Differential Brands Group Inc.
Form 10-Q
May 15, 2018
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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 March 31, 2018

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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 May 15, 2018 was 13,974,535.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

DIFFERENTIAL BRANDS GROUP INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands, except share data)

	March 31, 2018 (unaudited)	December 31, 2017 (Note 1)	March 31, 2017 (unaudited)
ASSETS			
Current assets			
Cash and cash equivalents	$ 4,331	$ 8,250	$ 4,038
Accounts receivable, net	24,513	22,246	22,723
Inventories	33,921	31,733	28,490
Prepaid expenses and other current assets	6,170	4,832	3,708
Total current assets	68,935	67,061	58,959
Property and equipment, net	8,120	8,417	10,170
Goodwill	8,536	8,380	8,284
Intangible assets, net	89,162	89,332	91,199
Other assets	1,914	484	467
Total assets	$ 176,667	$ 173,674	$ 169,079
LIABILITIES AND EQUITY			
Current liabilities			
Accounts payable and accrued expenses	$ 24,939	$ 22,204	$ 20,810
Short-term convertible note	—	13,694	13,308
Current portion of long-term debt	2,813	2,813	1,875
Total current liabilities	27,752	38,711	35,993
Line of credit	22,915	21,254	16,287
Convertible notes	14,189	13,866	12,947
Long-term debt, net of current portion	44,035	44,896	46,538
Deferred income taxes, net	7,308	6,650	11,054
Other liabilities	3,924	3,554	3,619
Total liabilities	120,123	128,931	126,438
Commitments and contingencies (Note 14)			
Equity			
Series A convertible preferred stock, $0.10 par value: 50,000 shares authorized, issued and outstanding at March 31, 2018,	5	5	5

December 31, 2017 and March 31, 2017			
Series A-1 convertible preferred stock, $0.10 par value: 4,587,964, 0 and 0 shares authorized, issued and outstanding at March 31, 2018, December 31, 2017 and March 31, 2017, respectively	459	—	—
Common stock, $0.10 par value: 100,000,000 shares authorized, 13,599,285, 13,488,366 and 13,297,688 shares issued and outstanding at March 31, 2018, December 31, 2017 and March 31, 2017, respectively	1,360	1,349	1,330
Additional paid-in capital	75,192	61,314	59,531
Accumulated other comprehensive income (loss)	1,034	271	(137)
Accumulated deficit	(21,506)	(18,196)	(18,088)
Total equity	56,544	44,743	42,641
Total liabilities and equity	$ 176,667	$ 173,674	$ 169,079

The accompanying notes are an integral part of these condensed consolidated financial statements.

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DIFFERENTIAL BRANDS GROUP INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND

COMPREHENSIVE INCOME (LOSS)

(in thousands, except per share data)

(unaudited)

	Three months ended March 31, 2018	2017
Net sales	$ 38,818	$ 40,103
Cost of goods sold	22,563	21,499
Gross profit	16,255	18,604
Operating expenses		
Selling, general and administrative	15,348	17,411
Depreciation and amortization	1,463	1,498
Total operating expenses	16,811	18,909
Operating loss	(556)	(305)
Interest expense	2,215	2,047
Other (income) expense, net	(1)	24
Loss before income taxes	(2,770)	(2,376)
Income tax provision (benefit)	1,315	(26)
Net loss	$ (4,085)	$ (2,350)
Net loss attributable to common stockholders	$ (5,847)	$ (3,701)
Net loss	$ (4,085)	$ (2,350)
Other comprehensive income, net of tax:		
Foreign currency translation adjustment	763	84
Other comprehensive income	763	84
Comprehensive loss	$ (3,322)	$ (2,266)
Loss per common share - basic	$ (0.43)	$ (0.28)
Loss per common share - diluted	$ (0.43)	$ (0.28)
Weighted average shares outstanding		
Basic	13,550	13,287
Diluted	13,550	13,287

The accompanying notes are an integral part of these condensed consolidated financial statements.

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DIFFERENTIAL BRANDS GROUP INC.

