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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 December 28, 2013  
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 1-15583

**DELTA APPAREL, INC.**

(Exact name of registrant as specified in its charter)

**GEORGIA**

(State or Other Jurisdiction of  
Incorporation or Organization)

**322 South Main Street  
Greenville, SC**

(Address of principal executive offices)

**58-2508794**

(I.R.S. Employer  
Identification No.)

**29601**

(Zip Code)

**(864) 232-5200**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 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 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 the definitions of a "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company

(Do not check if a smaller reporting  
company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of January 24, 2014, there were outstanding 7,901,848 shares of the registrant's common stock, par value of \$0.01 per share, which is the only class of outstanding common or voting stock of the registrant.

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**PART 1. FINANCIAL INFORMATION**  
**Item 1. Financial Statements**

**Delta Apparel, Inc. and Subsidiaries**  
**Condensed Consolidated Balance Sheets**  
(Amounts in thousands, except share amounts and per share data)  
(Unaudited)

	December 28, 2013	September 28, 2013
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 288	\$ 829
Accounts receivable, less allowances of \$2,908 and \$2,958 respectively	49,792	68,707
Income tax receivable	3,042	1,232
Inventories, net	174,198	165,190
Prepaid expenses and other current assets	4,600	3,786
Deferred income taxes	5,670	5,981
Total current assets	237,590	245,725
Property, plant and equipment, net	42,795	40,600
Goodwill	36,729	36,729
Intangibles, net	24,497	24,837
Other assets	3,784	3,871
Total assets	\$ 345,395	\$ 351,762
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 47,923	\$ 52,877
Accrued expenses	17,068	17,463
Current portion of long-term debt	14,504	3,704
Total current liabilities	79,495	74,044
Long-term debt, less current maturities	118,340	131,030
Deferred income taxes	4,628	3,610
Other liabilities	1,592	806
Contingent consideration	3,400	3,400
Total liabilities	\$ 207,455	\$ 212,890
Shareholders' equity:		
Preferred stock—\$0.01 par value, 2,000,000 shares authorized, none issued and outstanding	—	—
Common stock—\$0.01 par value, 15,000,000 shares authorized, 9,646,972 shares issued, and 7,901,848 and 7,873,848 shares outstanding as of December 28, 2013 and September 28, 2013, respectively	96	96
Additional paid-in capital	59,682	59,428
Retained earnings	98,982	100,579
Accumulated other comprehensive loss	(472)	(557)
Treasury stock—1,745,124 and 1,773,124 shares as of December 28, 2013 and September 28, 2013, respectively	(20,348)	(20,674)
Total shareholders' equity	137,940	138,872
Total liabilities and shareholders' equity	\$ 345,395	\$ 351,762

See accompanying Notes to Condensed Consolidated Financial Statements.

**Delta Apparel, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Operations**  
(Amounts in thousands, except per share data)  
(Unaudited)

	Three Months Ended	
	December 28, 2013	December 29, 2012
Net sales	\$ 100,012	\$ 106,750
Cost of goods sold	80,970	83,995
Gross profit	19,042	22,755
Selling, general and administrative expenses	19,843	21,875
Other (income) expense, net	(127)	34
Operating (loss) income	(674)	846
Interest expense, net	1,458	887
Loss before benefit from income taxes	(2,132)	(41)
Benefit from income taxes	(535)	(87)
Net (loss) earnings	\$ (1,597)	\$ 46
Basic (loss) earnings per share	\$ (0.20)	\$ 0.01
Diluted (loss) earnings per share	\$ (0.20)	\$ 0.01
Weighted average number of shares outstanding	7,884	8,302
Dilutive effect of stock options and awards	—	311
Weighted average number of shares assuming dilution	7,884	8,613

See accompanying Notes to Condensed Consolidated Financial Statements.

**Delta Apparel, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Comprehensive (Loss) Income**  
(Amounts in thousands)  
(Unaudited)

	<b>Three Months Ended</b>	
	<b>December 28, 2013</b>	<b>December 29, 2012</b>
Net (loss) earnings	\$ (1,597)	\$ 46
Net unrealized gain on cash flow hedges	85	25
Comprehensive (loss) income	<u>\$ (1,512)</u>	<u>\$ 71</u>

See accompanying Notes to Condensed Consolidated Financial Statements.

