,180	323	0
Total Owners' Equity	(19,921)	<u>8,216</u>	23,837
Total Liabilities & Owners' Equity	\$ 232,053	\$ 236,596	\$ 248,571

Exhibit 3 Selected Data on Public Footwear Companies, March 15, 2007, except as noted (non-ratio values in \$ in thousands)

	Equity	Net		Equity	LTM	LTM	Revenue CAGR
Company	Market Value	Debt (1)	D/E	Beta	Revenue	Earnings	2000-06
D&B Shoe Company	420,098	125,442	29.9%	2.68	2,545,058	67,679	6.6%
Marina Wilderness	1,205,795	(91,559)	-7.6%	1.94	313,556	41,923	17.8%
General Shoe Corp.	533,463	171,835	32.2%	1.92	1,322,392	64,567	11.2%
Kinsley Coulter Products	165,560	82,236	49.7%	1.12	552,594	27,568	4.6%
Victory Athletic	35,303,250	7,653,207	21.7%	0.97	15,403,547	1,433,760	7.9%
Surfside Footwear	570,684	195,540	34.3%	2.13	1,241,529	73,124	10.1%
Alpine Company	1,056,033	300,550	28.5%	1.27	1,614,648	112,015	6.2%
Heartland Outdoor Footwear	1,454,875	(97,018)	-6.7%	1.01	1,176,144	86,156	8.5%
Templeton Athletic	397,709	169,579	42.6%	0.98	516,182	79,170	<u>14.4%</u>
Average			24.9%				9.7%
	_						
	EBIT	EBITDA	Net Inc.	EBIT	EBITDA	P/E	B/V
<u>Company</u>	Margin	Margin	Margin	Multiple	Multiple	Multiple	Multiple
D&B Shoe Company	4.4%	6.1%	2.7%	5.5x	3.9x	6.8x	0.9x
Marina Wilderness	22.1%	23.1%	13.4%	18.0x	16.9x	31.6x	6.0x
General Shoe Corp.	8.8%	11.5%	4.9%	6.8x	5.1x	9.1x	1.6x
Kinsley Coulter Products	6.9%	8.9%	5.0%	7.3x	5.5x	6.6x	0.7x
Victory Athletic	14.1%	16.0%	9.3%	22.1x	19.2x	27.1x	6.0x
Surfside Footwear	9.3%	10.8%	5.9%	7.4x	6.3x	8.6x	1.4x
Alpine Company	10.4%	12.2%	6.9%	9.0x	7.6x	10.4x	2.0x
II(1	10.8%	12.6%	7.3%	12.0x	10.1x	18.6x	3.1x
Heartland Outdoor Footwear					(0		1 2
Templeton Athletic	<u>19.9%</u>	<u>20.2%</u>	<u>15.3%</u>	<u>6.2x</u>	<u>6.0x</u>	<u>5.5x</u>	<u>1.2x</u>

Note: Market multiples are based on three year averages. "LTM" denotes latest twelve months.

Exhibit 4 Mercury Athletic Footwear Historical Financial Statements (\$ in thousands)

Operating Results:	2004	2005	2006
Net Revenue	\$ 340,578	\$ 358,780	\$ 431,121
Less: Cost of Goods Sold	<u>198,115</u>	205,820	<u>239,383</u>
Gross Profit	142,463	152,960	191,738
Less: Selling, General & Administrative	102,410	113,892	<u>139,933</u>
EBITDA	40,053	39,067	51,804
Less: Depreciation & Amortization	<u>7,699</u>	8,001	<u>9,506</u>
EBIT	32,353	31,066	42,299
Less: Corporate Administrative Charge	275	305	<u>366</u>
EBT	32,079	30,761	41,933
Less: Taxes	<u>12,190</u>	11,689	<u>15,934</u>
Net Income	\$ 19,889	\$ 19,072	\$ 25,998

Assets:	2004	2005	2006
Cash & Cash Equivalents	\$ 12,203	\$ 20,187	\$ 10,676
Accounts Receivable	29,115	38,654	45,910
Inventory	53,552	70,818	73,149
Prepaid Expenses	<u>7,809</u>	<u>15,810</u>	<u>10,172</u>
Total Current Assets	102,679	145,470	139,908
Property, Plant & Equipment	33,090	31,334	32,618
Trademarks & Other Intangibles	1,031	35,740	43,853
Goodwill	554	34,605	43,051
Other Assets	<u>5,657</u>	<u>11,884</u>	<u>11,162</u>
Total Assets	\$ 143,011	\$ 259,032	\$ 270,592
Liabilities & Owners' Equity:			
Accounts Payable	\$ 12,838	\$ 14,753	\$ 16,981
Accrued Expenses	<u>13,040</u>	21,955	<u>18,810</u>
Total Current Liabilities	25,878	36,708	35,791
Deferred Taxes	1,635	13,795	11,654
Pension Obligation	8,131	9,256	9,080
Owners' Equity	107,367	<u>199,274</u>	<u>214,067</u>
Total Liabilities & Owners' Equity	\$ 143,011	\$ 259,032	\$ 270,592