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(in thousands, unaudited)

	Common Stock		Preferred Series A		Preferred Series A-1		Additional	Accumulated Other Comprehensive Income	Accumulated	Total
	Shares	Par Value	Shares	Par Value	Shares	Par Value	Paid-In Capital	(Loss)	Deficit	Equity
Balance, January 1, 2017	13,239	$ 1,324	50	$ 5	—	$ —	$ 59,154	$ (221)	$ (15,738)	$ 44,524
Stock-based compensation	—	—	—	—	—	—	439	—	—	439
Issuance of restricted common stock, net of taxes withheld	59	6	—	—	—	—	(62)	—	—	(56)
Foreign currency translation	—	—	—	—	—	—	—	84	—	84
Net loss	—	—	—	—	—	—	—	—	(2,350)	(2,350)
Balance, March 31, 2017	13,298	$ 1,330	50	$ 5	—	$ —	$ 59,531	$ (137)	$ (18,088)	$ 42,641
Balance at January 1, 2018, as previously reported	13,488	$ 1,349	50	$ 5	—	$ —	$ 61,314	$ 271	$ (18,196)	$ 44,743
Impact of change in accounting policy	—	—	—	—	—	—	—	—	775	775
Adjusted balance at January 1, 2018	13,488	1,349	50	5	—	—	61,314	271	(17,421)	45,518
Issuance of Series A-1 convertible preferred stock	—	—	—	—	4,588	459	13,305	—	—	13,764
Stock-based compensation	—	—	—	—	—	—	637	—	—	637
	111	11	—	—	—	—	(64)	—	—	(53)

Issuance of restricted common stock, net of taxes withheld										
Foreign currency translation	—	—	—	—	—	—	—	763	—	763
Net loss	—	—	—	—	—	—	—	—	(4,085)	(4,085)
Balance, March 31, 2018	13,599	$ 1,360	50	$ 5	4,588	$ 459	$ 75,192	$ 1,034	$ (21,506)	$ 56,544

The accompanying notes are an integral part of these condensed consolidated financial statements.

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DIFFERENTIAL BRANDS GROUP INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, unaudited)

	Three months ended March 31, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (4,085)	$ (2,350)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,463	1,498
Amortization of deferred financing costs	110	103
Amortization of convertible notes discount	179	194
Paid-in-kind interest	437	425
Stock-based compensation	637	439
Provision for bad debts	94	187
Loss on disposal of assets	4	—
Deferred taxes	523	8
Changes in operating assets and liabilities:		
Accounts receivable	(145)	(2,685)
Inventories	(2,365)	(4,510)
Prepaid expenses and other assets	(628)	547
Accounts payable and accrued expenses	(416)	2,785
Other liabilities	317	(10)
Net cash used in operating activities	(3,875)	(3,369)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(439)	(337)
Net cash used in investing activities	(439)	(337)
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of long-term debt	(938)	—
Proceeds from line of credit, net	1,379	3,350
Payment of deferred financing costs	—	(124)
Repayment of customer cash advances	—	(1,707)
Taxes paid in lieu of shares issued for stock-based compensation	(53)	(223)
Net cash provided by financing activities	388	1,296
Effect of exchange rate changes on cash and cash equivalents	7	(28)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(3,919)	(2,438)
CASH AND CASH EQUIVALENTS, at beginning of period	8,250	6,476
CASH AND CASH EQUIVALENTS, at end of period	$ 4,331	$ 4,038

Supplemental disclosures of cash flow information:

Interest paid	$ 3,021	$ 111
Income taxes paid	$ 6	$ 4
Supplemental disclosures of non-cash investing and financing activities:		
Conversion of Short-Term Convertible Note	$ 13,764	$ —
Unpaid purchases of property and equipment	$ 101	$ 62

The accompanying notes are an integral part of these condensed consolidated financial statements.

