

Munsingwear, Inc. Case Study Instructions

This case tests your ability to think strategically

Prize:

Pretend you have traded in your hush puppy shoes or sandals in for a pair of wing-tips. You are now an investment banker who is being asked to help Munsingwear, Inc. “**enhance shareholder value.**” How would you advise the CEO in improving their operations and profitability? Your fee, if your advice salvages value for shareholders and/or turns this company around, would be \$500,000. If you solve this case with an analysis of how this company could be profitable and you idea of its probable valuation with an explanation backing your valuation, tell me where to send your fee.

Instructions:

Use only what is in this case study for your analysis. If you feel critical information is lacking, then state what is missing and how it prevents you from advising your client. You will have a chance to speak to the CEO, Mr. Lowell Fisher, in class.

After reading the 10-K what would you advise? Why? Please give no more than a written paragraph answer. Provide a brief pro-forma of your analysis if necessary.

Please provide a short analysis (no more than one or two paragraphs) of how you would restructure the company to make it profitable on a normalized basis. Then provide a back of the envelop valuation based on conservative assumptions.

Good luck in your new wing tips! Do not take more than 30-40 minutes! If you win, do you want the funds wired to your off-shore account?

Munsingwear, Inc. Case Study

FORM 10-K

For the fiscal year ended January 6, 1996

Munsingwear, Inc.

IRS # 41-0429620

8000 W. 78th Street, Suite-400, Minneapolis, Minnesota 55439

Telephone number: 612-943-5000

Delaware: State of Incorporation

The aggregate market value of the voting stock held by nonaffiliates of the Registrant at April 1, 1996 was \$9,384,000 based on the closing price of \$7.25 per share at that date.

The number of shares of common stock outstanding at April 1, 1996 was 2,037,078

A. GENERAL DEVELOPMENT OF BUSINESS

The Company was incorporated under the laws of Delaware in 1923 as the successor to a business founded in 1886. The Company’s principal executive offices are located at 8000 W. 78th Street, Suite-400, Minneapolis, Minnesota 55439, and its telephone number: 612-943-5000. As used in this document, the term “Company” refers to Munsingwear, Inc. and its subsidiaries unless otherwise noted or indicated by the context. At Jan. 6, 1996, the Company had one subsidiary, Munsingwear UK Limited, which was idled in 1994.

After suffering a severely weakened financial condition, primarily due to losses of \$89, 243,000 during the years 1989 through 1990, the Company, on July 3, 1991, filed a voluntary petition for bankruptcy under Chapter 11 of the US Bankruptcy Code, together with a proposed Plan of Reorganization. The Company emerged from bankruptcy on Oct. 29, 1991.

Prior to the reductions in operation implemented during 1989 through 1991, the Company designed, manufactured and distributed a broad range of men's and children's apparel through several operating divisions and subsidiaries. Today the Company's operations consist of what was formerly the Men's Apparel Division and sell primarily men's knit sport shirts under the following major brands or labels: Munsingwear®, Grand Slam®, Grand Slam Tour™, Penguin Sport™ and Slammer®. In addition, the Company licenses its trade names and trademarks for use in a variety of products.

In the recent two fiscal years, the Company's sales by channel of distribution have undergone significant change. In 1995, sales to premium/special markets and golf Pro shop customers rose 52% collectively over 1994. This is the result of management's attempt to reduce the Company's reliance on sales to traditional retail apparel channels of distribution where heavy promotional pricing, discounting and advertising activities are required.

In late 1995, the Company retained the services of an investment banking firm to explore a range of opportunities to maximize shareholder value.

B. FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS

The Company operates in one industry segment, apparel manufacturing. As of Jan. 6, 1996, the Company's foreign operations were not material.

C. NARRATIVE DESCRIPTION OF BUSINESS

Principal Products:

The Company sells primarily men's knit sport shirts under four major brands or labels: Munsingwear®, Grand Slam®, Grand Slam Tour™, and Penguin Sport™. Grand Slam® and Penguin Sport™ products are sold primarily to department stores, specialty stores and Sears. Munsingwear® products are sold primarily to premium/special markets customers and to national chain stores, such as Montgomery Ward. Grand Slam Tour™ is sold primarily through golf pro shops.