**Delta Apparel, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Cash Flows**  
(Amounts in thousands)  
(Unaudited)

	Three Months Ended	
	December 28, 2013	December 29, 2012
<b>Operating activities:</b>		
Net (loss) earnings from continuing operations	\$ (1,597)	\$ 46
<b>Adjustments to reconcile earnings to net cash provided by operating activities:</b>		
Depreciation and amortization	2,244	2,026
Amortization of deferred financing fees	88	90
Excess tax benefits from exercise of stock options	(18)	(21)
Provision for (benefit from) deferred income taxes	1,329	(13)
Non-cash stock compensation	247	(212)
(Gain) loss on disposal or impairment of property and equipment	(86)	10
Release of cash held in escrow	3,000	—
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	18,916	12,546
Inventories	(9,008)	(6,545)
Prepaid expenses and other assets	(816)	(1,052)
Accounts payable	(4,954)	16
Accrued expenses	(395)	(4,336)
Income tax receivable	(1,792)	(1,561)
Other liabilities	871	(10)
Net cash provided by operating activities	<u>8,029</u>	<u>984</u>
<b>Investing activities:</b>		
Purchases of property and equipment, net	(4,014)	(2,163)
Net cash used in investing activities	<u>(4,014)</u>	<u>(2,163)</u>
<b>Financing activities:</b>		
Proceeds from long-term debt	132,994	123,667
Repayment of long-term debt	(137,884)	(121,364)
Repurchase of common stock	—	(2,014)
Proceeds from exercise of stock options	316	—
Payment of withholding taxes on exercise of stock options	—	(31)
Excess tax benefits from exercise of stock options	18	21
Net cash (used in) provided by financing activities	<u>(4,556)</u>	<u>279</u>
Net decrease in cash and cash equivalents	<u>(541)</u>	<u>(900)</u>
Cash and cash equivalents at beginning of period	829	1,840
Cash and cash equivalents at end of period	<u>\$ 288</u>	<u>\$ 940</u>
<b>Supplemental cash flow information:</b>		
Cash paid during the period for interest	\$ 1,095	\$ 790
Cash paid during the period for income taxes, net of refunds received	\$ 56	\$ 1,502

See accompanying Notes to Condensed Consolidated Financial Statements.

**Delta Apparel, Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**Note A—Basis of Presentation and Description of Business**

On August 26, 2013, our Board of Directors determined that the Company's fiscal year will begin on the Sunday closest to September 30th of each year and end on the Saturday closest to September 30th of each year. The change is intended to better align our planning, financial and reporting functions with the seasonality of our business.

We prepared the accompanying interim condensed consolidated financial statements in accordance with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles ("U.S. GAAP") for complete financial statements. We believe these Condensed Consolidated Financial Statements consist of normal recurring adjustments considered necessary for a fair presentation. Operating results for the three months ended December 28, 2013, are not necessarily indicative of the results that may be expected for our fiscal year ending September 27, 2014. Although our various product lines are sold on a year-round basis, the demand for specific products or styles reflects some seasonality, with sales in our June fiscal quarter generally being the highest and sales in our December quarter generally being the lowest. For more information regarding our results of operations and financial position, refer to the Consolidated Financial Statements and footnotes included in our Form 10-K for our fiscal year ended June 29, 2013, filed with the United States Securities and Exchange Commission ("SEC").

"Delta Apparel", the "Company", and "we", "us" and "our" are used interchangeably to refer to Delta Apparel, Inc. together with our domestic wholly-owned subsidiaries, including M.J. Soffe, LLC ("Soffe"), Junkfood Clothing Company ("Junkfood"), To The Game, LLC ("To The Game"), Art Gun, LLC ("Art Gun"), and other international subsidiaries, as appropriate to the context.

Delta Apparel, Inc. is an international apparel design, marketing, manufacturing and sourcing company that features a diverse portfolio of lifestyle basic and branded activewear apparel and headwear. We specialize in selling casual and athletic products through a variety of distribution channels and distribution tiers including specialty stores, boutiques, department stores, mid and mass channels, college bookstores and the U.S. military. Our products are made available direct-to-consumer on our websites at [www.soffe.com](http://www.soffe.com), [www.junkfoodclothing.com](http://www.junkfoodclothing.com), [www.saltlife.com](http://www.saltlife.com) and [www.deltaapparel.com](http://www.deltaapparel.com). We design and internally manufacture the majority of our products, which allows us to offer a high degree of consistency and quality control as well as leverage scale efficiencies. We have manufacturing operations located in the United States, El Salvador, Honduras and Mexico, and use domestic and foreign contractors as additional sources of production. Our distribution facilities are strategically located throughout the United States to better serve our customers with same-day shipping on our catalog products and weekly replenishments to retailers.