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DIFFERENTIAL BRANDS GROUP INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands except share and per share data)

(unaudited)

1. Business Description and Basis of Presentation

The condensed consolidated balance sheet as of December 31, 2017 of Differential Brands Group Inc. and its subsidiaries (“we,” “us,” the “Company” or “Differential”) has been derived from audited financial statements of the Company. The condensed consolidated financial statements as of and for the three months ended March 31, 2018 and 2017 and the related footnote information have been prepared on a basis consistent with the consolidated financial statements as of and for the years ended December 31, 2017 and 2016. In addition, these condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements and thus should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) that management considers necessary to present fairly the financial position, results of operations and cash flows of the Company for the interim periods presented. The results for the three months ended March 31, 2018 are not necessarily indicative of the results anticipated for the entire year ending December 31, 2018. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results may differ from those estimates.

The Company began operations in 1987 as Innovo, Inc. Since the Company’s founding, the Company has evolved from producing craft and accessory products to designing and selling apparel products. Currently, the Company’s principal business activity involves the design, development and worldwide marketing of: (i) apparel products, which include denim jeans, related casual wear and accessories bearing the brand name Hudson®; (ii) apparel products and accessories bearing the brand name Robert Graham®; and (iii) footwear, apparel and accessories bearing the brand name SWIMS®. Our primary operating subsidiaries are Hudson Clothing, LLC (“Hudson”), Robert Graham Designs, LLC and Robert Graham Retail, LLC (collectively “Robert Graham” or “RG”), and DFBG Swims, LLC (“Swims”). In addition, we have other non-operating subsidiaries.

The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

In connection with the acquisition of all of the outstanding equity interests of RG Parent LLC and its subsidiaries on January 28, 2016 (the "RG Merger"), we entered into (i) a credit and security agreement (as later amended, the "ABL Credit Agreement") with Wells Fargo Bank, National Association, as lender, (ii) a 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 Commercial Services, Inc. ("CIT"), a unit of CIT Group (the "A&R Factoring Agreement").

On July 18, 2016, the Company completed the acquisition of all of the outstanding share capital of Norwegian private limited company SWIMS AS ("SWIMS").

The Company's reportable business segments are "Wholesale", "Consumer Direct" and "Corporate and other". The Company manages, evaluates and aggregates its operating segments for segment reporting purposes primarily on the basis of business activity and operation. The Wholesale segment is comprised of sales of products to premium nationwide department stores, boutiques, specialty retailers, and select off-price and international customers. The Wholesale segment also includes expenses from sales and customer service departments, trade shows, warehouse distribution, design and production, and product samples. The Consumer Direct segment is comprised of sales to consumers through the Robert Graham® brand full-price retail stores and outlet stores, through the SWIMS® brand outlet stores and through the online ecommerce sites at www.hudsonjeans.com, www.robertgraham.us and

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www.swims.com. The information contained on, or that can be accessed through, these websites is not a part of this Quarterly Report and is not incorporated by reference herein. The Corporate and other segment is comprised of revenue from trademark licensing agreements and expenses from corporate operations, which include the executive, finance, legal, information technology and human resources departments and general brand marketing and advertising expenses associated with the Company's brands.

2. Summary of Significant Accounting Policies

Information regarding significant accounting policies is contained in Note 2, "Summary of Significant Accounting Policies" of the consolidated financial statements in the Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Correction of an Immaterial Error

During the 2017 year end close, the Company determined that basic and diluted Earnings per Share ("EPS") had been incorrectly stated in the prior period financial statements. Historically, cumulative preferred dividends for the period were not included in the Company's calculation of EPS. However, in accordance with Accounting Standards Codification ("ASC") 260, Earnings per Share, income available to common stockholders is to be computed by deducting the dividends accumulated for the period on cumulative preferred stock. The Company's Series A Convertible Preferred Stock (the "Series A Preferred Stock") entitles the holder to receive cumulative dividends when, as and if declared by the Board of Directors, payable at an annual rate of 10% through the date on which the liquidation preference is paid to the holder in connection with the liquidation of the Company or the date on which such Series A Preferred Stock is otherwise re-acquired by the Company. The amount of the cumulative dividend accrued on the Series A Preferred Stock has been disclosed previously in the Company's filings. The Company has corrected the calculation of basic and diluted EPS to include the accrued cumulative preferred dividends for the period. Management evaluated the materiality of the error from a quantitative and qualitative perspective and concluded that this adjustment was not material to the Company's presentation and disclosures, and has no impact on the Company's financial position, results of operations and cash flows. Accordingly, no amendments to previously filed reports are required. However, the Company has elected to revise the historical condensed consolidated financial information presented herein to reflect the correction of this error for the prior period presented and to conform to the current period presentation. As a result of this correction, for the quarter ended March 31, 2017, basic and diluted loss per common share was corrected from a loss of $0.18 per share to a loss of $0.28 per share.