Sources and Availability of Raw Materials and Products:

Approximately 60% of the Company's products are manufactured domestically. The other 40% is sourced primarily from manufacturers in the Far East through a relationship with Associated Merchandising Corporation (AMC). The Company also sources some product through the 807 program in the Caribbean Basin. The principal raw materials used in the domestic production process are cotton, synthetic and cotton/synthetic blended goods obtained principally from United States sources. The Company purchases most of its piece goods from approximately ten sources. There are currently no major problems in availability of raw materials and alternative sources are available. The Company's Fairmount, NC manufacturing facility includes a material warehouse, cutting, sewing and embroidery operations, and finished goods distribution center. The company also utilizes contract swing manufacturers in close proximity to its North Carolina facility to meet demand during peak production periods. All products, both domestically and offshore produced, are distributed to customers from the North Carolina facility.

Trademarks and Trade Names:

In 1991, management initiated the strategy to actively pursue licensing as a vital part of the Company's growth plan. During the period 1991 through 1993, the Company entered into eleven license agreements, and in 1994, renegotiated its licenses with Fruit of the Loom which, among other things, extended the original agreement for twenty-five years. In 1995, the Company entered into four additional license agreements. Management intends to continue development of its licensing programs and believes that its advertising, styling and brand name

identification established over many years are important to the competitive position of the company. The Company has the following license agreements:

- ❖ A license with Fruit of the Loom, Inc. to market underwear and active wear.
- ❖ A license with a New York entity to market sleepwear.
- ❖ Five licenses with Montgomery Ward to market men's pants, outerwear, accessories, dress wear and shirts.
- ❖ A license with a Canadian corporation to market knit shirts.
- ❖ A license with a North Carolina entity to market men's and boys' hosiery.
- ❖ A license with a Peoples Republic of China entity to market a variety of clothing and accessories.
- ❖ A license with a South Carolina entity to market sweaters.
- ❖ A license with a Missouri entity to market outerwear.
- ❖ A license with a New York entity to market woven shirts.
- ❖ A license with a South African entity for apparel.

Management's emphasis on licensing activities in recent years has led to a dramatic increase in the Company's royalty income, from \$1,162,000 in 1991 to \$4,609,000 in 1995.

Seasonal Aspects of the Business:

Sales of the Company's products can vary significantly by season, with peak shipments normally occurring in the first and second quarters of the fiscal year.

Working Capital Practices:

The Company maintains a secured bank line of credit to meet its working capital needs. Peak borrowings under this agreement normally occur in the first six months of the year during the heavier shipping period and during the fourth quarter when inventories are increased to meet the additional first and second quarter sales volume. Seasonal increases in inventory are normal for the apparel manufacturing industry. The bank line of credit is also used for letters of credit that are required for generally all of the Company's purchases from offshore sources. The Company allows returns of merchandise as a result of shipping errors, damaged merchandise and for other reasons. Returns have been less than 4% of sales in each of the past two years.

Customers:

The Company sells to approximately 4,500 customers. Sales to Sam's Club (a division of Wal-Mart Stores, Inc.) in 1994 and 1993 were 16% and 21%, respectively, of net sales. In 1995, no single customers represented more than 10% of total Company sales.

Backlog of Orders:

The Company's backlog of unfilled orders at January 6, 1996 was approximately \$15,600,000 as compared to \$18,800,000 a year ago. The decrease was due primarily to management's emphasis on reducing reliance on traditional retail apparel customers. The unfilled order backlog does not necessarily relate directly to future sales.

Competition:

The apparel industry in the United States is highly competitive and characterized by a relatively small number of broad line companies and a large number of specialty manufacturers. In addition, there are unbranded and private label competitors as well as numerous, small specialty manufacturers competing with the Company. The principal methods of competition in the apparel industry are pricing, styling, quality (both in material and production), inventory replenishment programs and customer service. The Company seeks to maintain its competitive position in the markets in which it operates through the use of all these methods.