Exhibit 5 Mercury Athletic Footwear Segment Data, 2004-2006 (\$ in thousands)

Eigest Veer 2006.	Men's	Men's	Women's Athletic	Women's	Unallocated	Consolidated
Fiscal Year 2006:	Athletic	Casual		Casual	Corporate	
Revenue	\$ 219,093	51,663	123,563	36,802	0	431,121
Operating Income	31,421	8,242	12,703	(843)	(9,224)	42,299
Total Assets	\$ 148,576	28,457	27,978	34,701	30,880	270,592
Fiscal Year 2005:						
Revenue	\$ 151,900	55,402	108,097	43,381	0	358,780
Operating Income	18,398	9,077	11,631	(1,013)	(7,027)	31,066
Total Assets	\$ 173,482	30,842	24,267	12,197	18,244	259,032
Fiscal Year 2004:						
Revenue	\$ 131,636	58,787	95,897	54,258	0	340,578
Operating Income	17,720	9,196	9,109	462	(4,134)	32,353
Total Assets	\$ 39,543	34,966	22,526	15,056	30,919	143,011
	Men's	Men's	Women's	Women's	Unallocated	
	Athletic	Casual	Athletic	Casual	Corporate	Consolidated
2006 EBIT Margins	14.3%	16.0%	10.3%	-2.3%	-2.1%	9.8%
2005 EBIT Margins	12.1%	16.4%	10.8%	-2.3%	-2.0%	8.7%
2004 EBIT Margins	13.5%	15.6%	9.5%	0.9%	-1.2%	9.5%

Exhibit 6 Mercury Athletic Footwear: Base Case Projected Segment Performance (\$ in thousands)

Men's Athletic:	2007	2008	2009	2010	2011
Revenue	\$ 251,957	\$ 282,192	\$ 310,411	\$ 335,244	\$ 352,006
Less: Operating Expenses*	218,435	<u>244,647</u>	269,112	<u>290,641</u>	<u>305,173</u>
Operating Income	33,522	37,545	41,299	44,603	46,834
Men's Casual:					
Revenue	52,179	53,223	54,287	55,916	57,594
Less: Operating Expenses*	43,834	44,711	45,605	46,973	<u>48,382</u>
Operating Income	8,345	8,512	8,682	8,943	9,211
Women's Athletic:					
Revenue	138,390	153,613	167,438	179,159	188,117
Less: Operating Expenses*	124,302	<u>137,976</u>	150,393	<u>160,921</u>	<u>168,967</u>
Operating Income	14,088	15,638	17,045	18,238	19,150
Women's Casual:					
Revenue	36,802	0	0	0	0
Less: Operating Expenses*	<u>37,265</u>	0	0	0	0
Operating Income	(463)	0	0	0	0
Consolidated Revenue	479,329	489,028	532,137	570,319	597,717
Less: Operating Expenses*	423,837	427,333	465,110	498,535	522,522
Less: Corporate Overhead	8,487	<u>8,659</u>	9,422	10,098	<u>10,583</u>
Consolidated Operating Income	\$ 47,005	\$ 53,036	\$ 57,605	\$ 61,686	\$ 64,612
Estimated Capital Expenditures	11,983	12,226	13,303	14,258	14,943
Estimated Depreciation	9,587	9,781	10,643	11,406	11,954
* Operating Expenses include an allocatio	n of depreciat	ion for each se	egment.		

Exhibit 7 Mercury Athletic Footwear: Projection of Selected Balance Sheet Accounts; 2007–2011 (\$ in thousands)

Selected Balance Sheet Accounts:	2007	2008	2009	2010	2011
<u>Assets</u>					
Cash Used in Operations	\$ 4,161	\$ 4,195	\$ 4,566	\$ 4,894	\$ 5,130
Accounts Receivable	47,888	48,857	53,164	56,978	59,715
Inventory	83,770	85,465	92,999	99,672	104,460
Prepaid Expenses	14,474	14,767	16,069	17,222	18,049
Property, Plant & Equipment	35,015	37,460	40,120	42,972	45,961
Trademarks & Other Intangibles	43,853	43,853	43,853	43,853	43,853
Goodwill	43,051	43,051	43,051	43,051	43,051
Other Assets	11,162	11,162	11,162	11,162	11,162
<u>Liabilities</u>					
Accounts Payable	\$ 18,830	\$ 18,985	\$ 20,664	\$ 22,149	\$ 23,214
Accrued Expenses	22,778	22,966	24,996	26,792	28,081
Deferred Taxes	11,654	11,654	11,654	11,654	11,654
Pension Obligation	9,080	9,080	9,080	9,080	9,080