Revenue Recognition

The Company adopted ASC 606, Revenue from Contracts with Customers, with a date of initial application of January 1, 2018. As a result, the Company has changed its accounting policy for revenue recognition as described below. The Company applied ASC 606 using the modified retrospective approach – i.e. by recognizing the cumulative effect of initially applying ASC 606 as an adjustment to the opening balance of equity at January 1, 2018. Therefore, the comparative information has not been adjusted and continues to be reported under ASC 605. The details of the significant changes and quantitative impact of the changes are set out below. The Company applied the modified retrospective approach only to contracts that were not complete as of the date of the initial application, January 1, 2018.

Effective January 1, 2018, wholesale revenues are recorded when a contract with the customer is agreed to by both parties and product has been transferred, which occurs at the point of shipment from the Company's warehouse, and recorded at the transaction price based on the amount the Company expects to receive. Collection is probable as the majority of shipments occur to reputable credit worthy businesses and through factored relationships which guarantee payment. Estimated reductions to revenue for customer allowances are recorded based upon history as a percentage of sales and current outstanding chargebacks. The Company may allow for returns based upon pre-approval or in the case of damaged goods. Such returns are estimated based on historical experience and also specific claims filed by the customer. Beginning January 1, 2018, a refund liability is included in accounts payable and accrued expenses within the accompanying condensed consolidated balance sheet, which was previously recorded net of accounts receivable. Also, effective January 1, 2018, the Company records a return asset receivable in prepaid expenses and other current assets within the accompanying condensed consolidated balance sheet. Prior to January 1, 2018, inventory expected to be

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returned was recorded within inventories. The return asset receivable is evaluated for impairment each period. The Company recorded a decrease of $569 thousand to opening accumulated deficit as of January 1, 2018 to record the return asset receivable and related impairment charge.

Retail store revenue is recognized at the time the customer takes possession of the related merchandise. Ecommerce sales of products ordered through the Company's retail internet sites known as www.hudsonjeans.com, www.robertgraham.us and www.swims.com are recognized at the point of shipment to the customer. Prior to January 1, 2018, revenue for ecommerce sales was recorded at the point of delivery to the customer. The Company recorded an adjustment to opening accumulated deficit as of January 1, 2018, an increase of $39 thousand, to reflect the change in accounting policy. Ecommerce revenue is reduced by an estimate for returns based on the historical rate of return as a percent of sales. Retail store revenue and ecommerce revenue exclude sales taxes.

Revenue from licensing arrangements is recognized based on actual sales when the Company expects royalties to exceed the minimum guarantee. For licensing arrangements in which the Company does not expect royalties to exceed the minimum guarantee, an estimate of the transaction price is recognized on a straight-line basis over the term of the contract. A contract asset is recorded for revenue recognized in advance of the contract payment terms, which is included in other assets within the accompanying condensed consolidated balance sheet. Nonrefundable upfront fees are recorded as a contract liability and revenue is recognized straight-line over the term of the contract. Contract liabilities are included in other liabilities within the accompanying condensed consolidated balance sheet. Prior to January 1, 2018, revenue from licensing arrangements was recognized when earned in accordance with the terms of the underlying agreements and deemed collectible, generally based upon the higher of (a) the contractually guaranteed minimum royalty or (b) actual net sales data received from licensees. The Company recorded an adjustment to opening accumulated deficit as of January 1, 2018, an increase of $1.3 million, to reflect the change in accounting policy.