Research and Development:

The Company is involved in limited experimental research activities related to the development of new fabrics and production methods. Research and development expenses, other than for product design, are not significant.

Environmental Considerations:

The Company's manufacturing operations are subject to various federal, state and local laws restricting the discharge of materials into the environment. The Company is not involved in any pending or threatened proceedings which would require curtailment of its operations because of such regulations. In 1995, the company's capital expenditures for environmental control facilities were not significant, and no significant capital expenditures related to environmental issues are projected in 1996.

Item 1: Employees:

As of January 6, 1996, there were 343 employees, none of whom were represented by a union.

D. FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

Sales to unaffiliated foreign customers located outside the United States and its territories for the past three years were not significant.

Item 2. Properties

At January 6, 1996, the Company occupied the following properties:
 Management considers facilities adequate for current operations. At Jan. 6, 1996, no facilities were occupied Under capitalized leases.

Property	Sq/ Footage	Approx. Percentage Utilized	Lease Expires
Minn., MN HQ	29,200	50	1996
Fairmont, NC – Cutting and sewing plant, warehouse and distribution center	139,100	100	Owned
New York, NY – Sales office/showroom	1,000	100	1997
Dallas, TX – Sales office/showroom	500	100	1996

Item 3. Legal Proceedings

None of a significant nature.

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

None.

Executive Officers of the Registrant

The following information is furnished with respect to the Company's executive officers as of the date hereof, pursuant to Item 401 (b) of Regulation S-K. Each of the officers has been appointed to serve in his respective office until his successor has been elected.

Name and Age	Position	Officer Since
Lowell M. Fisher (63)	Director of the Company; President and CEO, October 1993 to	1993

ABOUT THE COMPANY

The Company was founded in 1886 as a manufacturer of men's underwear. Throughout the early 1900's, the Company was an innovator of new textile and apparel manufacturing processes and, during the 1940's and 1950's, expanded its product lines, acquired a women's intimate apparel company and, in 1955, introduced the Grand Slam (R) collection of golf apparel bearing the well-known Penguin ® emblem. During the 1960's and 1970's, manufacturing facilities were added, textile research and development departments were established and the Company entered into numerous licensing agreements for the use of its trade names and trademarks.

Today the Company derives its revenues primarily from the sale of men's sportswear apparel and the licensing of men's underwear, active wear and other related apparel. The Company's products are sold primarily through premium/special markets, department stores, golf pro shops, national chain stores, specialty stores, sporting goods stores and wholesale clubs. The Company designs, manufactures, imports, markets and licenses branded men's lifestyle apparel under the Grand Slam ®, Grand Slam Tour®, Munsingwear ®, and Penguin Sport™ labels. The Company is headquartered in Minneapolis, MN and has 343 employees in company-wide operations.

LETTER TO STOCKHOLDERS

Revenues for 1995 were \$56.1 million, a 34% increase over last year. Dramatic sales growth in our premium/special markets and golf pro shop businesses more than offset a small decline in business with our traditional customers, such as department and specialty stores, national chain stores and wholesale clubs. Premium/special markets volume increased seven-fold while golf Pro shop volume increased 52%. In 1995 these two businesses represented 40% of our total sales volume and are expected to exceed 50% of total Company sales in 1996. As recent transition the Company has undergone over the past two years, significantly reducing our exposure to the difficult retail apparel marketplace.

Royalty income was up slightly to \$4.6 million. As a reminder, 1994 royalty income had increased 25% as a result of additional license agreements and a twenty-five year extension to the Fruit of the Loom license, which will also lead to lower cash receipts from existing licensing agreements starting in 1996. The Munsingwear trade names and trademarks have always signified quality to the licensing market and we will continue to actively pursue additional license agreements.

While we achieved significant revenue growth in 1995, we were not successful in becoming profitable. The loss of \$2.3 million, \$1.13 per share, was primarily the result of deep markdowns on excess end-of-season merchandise related to the retail department store channel of distribution, losses related to an unsuccessful entry into "Friday-wear", increased advertising expenses in support of the retail department store business and restructuring costs related to completed staff reductions and reduced office space requirements. In addition, costs associated with our PGA Tour endorsement program increased, yet we feel this program is necessary to give Munsingwear brands consumer exposure. We were successful in reducing selling, general and administrative expenses as a percent of sales – from 32% in 1994 to 27% in 1995. Interest expense was up significantly due to inventory build-up required to service the explosive sales growth in the premium/special markets business. Throughout the year we also experienced higher than planned levels of inventory for the retail department store business, which did not meet sales forecasts. Ultimately, we sold this inventory at deep discounts.