We were incorporated in Georgia in 1999 and our headquarters is located at 322 South Main Street, Greenville, South Carolina 29601 (telephone number: 864-232-5200). Our common stock trades on the NYSE MKT under the symbol "DLA". We operate on a 52-53 week fiscal year ending on the Saturday closest to September 30.

**Note B—Accounting Policies**

Our accounting policies are consistent with those described in our Significant Accounting Policies in our Form 10-K for the fiscal year ended June 29, 2013, filed with the SEC.

**Note C—New Accounting Standards**

Recently Adopted Standards

In July 2012, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2012-02, *Intangibles - Goodwill and Other (Topic 350), Testing Indefinite-Lived Intangible Assets for Impairment*, ("ASU 2012-02"). This new guidance adds an optional qualitative assessment for determining whether an indefinite-lived intangible asset is impaired. Companies have the option to first perform a qualitative assessment to determine whether it is more likely than not (likelihood of more than 50%) that an indefinite-lived intangible is impaired. If a company determines that it is more likely than not that the fair value of such an asset exceeds its carrying amount, it would not need to calculate whether the fair value of such an asset exceeds its carrying amount and it would not need to calculate the fair value of the asset in that year. The company must, however, make a positive assertion about the conclusion and the circumstances taken into account to reach that conclusion. However, if the company determines otherwise, it must calculate the fair value of the asset and compare that value with its carrying amount. If the carrying amount of the company's intangible asset exceeds its fair value, the company must record an impairment charge for the amount of that excess, if any. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. ASU 2012-02 was adopted on June 30, 2013, and the adoption had no impact on our financial statements.

In February 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220), Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* ("ASU 2013-02"). This guidance requires companies to report information about reclassifications out of accumulated other comprehensive income in one place. These reclassifications must be presented by component.

If these items are significant and are reclassified in their entirety in the period, companies must report the effect of the reclassifications on the respective line items in the statement where net income is presented. If the items are not reclassified in their entirety to net income in the period, companies must cross-reference in a note. ASU 2013-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. ASU 2013-02 was adopted on June 30, 2013, and the adoption had no impact on our financial statements.

In July 2013, the FASB issued ASU No. 2013-10, *Derivatives and Hedging (Topic 815), Inclusion of the Fed Funds Effective Swap Rate as a Benchmark Interest Rate for Hedge Accounting Purposes* ("ASU 2013-10"). This guidance allows an entity to now designate the Federal Funds Effective Swap Rate, (the Overnight Index Swap rate, or OIS rate, in the United States) as a benchmark interest rate for hedge accounting purposes in addition to the interest rate on direct Treasury obligations of the United States government and the London Interbank Offered Rate ("LIBOR"). The FASB also eliminated the restriction on designating different benchmark interest rate hedges for similar hedges. ASU 2013-10 is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 2013. ASU 2013-10 was adopted on June 30, 2013, and the adoption had no impact on our financial statements.

#### Standards Not Yet Adopted

In July 2013, the FASB issued ASU No. 2013-11, *Income Taxes (Topic 740), Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, ("ASU 2013-11"). This new guidance requires entities to present unrecognized tax benefits as a decrease in a net operating loss, similar tax loss or tax credit carryforward if certain criteria are met. The determination of whether a deferred tax asset is available is based on the unrecognized tax benefit and the deferred tax asset that exists as of the reporting date and presumes disallowance of the tax position at the reporting date. This amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2013. ASU 2013-11 is therefore effective for our fiscal year beginning September 28, 2014.