Amounts related to shipping and handling that are billed to customers are considered to be activities to fulfill a promise to transfer the goods and are reflected in net sales, and the related costs are reflected in cost of goods sold within the accompanying condensed consolidated statements of operations and comprehensive income (loss). This accounting policy is consistent with the Company's treatment of shipping and handling revenue prior to January 1, 2018.

The following tables summarize the impact of adopting ASC 606 on the Company's condensed consolidated balance sheet as of January 1, 2018:

	Impact of changes in accounting policies		
	Balances with adoption of ASC 606	Adjustments	Balances without adoption of ASC 606
Accounts receivable, net	$ 24,398	$ 2,152	$ 22,246

Inventories	31,389	(344)	31,733
Prepaid expenses and other current assets	5,584	752	4,832
Other assets	1,828	1,344	484
Accounts payable and accrued expenses	19,127	(3,077)	22,204
Other liabilities	3,502	(52)	3,554
Accumulated deficit	(18,971)	(775)	(18,196)

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The following tables summarize the impact of adopting ASC 606 on the Company's condensed consolidated financial statements as of and for the three months ended March 31, 2018:

Condensed Consolidated Statement of Operations	Impact of changes in accounting policies		
for the three months ended March 31, 2018	As reported	Adjustments	Balances without adoption of ASC 606
Net sales	$ 38,818	$ (18)	$ 38,800
Cost of goods sold	22,563	(74)	22,489
Gross profit	16,255	56	16,311
Operating expenses			
Selling, general and administrative	15,348	—	15,348
Depreciation and amortization	1,463	—	1,463
Total operating expenses	16,811	—	16,811
Operating loss	(556)	56	(500)
Interest expense	2,215	—	2,215
Other (income) expense, net	(1)	—	(1)
Loss before income taxes	(2,770)	56	(2,714)
Income tax provision (benefit)	1,315	—	1,315
Net loss	$ (4,085)	$ 56	$ (4,029)

Condensed Consolidated Balance Sheet	Impact of changes in accounting policies		
as of March 31, 2018	As reported	Adjustments	Balances without adoption of ASC 606
Cash and cash equivalents	$ 4,331	$ —	$ 4,331
Accounts receivable, net	24,513	(2,066)	22,447
Inventories	33,921	326	34,247
Prepaid expenses and other current assets	6,170	(659)	5,511
Property and equipment, net	8,120	—	8,120
Goodwill	8,536	—	8,536
Intangible assets, net	89,162	—	89,162
Other assets	1,914	(1,430)	484
Total assets	$ 176,667	$ (3,829)	$ 172,838
Accounts payable and accrued expenses	$ 24,939	$ (2,747)	$ 22,192
Short-term convertible note	—	—	—
Current portion of long-term debt	2,813	—	2,813
Line of credit	22,915	—	22,915
Convertible notes	14,189	—	14,189

Long-term debt, net of current portion	44,035	—	44,035
Deferred income taxes, net	7,308	—	7,308
Other liabilities	3,924	(363)	3,561
Total liabilities	120,123	(3,110)	117,013
Series A convertible preferred stock	5	—	5
Series A-1 convertible preferred stock	459	—	459
Common stock	1,360	—	1,360
Additional paid-in capital	75,192	—	75,192
Accumulated other comprehensive income (loss)	1,034	—	1,034
Accumulated deficit	(21,506)	(719)	(22,225)
Total equity	56,544	(719)	55,825
Total liabilities and equity	$ 176,667	$ (3,829)	$ 172,838