Looking ahead to 1996, we plan to continue to grow the premium/special markets business which has achieved exceptional results the past two years. Munsingwear's strong consumer brand recognition, the Penguin logo,

quality product and the agility to merchandise across a broad product line give us a competitive advantage. We are confident that increased revenues and a return to profitability will be achieved due to the following:

- Continued strong sales growth in premium/special markets and golf pro shop businesses.
- Cost reduction programs.
- Continued focus on core capability – men’s, short sleeve, knit, and moderately priced golf shirts.

(Picture of LOWELL M. FISHER)

- Innovative designs and fabrics throughout all product lines.
- Continued upgrading of management information systems.
- Strengthening of our Board of Directors by the addition of three new members, Thomas D. Gleason, who was named non-executive Chairman of the Board in January of this year, and Kevin S. Moore and William J. Morgan, who represent the Company’s two largest single stockholders.

In late 1995 we retained the services of an investment banking firm to help us explore a range of opportunities to maximize shareholder value, and we expect this activity to accelerate in 1996. Please refer to the Management’s discussion and analysis section in this annual report for additional financial analysis and a statement regarding forward-looking information.

Although 1995 was a difficult year for retailing, the Company achieved extremely promising revenue growth in our two most profitable businesses—premium/special markets and golf pro shops. These results reaffirmed our decision to continue the Company’s transition – expanding markets, enhancing product quality, increasing consumer value and investing in infrastructure. As a result, we are now in a much stronger strategic position and I look forward to working with Tom Gleason and the Board in continuing our efforts to ensure the long-term success and profitability of the Company.

In closing, I would like to thank our customers, suppliers and lender, who have continued to support us throughout the Company’s transition. Finally, I would like to take this opportunity to thank all Munsingwear employees for their hard work and effort which led to spectacular 1995 sales growth and reinforces our optimism for 1996.

Sincerely,

/s/ Lowell M. Fisher

Lowell M. Fisher, President and CEO.

Financial Statements on the next page

CONSOLIDATED STATEMENTS OF OPERATIONS
(AMOUNTS IN THOUSANDS, EXCEPT PERSHARE DATA)

MUNSINGWEAR, INC.	Year Ended January 6, 1996	Year Ended January 7, 1995	Year Ended January 1, 1994
REVENUES			
Net Sales	\$ 51,512	\$ 37,407	\$ 37,635
Royalties	4,609	4,528	3,624
	<u>56,121</u>	<u>41,935</u>	<u>41,259</u>
EXPENSES:			
Cost of goods sold	42,714	30,029	28,783
SG&A	13,961	12,134	11,869
Restructuring costs (Note 9)	520	---	---
(Gain) loss on closing of facilities (Note 9)	---	(100)	450
	<u>57,195</u>	<u>42,063</u>	<u>41,102</u>
OPER. INCOME (LOSS)	(1,074)	(128)	157
Interest expense	(1,158)	(353)	(286)
Other	2	177	(74)
Loss before inc. taxes and extraordinary item	(2,230)	(304)	(203)
Provision for inc. taxes	105	108	139
Loss before extraordinary item	(2,230)	(304)	(203)
Extraordinary loss from early debt extinguishment	---	161	---
NET LOSS	<u>\$ (2,335)</u>	<u>\$ (573)</u>	<u>\$ (342)</u>
Net Loss per common share:			
Loss before extraordinary item	\$ (1.13)	\$ (.20)	\$ (.16)
Extraordinary item	---	(.08)	---
NET LOSS PER CS	<u>\$ (1.13)</u>	<u>\$ (.28)</u>	<u>\$ (.16)</u>
Weighted avg. OS	<u>2,066</u>	<u>2,066</u>	<u>2,093</u>