#### **Note D—Salt Life Acquisition**

On August 27, 2013, To The Game purchased substantially all of the assets of Salt Life Holdings, LLC, including all of its domestic and international trademark rights in the Salt Life brand (the "Salt Life Acquisition"). The purchase price for the Salt Life Acquisition consisted of: (i) a cash payment at closing of \$12,000,000, (ii) a deposit at closing of \$3,000,000 into an escrow account to be held to secure indemnification obligations under the asset purchase agreement and to be held for a period of up to fifty-four months following the closing, and (iii) delivery of two promissory notes in the aggregate principal amount of \$22,000,000. An additional amount may be payable in cash after the end of calendar year 2019 if financial performance targets involving the sale of Salt Life-branded products are met during the 2019 calendar year. At December 28, 2013, we had \$3.4 million accrued in contingent consideration associated with the Salt Life Acquisition. We financed the cash portion of the purchase price through our Fourth Amended and Restated Loan and Security Agreement, as amended on August 27, 2013. We expensed all acquisition related costs in the selling, general and administrative expense line item of our Condensed Consolidated Statements of Operations in the quarter ended September 28, 2013.

On December 6, 2013, we entered into an agreement (the "IMG Agreement") with IMG Worldwide, Inc. ("IMG") that provides for the termination of the Salt Life brand license agreements entered into between Delta and IMG (as agent on behalf of Salt Life Holdings) prior to the Salt Life Acquisition as well as the agency agreement entered into between Salt Life Holdings and IMG prior to the Salt Life Acquisition. In addition, the IMG Agreement provides that Delta and Salt Life Holdings are released from all obligations and liabilities under those agreements or relating to the Salt Life Acquisition. Pursuant to the IMG Agreement, To The Game and IMG entered into a new, multi-year agency agreement whereby IMG will represent To The Game with respect to the licensing of the Salt Life brand in connection with certain product and service categories. To The Game agreed to pay IMG installments totaling \$3,500,000 and will utilize the above-referenced \$3,000,000, which was released from escrow during the quarter ended December 28, 2013, toward these payment obligations, along with additional amounts it previously accrued for royalty obligations under the above-referenced Salt Life brand license agreements. The payment terms require To The Game to pay IMG \$1.55 million by December 31, 2013, as well as ten quarterly installments of \$195 thousand beginning on March 15, 2014. We recorded the fair value of the liability on our financials with \$2.3 million in accrued expenses and \$0.8 million in other liabilities.

The Salt Life Acquisition continues our strategy of building lifestyle brands that take advantage of our creative capabilities, vertical manufacturing platform and international sourcing competencies. Prior to the Salt Life Acquisition, To The Game sold Salt Life-branded products under exclusive license agreements which began in January 2011. As such, the results of Salt Life sales have been included in the Condensed Consolidated Financial Statements since that time.

We accounted for the Salt Life Acquisition pursuant to ASC 805, *Business Combinations*, with purchase price allocated based upon fair value. We have identified certain intangible assets associated with Salt Life, including trade name and trademarks, license agreements, non-compete agreements and goodwill. The total amount of goodwill is expected to be deductible for tax purposes. Components of the intangible assets recorded at acquisition are as follows:

		<b>Economic Life</b>
Goodwill	\$ 19,917	N/A
<b>Intangibles:</b>		
Tradename/trademarks	16,000	30 yrs
License agreements	2,100	15 – 30 yrs
Non-compete agreements	770	6.6 yrs
Total intangibles	<u>18,870</u>	
Total goodwill and intangibles	<u>\$ 38,787</u>	

We are currently in the process of finalizing the valuations and thus the initial allocation of the purchase price is subject to change until the allocation is finalized.

**Note E—Inventories**

Inventories, net of reserves of \$6.6 million as of December 28, 2013, and \$6.9 million as of September 28, 2013, consist of the following (in thousands):

	<b>December 28, 2013</b>	<b>September 28, 2013</b>
Raw materials	\$ 10,993	\$ 11,917
Work in process	14,429	15,121
Finished goods	148,776	138,152
	<u>\$ 174,198</u>	<u>\$ 165,190</u>

Raw materials include finished yarn and direct materials for the basics segment and include direct embellishment materials and undecorated garments and headwear for the branded segment. We regularly review inventory quantities on hand and record reserves for obsolescence, excess quantities, irregulars and slow-moving inventory based on historical selling prices, current market conditions, and forecasted product demand, to reduce inventory to its net realizable value.

**Note F—Debt**

On May 27, 2011, Delta Apparel, Soffe, Junkfood, To The Game and Art Gun entered into a Fourth Amended and Restated Loan and Security Agreement (the "Loan Agreement") with the financial institutions named in the Loan Agreement as Lenders, Wells Fargo Bank, National Association, as Administrative Agent, Bank of America, N.A., as Syndication Agent, Wells Fargo Capital Finance, LLC, as Sole Lead Arranger, and Wells Fargo Capital Finance, LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Joint Bookrunners.