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Condensed Consolidated Statement of Cash Flows	Impact of changes in accounting policies		
for the three months ended March 31, 2018	As reported	Adjustments	Balances without adoption of ASC 606
Net loss	$ (4,085)	$ 56	$ (4,029)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	1,463	—	1,463
Amortization of deferred financing costs	110	—	110
Amortization of convertible notes discount	179	—	179
Paid-in-kind interest	437	—	437
Stock-based compensation	637	—	637
Provision for bad debts	94	—	94
Loss on disposal of assets	4	—	4
Deferred taxes	523	—	523
Changes in operating assets and liabilities:			
Accounts receivable	(145)	46	(99)
Inventories	(2,365)	123	(2,242)
Prepaid expenses and other assets	(628)	86	(542)
Accounts payable and accrued expenses	(416)	—	(416)
Other liabilities	317	(311)	6
Net cash used in operating activities	(3,875)	—	(3,875)
Net cash used in investing activities	(439)	—	(439)
Net cash provided by financing activities	388	—	388
Effect of exchange rate changes on cash and cash equivalents	7	—	7
Net change in cash and cash equivalents	(3,919)	—	(3,919)
Cash and cash equivalents, at beginning of period	8,250	—	8,250
Cash and cash equivalents, at end of period	$ 4,331	$ —	$ 4,331

Financial Accounting Standards Recently Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, ASC 606. This amendment prescribes that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The amendment supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the Industry Topics of the Codification. For the Company's annual and interim reporting periods the mandatory adoption date of ASC 606 is January 1, 2018, and two methods of adoption are allowed, either a full retrospective adoption or a modified retrospective adoption. In August 2015, the FASB issued ASU No. 2015-14, which deferred the effective date of ASU No. 2014-09 to the first quarter of 2018. In March 2016, April 2016, May 2016, December 2016 and May 2017, the FASB issued ASU No. 2016-08, ASU No. 2016-10, ASU No. 2016-12, ASU No. 2016-20, and ASU No. 2017-10, respectively, as clarifications to ASU No. 2014-09. ASU No. 2016-08 clarifies how to identify the unit of accounting for the principal versus agent evaluation, how to apply the control principle to certain types of arrangements, such as service transactions, and reframed the indicators in the guidance to focus on evidence that an entity is acting as a principal rather than as an agent. ASU No. 2016-10 clarifies the existing guidance on identifying performance obligations and licensing implementation. ASU No. 2016-12 adds practical expedients related to the transition for contract modifications and further defines a completed contract, clarifies the objective of the collectability assessment and how revenue is recognized if collectability is not probable, and when non-cash considerations should be measured. ASU No. 2016-20 corrects or improves guidance in 13 narrow focus aspects of the guidance. ASU No. 2017-10 clarifies that the grantor in a service concession arrangement is the operating entity’s customer for purposes of

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revenue recognition. The effective dates for these ASUs are the same as the effective date for ASU No. 2014-09, for the Company's annual and interim periods beginning January 1, 2018. These ASUs also require enhanced disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows. The Company adopted the new revenue standards in the first quarter of 2018 using the modified retrospective approach. Please see above for a description of the changes.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. ASU No. 2016-15 amends the guidance in ASC 230 on the classification of certain cash receipts and payments in the statement of cash flows. The primary purpose of ASU No. 2016-15 is to reduce the diversity in practice that has resulted from the lack of consistent principles on this topic. ASU No. 2016-15 is effective for annual and interim periods beginning after December 15, 2017, and early adoption is permitted for all entities. Entities must apply the guidance retrospectively to all periods presented but may apply it prospectively from the earliest date practicable if retrospective application would be impracticable. The Company adopted ASU No. 2016-15 in the first quarter of 2018 and there was no impact on the condensed consolidated financial statements.

