Differential Brands Group Inc.
Form 10-Q
August 16, 2016

UNITED STATES

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 quarterly period ended June 30, 2016

OR

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

For the transition period from   to

Commission File Number: 0-18926

DIFFERENTIAL BRANDS GROUP INC.

(Exact name of registrant as specified in its charter)

Delaware	11-2928178
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1231 South Gerhart Avenue, Commerce, California	90022
(Address of principal executive offices)	(Zip Code)

(323) 890-1800

(Registrant's telephone number, including area code)

N/A

(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 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes No

The number of shares of the registrant’s common stock outstanding as of August 11, 2016 was 13,082,659.

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DIFFERENTIAL BRANDS GROUP INC. AND SUBSIDIARIES

INDEX TO QUARTERLY REPORT ON FORM 10-Q

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EXPLANATORY NOTE

Differential Brands Group Inc. and subsidiaries ("we," "us," "our," the "Company" or "Differential") began operations in 1987 as Innovo, Inc. Since our founding, we have evolved from producing craft and accessory products to designing and selling apparel products bearing the Hudson® and Robert Graham® and as of July 18, 2016, the SWIMS® brand names. Prior to the Joe's Asset Sale discussed below, we also designed and sold apparel products bearing the various Joe's ® brand names.

As previously reported, on September 11, 2015, we completed the sale of certain of our operating and intellectual property assets related to the business operated under the brand names "Joe's Jeans," "Joe's," "Joe's JD" and "else" (the "Joe's Business") to GBG USA Inc., a Delaware corporation (the "GBG"), and the sale of certain of our intellectual property assets related to the Joe's Business to Joe's Holdings LLC, a Delaware limited liability company ("Joe's Holdings"), for an aggregate purchase price of $80 million (the "Joe's Asset Sale"). The proceeds of the Joe's Asset Sale were used to repay all of our indebtedness outstanding under the term loan credit agreement, dated September 30, 2013 (the "Garrison Term Loan Credit Agreement"), with Garrison Loan Agency Services LLC ("Garrison") and a portion of our indebtedness outstanding under our revolving credit agreement (the "CIT Revolving Credit Agreement"), dated September 30, 2013, as amended, with CIT Commercial Services, Inc. ("CIT"), a unit of CIT Group. In November 2014, we had received an initial notice of default and event of default and demand for payment of default interest from Garrison under the Garrison Term Loan Credit Agreement, which also triggered a default and event of default under the terms of the CIT Revolving Credit Agreement and our separate factoring facility with CIT. On February 10, 2015, we had received additional notices of default and events of default for failure to comply with certain financial and other covenants and a demand for continued payment of default interest from both Garrison and CIT. As a result of the repayment based on the proceeds of the Joe's Asset Sale, the Garrison Term Loan Credit Agreement was paid in full and terminated on September 11, 2015, and we entered into the amended and restated revolving credit agreement (the "CIT Amended and Restated Revolving Credit Agreement"), dated September 11, 2015, which provided for a maximum credit availability of $7.5 million and waived certain defaults that remained in effect until the closing of the RG Merger (as defined below).

Additionally, as previously reported, on January 28, 2016, we completed the acquisition (the "RG Merger") of all of the outstanding equity interests of RG Parent LLC and its subsidiaries ("Robert Graham" or "RG"), a business engaged in the design, development, sales and licensing of apparel products and accessories that bear the brand name Robert Graham® (the "Robert Graham Business"), as contemplated by the Agreement and Plan of Merger, dated as of September 8, 2015 (the "RG Merger Agreement"), by and among RG, JJ Merger Sub, LLC ("RG Merger Sub") and us, for an aggregate of $81.0 million in cash and 8,825,461 shares of our common stock, par value $0.10 per share ("common stock") (after giving effect to the Reverse Stock Split (as defined below)). Pursuant to the RG Merger Agreement, among other things, RG Merger Sub was merged with and into RG, so that RG, as the surviving entity, became our wholly-owned subsidiary. The aggregate cash consideration was used to repay $19.0 million of RG's outstanding loans and indebtedness under its revolving credit agreement with J.P. Morgan Chase Bank, N.A. On the RG Merger's closing date, all outstanding loans under the CIT Amended and Restated Revolving Credit Agreement were repaid and it was terminated in connection with entering into (i) a new credit and security agreement (as later amended, the "ABL Credit Agreement") with Wells Fargo Bank, National Association, as lender, (ii) a new credit and security agreement with TCW Asset Management Company, as agent, and the lenders party thereto (as later amended, the "Term Credit Agreement"), and (iii) an amended and restated deferred purchase factoring agreement with CIT.