The accompanying notes are an integral part of these financial statements
CONSOLIDATED BALANCE SHEETS (AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

	January 6, 1996	January 7, 1995
ASSETS		
Current Assets:		
Cash and CE	\$62	\$ 73
Receivables:		
Trade, net of allowance of \$511 and \$442	8,260	4,852
Other	<u>277</u>	<u>286</u>
Inventories	14,641	14,219
Prepaid expenses	<u>1,004</u>	<u>1,286</u>
TOTAL CURRENT ASSETS	24,244	20,716
PP&E		
Land	15	15
Buildings and leasehold improvements	568	550
Machinery and equipment	<u>3,928</u>	<u>3,041</u>
	4,511	3,606
Less accumulated D&A	<u>1,584</u>	<u>1,330</u>
	2,927	2,276
TRADEMARKS net of accumulated Amortization of \$1,274 and \$1,010	4,173	4,437
Deferred taxes, NET OF VALUATION ALLOWANCE OF \$11,796 AND \$11,151	2,309	2,309
	<u>\$ 33,653</u>	<u>\$ 29,738</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Line of credit borrowings	\$ 10,890	\$ 5,592
Current maturities of long-term debt	21	19
Accounts payable	5,008	3,760
Accrued payroll and employee benefits	1,009	1,028
Unearned royalty income	2,993	3,159
Other accruals	397	311
TOTAL CURRENT LIABILITIES:	20,318	13,869
LONG-TERM LIABILITIES:		
Long-term debt, less current liabilities	22	38
Postretirement benefits	319	312
Unearned royalty income	10	200
	351	550
TOTAL LONG-TERM LIABILITIES	351	550
STOCKHOLDERS' EQUITY		
Common Stock, \$0.01 par value 2,065,594 shares issued and issuable	21	21
Additional paid-in capital	15,112	15,112
	<u>(2,149)</u>	<u>185</u>
TOTAL STOCKHOLDERS' EQUITY	12,984	15,319
	<u>\$ 33,653</u>	<u>\$ 29,738</u>

	Year Ended January 6, 1996	Year Ended January 7, 1995	Year Ended January 1, 1994
CASH FLOWS			
OPERATING ACTIVITIES			
Net loss from continuing operations	\$ (2,335)	\$ (573)	\$ (342)
Reconciling items:			
Deprec. & Amort.	782	712	873
Deferred Taxes	--	(69)	--
Provision for losses on accounts receivable	69	142	204
Loss on restructuring	193	---	--
(gain) loss on closing of facilities	--	(100)	450
Change in unearned royalty income	(356)	2,729	(690)
Changes in operating assets and liabilities:			
Receivables	(3,468)	(380)	(716)
Inventories	(422)	(5,986)	(425)
Prepaid expenses	282	(254)	(192)
Accounts Payable	1,248	944	(164)
Other accrued liabilities	<u>(87)</u>	<u>(292)</u>	<u>(305)</u>
NET CASH USED IN OPERATING ACTIVITIES	(4,094)	(3,127)	(1,307)
INVESTING ACTIVITIES			
Purchases of PP&E	(1,201)	(865)	(490)
NET CASH USED IN INVESTING ACTIVITIES	(1,201)	(865)	(490)
FINANCING ACTIVITIES			
Net Change in previous line of credit borrowings	---	(\$1,698)	\$1,698
Net Change in new line of credit borrowings	5,298	5,592	--
Principal payments on long-term debt and capital lease obligations	(14)	(270)	(303)
Proceeds from exercise of stock options	--	--	133
NET CASH PROVIDED BY FINANCING ACTIVITIES	5,284	3,624	1,528
DECREASES IN CASH AND CASH EQUIVALENTS	(11)	(368)	(269)
Cash and Cash Equivalents at beginning of period	73	441	710
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 62	\$ 73	\$ 441
Supplemental disclosures of cash flow information:			
Cash paid for taxes	<u>\$ 178</u>	<u>\$ 122</u>	<u>\$ 153</u>
Cash paid for interest	\$ 1,078	\$ 370	\$ 273

END