Recently Issued Financial Accounting Standards

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which affects the accounting for leases. The guidance requires lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by all leases with terms of more than 12 months. The amendment also will require qualitative and quantitative disclosures designed to give financial statement users information on the amount, timing, and uncertainty of cash flows arising from leases. This ASU is effective for fiscal years beginning after December 15, 2018 and interim periods within that reporting period. Early application is permitted. The Company is currently assessing the impact of the new standard on its condensed consolidated financial statements, but anticipates an increase in assets and liabilities due to the recognition of the required right-of-use asset and corresponding liability for all lease obligations that are currently classified as operating leases, such as real estate leases for corporate headquarters, administrative offices, retail stores, and showrooms as well as additional disclosure on all its lease obligations. The income statement recognition of lease expense is not expected to significantly change from the current methodology.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments — Credit Losses — Measurement of Credit Losses on Financial Instruments, an accounting standards update that introduces a new model for recognizing credit losses on financial instruments based on an estimate of current expected credit losses. This includes accounts receivable, trade receivables, loans, held-to-maturity debt securities, net investments in leases and certain off-balance sheet credit exposures. The guidance also modifies the impairment model for available-for-sale debt securities. The update is effective for fiscal years beginning after December 15, 2019 and interim periods within that reporting period. The Company is currently assessing the potential effects this update may have on its condensed consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU No. 2018-02 permits entities to reclassify tax effects stranded in accumulated other comprehensive income as a result of tax reform to retained earnings. This ASU gives entities the option to reclassify these amounts and requires new disclosures, regardless of whether they elect to do so. The guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption in any period is permitted. The Company is currently evaluating the impact the adoption of ASU No. 2018-02 will have on its condensed consolidated financial statements.

3. Factored Accounts and Receivables

A&R Factoring Agreement

In January 2016, in connection with the RG Merger, the Company entered into the A&R Factoring Agreement with CIT, through its subsidiaries, Robert Graham and Hudson. Following the SWIMS acquisition, SWIMS became a party to the A&R Factoring Agreement pursuant to a joinder agreement dated November 16, 2018. The A&R Factoring Agreement provides that the Company sell and assign to CIT certain domestic accounts receivable, including accounts

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arising from or related to sales of inventory and the rendition of services. Under the A&R Factoring Agreement, the Company pays various factoring rates depending on the credit risk associated with the nature of the account. The A&R Factoring Agreement may be terminated by CIT upon 60 days' written notice or immediately upon the occurrence of an event of default as defined in the agreement. The A&R Factoring Agreement may be terminated by the Company upon 60 days' written notice prior to December 31, 2020 or annually with 60 days' written notice prior to December 31 of each year thereafter.

SWIMS Factoring Agreement

In connection with the acquisition of SWIMS, SWIMS has maintained a preexisting Credit Assurance and Factoring Agreement between SWIMS and DNB Bank ASA ("DNB"), dated August 26, 2013 (the "SWIMS Factoring Agreement"). The SWIMS Factoring Agreement is a combined credit assurance and factoring agreement, pursuant to which SWIMS is granted financing of up to 80% of its preapproved outstanding invoiced international receivables. DNB receives an annual commission based on invoiced revenues and a quarterly commission of the maximum financing amount plus other administrative costs. The SWIMS Factoring Agreement is secured with (a) first-priority lien on SWIMS's (i) machinery and plant (up to NOK 10.0 million) and (ii) inventory (up to NOK 10.0 million) and (b) additional liens on SWIMS's factoring in the amount of NOK 1.0 million (first lien), NOK 4.0 million (second lien), NOK 7.0 million (third lien) and NOK 2.5 million (fourth lien). The SWIMS Factoring Agreement may be terminated by SWIMS upon 14 days' prior written notice for any reason and by DNB upon 14 days' prior written notice for just cause. DNB may also terminate the SWIMS Factoring Agreement without any prior written notice in the event of a material breach by SWIMS. As of March 31, 2018, SWIMS had outstanding financing commitments on NOK 20.6 million (approximately $2.7 million as of March 31, 2018) of its preapproved outstanding invoiced receivables pursuant to the SWIMS Factoring Agreement.