Effective upon consummation of the RG Merger, we changed our name from "Joe's Jeans Inc." to "Differential Brands Group Inc." and our trading symbol from "JOEZ" to "DFBG," and effected a reverse stock split (the "Reverse Stock Split") of our issued and outstanding common stock such that each 30 shares of our issued and outstanding common stock were reclassified into one share of our issued and outstanding common stock, which Reverse Stock Split did not change the par value or the amount of authorized shares of our common stock. The primary purpose of the Reverse Stock Split was to increase the per-share market price of our common stock in order to maintain our listing on The Nasdaq Capital Market maintained by The Nasdaq Stock Market LLC ("NASDAQ"). Unless otherwise indicated, all share amounts in this Quarterly Report on Form 10-Q (this "Quarterly Report") have been adjusted to reflect the Reverse Stock Split.

After the closing of the Joe's Asset Sale on September 11, 2015, we retained and operated 32 Joe's® brand retail stores, of which we transferred 18 retail stores to GBG on January 28, 2016 for no additional consideration. As of February 29, 2016, the remaining 14 Joe's® brand retail stores were closed and are reported as discontinued operations.

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GBG supplied Joe's® branded merchandise to the retail stores for resale under a license from Joe's Holdings until the stores were transferred or closed.

The RG Merger has been accounted for as a reverse merger and recapitalization. As a result of the RG Merger, RG is a wholly-owned subsidiary of the Company, the Company no longer owns certain assets and intellectual property of the Joe's Business and the Company retains ownership of the businesses associated with its Hudson® brand (the "Hudson Business"). The former RG members own a majority of our issued and outstanding equity after the RG Merger. Under the acquisition method, RG is deemed the accounting acquirer for financial reporting purposes, with the Company, as the legal acquirer, being viewed as the accounting acquiree. As a result, the assets, liabilities and operations reflected in the historical condensed consolidated financial statements and elsewhere in this Quarterly Report prior to the RG Merger are those of RG and will be recorded at the historical cost basis and the Company's future periodic reports will reflect RG's historical financial condition and results of operations for comparative purposes. For the three and six months ended June 30, 2016, the Company's condensed consolidated financial statements include: (i) from January 1, 2016 up to the day prior to the closing of the RG Merger on January 28, 2016, the results of operations and cash flows of RG; (ii) from and after the RG Merger's closing date on January 28, 2016, the results of continuing operations, cash flows and, as applicable, the assets and liabilities of the combined company, comprising the Company's Hudson Business and RG; and (iii) from and after the RG Merger's closing date on January 28, 2016, the results of the discontinued operations from the Joe's® brand retail stores that were not transferred to GBG but that closed as of February 29, 2016.

Prior to the RG Merger, RG and the Company had different fiscal year ends, with RG's fiscal year ending on December 31 and the Company's fiscal year ending on November 30. In connection with the RG Merger, the Company changed its fiscal year end to December 31. The accounting policies of the Company are similar in all material respects to those of RG, except as set forth in our accompanying notes to unaudited condensed consolidated financial statements.

The Company continues to be a "smaller reporting company," as defined under the Securities Exchange Act of 1934, as amended (the "Exchange Act") following the RG Merger.

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PART I — FINANCIAL INFORMATION

Item 1.Financial Statements.

DIFFERENTIAL BRANDS GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	June 30, 2016 (unaudited)	December 31, 2015 (note 1)
ASSETS		
Current assets		
Cash and cash equivalents	$ 8,368	$ 1,966
Factored accounts receivable, net	12,155	4,917
Accounts receivable, net	1,521	1,836
Royalties receivable	663	547
Inventories	26,759	15,353
Prepaid expenses and other current assets	1,976	1,351
Total current assets	51,442	25,970
Property and equipment, net	13,003	13,406
Goodwill	6,524	2,286
Trade names and other intangibles, net	84,965	39,823
Other assets	477	1,374
Total assets	$ 156,411	$ 82,859
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 19,114	$ 13,084
Cash advances from customers	1,724	—
Current portion of long-term debt	875	—
Current portion of loan payable	—	1,167
Total current liabilities	21,713	14,251
Long-term debt, net of current portion	47,694	—
Line of credit	12,000	17,013
Convertible notes	12,251	—
Deferred income taxes, net	9,723	—
Deferred rent	3,624	3,568
Other liabilities	81	—
Loan payable, net of current portion	—	486
Total liabilities	107,086	35,318
Commitments and contingencies		

Equity		
Preferred members	—	24,798
Common members	—	22,743
Series A convertible preferred stock, $0.10 par value: 50 and 0 shares authorized, issued and outstanding at June 30, 2016 and December 31, 2015, respectively	5	—
Common stock, $0.10 par value: 100,000 and 0 shares authorized, 12,379 and 0 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	1,239	—
Additional paid-in capital	56,093	—
Accumulated deficit	(8,012)	—
Total equity	49,325	47,541
Total liabilities and equity	$ 156,411	$ 82,859

See accompanying notes to unaudited condensed consolidated financial statements.