Accounts receivable consists of the following (in thousands):

	March 31, 2018	December 31, 2017	March 31, 2017
Non-recourse receivables assigned to factor	$ 17,902	$ 19,566	$ 20,504
Client recourse receivables	3,253	1,473	3,103
Total receivables assigned to factor	21,155	21,039	23,607
Allowance for customer credits	(1,162)	(3,597)	(4,424)
Total factored accounts receivable, net	$ 19,993	$ 17,442	$ 19,183
Non-factored accounts receivable	$ 5,271	$ 5,974	$ 4,783
Allowance for customer credits	(448)	(863)	(1,041)
Allowance for doubtful accounts	(303)	(307)	(202)
Total non-factored accounts receivable, net	$ 4,520	$ 4,804	$ 3,540
Total accounts receivable, net	$ 24,513	$ 22,246	$ 22,723

Of the total amount of receivables sold by the Company as of March 31, 2018, December 31, 2017 and March 31, 2017, the Company holds the risk of payment of approximately $3.3 million, $1.5 million and $3.1 million, respectively, in the event of non-payment by the customers.

4. Inventories

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Inventories are valued at net realizable value with cost determined by the first-in, first-out method. Inventories consisted of the following (in thousands):

	March 31, 2018	December 31, 2017	March 31, 2017
Finished goods	$ 32,038	$ 29,721	$ 26,426
Finished goods consigned to others	1,388	1,524	1,439
Work in progress	227	218	389
Raw materials	268	270	236
Total inventories	$ 33,921	$ 31,733	$ 28,490

5. Impairment of Long-Lived Assets

When the Company determines that the carrying value of long lived assets, such as property and equipment, may not be recoverable based upon the existence of one or more factors, and the carrying value exceeds the estimated undiscounted cash flows expected to be generated by the asset, impairment is measured based on a projected discounted cash flow method using a discount rate determined by management. These cash flows are calculated by netting future estimated sales against associated merchandise costs and other related expenses such as payroll, occupancy and marketing. The impairment loss calculations require management to apply judgment in estimating future cash flows and the discount rates that reflect the risk inherent in future cash flows.

Future expected cash flows for retail store assets are based on management’s estimates of future cash flows over the remaining lease period or expected life, if shorter. The Company considers historical trends, expected future business trends and other factors when estimating each store’s future cash flow. The Company also considers factors such as: the local environment for each store location, including mall traffic and competition; the ability to successfully implement strategic initiatives; and the ability to control variable costs such as cost of goods sold and payroll, and in some cases, renegotiate lease costs. If actual results are not consistent with the assumptions and judgments used in estimating future cash flows and asset fair values, there may be additional exposure to future impairment losses that could be material to the results of operations. There was no impairment charge recorded related to the retail stores during both the three months ended March 31, 2018 and 2017.

6. Intangible Assets and Goodwill

Intangible assets are recorded at cost, less accumulated amortization. Amortization of intangible assets with finite lives is provided for over their estimated useful lives on a straight-line basis. The life of the trade names are indefinite. Intangible assets as of March 31, 2018 consisted of the following (in thousands):

	Amortization Period	Gross Amount	Accumulated Amortization	Net Amount

Trade names	Indefinite	$ 66,286	$ —	$ 66,286
Customer relationships	7 to 15 Years	35,200	12,385	22,815
Non-compete agreements	3 Years	142	81	61
Total		$ 101,628	$ 12,466	$ 89,162

Intangible assets as of December 31, 2017 consisted of the following (in thousands):

	Amortization Period	Gross Amount	Accumulated Amortization	Net Amount
Trade names	Indefinite	$ 65,812	$ —	$ 65,812
Customer relationships	7 to 15 Years	35,081	11,629	23,452
Non-compete agreements	3 Years	133	65	68
Total		$ 101,026	$ 11,694	$ 89,332

Intangible assets as of March 31, 2017 consisted of the following (in thousands):

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	Amortization Period	Gross Amount	Accumulated Amortization	Net Amount
Trade names	Indefinite	$ 65,519	$ —	$ 65,519
Customer relationships	7 to 15 Years	35,007	9,424	25,583
Non-compete agreements	3 Years	128	31	97
Total		$ 100,654	$ 9,455	$ 91,199

Amortization expense related to the intangible assets amounted to approximately $0.8 million and $0.7 million for the three months ended March 31, 2018 and 2017, respectively.

As of March 31, 2018, the future amortization expense related to the finite-lived intangible assets is as follows (in thousands):