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DIFFERENTIAL BRANDS GROUP INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Net sales	$ 32,373	$ 16,256	$ 66,088	$ 35,204
Cost of goods sold	15,274	6,310	28,686	13,367
Gross profit	17,099	9,946	37,402	21,837
Operating expenses				
Selling, general and administrative	18,718	9,259	39,147	19,551
Depreciation and amortization	1,501	936	2,863	1,833
Retail store impairment	—	—	279	—
	20,219	10,195	42,289	21,384
Operating (loss) income	(3,120)	(249)	(4,887)	453
Interest expense, net	1,995	134	3,336	268
(Loss) income before income tax	(5,115)	(383)	(8,223)	185
Income tax (benefit) provision	(1,510)	105	577	116
(Loss) income from continuing operations	(3,605)	(488)	(8,800)	69
Loss from discontinued operations, net of tax	—	—	(1,286)	—
Net (loss) income	$ (3,605)	$ (488)	$ (10,086)	$ 69
(Loss) earnings per common share - basic				
(Loss) earnings from continuing operations	$ (0.29)	$ (0.06)	$ (0.74)	$ 0.01
Loss from discontinued operations	—	—	(0.11)	—
(Loss) earnings per common share - basic	$ (0.29)	$ (0.06)	$ (0.85)	$ 0.01
(Loss) earnings per common share - diluted				
(Loss) earnings from continuing operations	$ (0.29)	$ (0.06)	$ (0.74)	$ 0.01
Loss from discontinued operations	—	—	(0.11)	—
(Loss) earnings per common share - diluted	$ (0.29)	$ (0.06)	$ (0.85)	$ 0.01
Weighted average shares outstanding				
Basic	12,380	8,825	11,852	8,825
Diluted	12,380	8,825	11,852	8,825

See accompanying notes to unaudited condensed consolidated financial statements.

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DIFFERENTIAL BRANDS GROUP INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six months ended	
	June 30, 2016	June 30, 2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net cash (used in) provided by continuing operating activities	$ (13,083)	$ 175
Net cash used in discontinued operating activities	(1,384)	—
Net cash (used in) provided by operating activities	(14,467)	175
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash paid in reverse acquisition with Robert Graham, net of cash acquired	(6,538)	—
Refund of security deposit	—	41
Purchases of property and equipment	(1,125)	(1,319)
Net cash used in investing activities	(7,663)	(1,278)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of Series A convertible preferred stock, net of offering costs	49,881	—
Proceeds from new term debt	50,000	—
Repayment of new term loan	(250)	—
Proceeds from line of credit	12,587	—
Repayment of terminated line of credit and loan payable	(23,349)	—
Payment of deferred financing costs	(1,584)	—
Redemption of unit holders	(58,218)	—
Proceeds from customer cash advances	831	
Payment of loan payable	—	(584)
Proceeds from line of credit	—	1,558
Payment of accrued distribution to members	(1,366)	(331)
Net cash provided by financing activities	28,532	643
NET CHANGE IN CASH AND CASH EQUIVALENTS	6,402	(460)
CASH AND CASH EQUIVALENTS, at beginning of period	1,966	792
CASH AND CASH EQUIVALENTS, at end of period	$ 8,368	$ 332
Supplemental disclosures of cash flow information:		
Interest paid	$ 1,563	$ 275
Income taxes paid	$ 507	$ 81

Supplemental disclosures of non-cash financing activities:		
Reclassification of other assets to offering costs	$ 812	$ —
Reclassification of other assets to deferred financing costs	$ 349	$ —
Issuance of convertible notes	$ 16,565	$ —
Common stock issued in reverse acquisition with Robert Graham	$ 20,000	$ —

See accompanying notes to unaudited condensed consolidated financial statements.

DIFFERENTIAL BRANDS GROUP INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(in thousands)

	Common Stock		Preferred Series A		Additional	Accumulated	Preferred Member		Common Member		Total
	Shares	Par Value	Shares	Par Value	Paid-In Capital	Deficit	Units	Amount	Units	Amount	Equity
Balance, January 1, 2015	—	$ —	—	$ —	$ —	$ —	5,100	$ 25,375	4,900	$ 23,298	$ 48,673