On August 27, 2013, Delta Apparel, To The Game, Junkfood, Soffe and Art Gun entered into a Consent and First Amendment to the Fourth Amended and Restated Loan and Security Agreement with Wells Fargo Bank, National Association and the other lenders set forth therein (the "Amended Loan Agreement"). Pursuant to the Amended Loan Agreement, in general and among other things, (1) the lenders and agent parties consented to the Salt Life Acquisition, (2) the maturity of the loans (other than the below referenced first in last out Tranche B ("FILO Tranche B")) under the Amended Loan Agreement was extended one year to May 27, 2017, (3) the lenders consented to Delta Apparel's Honduran subsidiaries borrowing up to an additional \$10,000,000 from a certain Honduran bank in connection with the purchase of certain equipment, and (4) the FILO Tranche B was added to provide Delta Apparel and its affiliate parties to the Amended Loan Agreement an additional 5% borrowing availability with respect to eligible accounts receivable and eligible inventory. The FILO Tranche B, and only the FILO Tranche B, will terminate by August 27, 2015 (subject to earlier cancellation by Delta Apparel), has a maximum borrowing availability of \$10,000,000, and includes interest rates between 150 and 200 basis points higher than the rates applicable to the other loans available under the Amended Loan Agreement.

Pursuant to the Amended Loan Agreement, our line of credit is \$145 million (subject to borrowing base limitations). Provided that no event of default exists, we have the option to increase the maximum credit available under the facility to \$200 million (subject to borrowing base limitations), conditioned upon the Administrative Agent's ability to secure additional commitments and customary closing conditions.

At December 28, 2013, we had \$98.0 million outstanding under our U.S. credit facility at an average interest rate of 2.5%, and had the ability to borrow an additional \$26.7 million. Our credit facility includes a financial covenant requiring that if the amount of availability falls below an amount equal to 12.5% of the lesser of the borrowing base or \$145 million, our Fixed Charge Coverage Ratio ("FCCR") (as defined in the Amended Loan Agreement) for the preceding 12 month period must not be less than 1.1 to 1.0. As availability was

above the minimum, we were not subject to the FCCR covenant at December 28, 2013. At December 28, 2013, and September 28, 2013, there was \$9.1 million and \$9.9 million, respectively, of retained earnings free of restrictions to make cash dividends or stock repurchases.

The Amended Loan Agreement contains a subjective acceleration clause and a “springing” lockbox arrangement (as defined in FASB Codification No. 470, *Debt* (“ASC 470”)), whereby remittances from customers will be forwarded to our general bank account and will not reduce the outstanding debt until and unless a specified event or an event of default occurs. Pursuant to ASC 470, we classify borrowings under the Amended Loan Agreement as long-term debt.

In conjunction with the Salt Life Acquisition, we issued two promissory notes in the aggregate principal of \$22 million and committed to a payment contingent on certain performance targets being met with respect to the sale of Salt Life products in calendar 2019. The promissory notes are zero-interest notes and state that interest will be imputed as required under Section 1274 of the Internal Revenue Code. We have imputed interest at 1.92% and 3.62% on the promissory notes that mature on June 30, 2016 and June 30, 2019, respectively. At December 28, 2013, the discounted value of the promissory notes was \$20.6 million.

In March 2011, we extinguished our existing debt with Banco Ficohsa, a Honduran bank, and entered into a new credit facility with it. The credit facility is secured by a first-priority lien on the assets of our Honduran operations and the loan is not guaranteed by the U.S. entity. The installment portion of the agreement carries a fixed interest rate of 7% for a term of seven years and is denominated in U.S. dollars. As of December 28, 2013, we had \$4.1 million outstanding on the installment portion of this loan. The revolving credit portion of the loan has a 7% fixed interest rate with an ongoing 18-month term (expiring March 2019) and is denominated in U.S. dollars. The revolving credit facility requires minimum payments during each 6-month period of the 18-month term; however, the agreement permits additional drawdowns to the extent payments are made, if certain objective covenants are met. The current revolving Honduran debt, by its nature, is not long-term, as it requires scheduled payments each six months. However, as the agreement permits us to re-borrow funds up to the amount repaid, subject to certain objective covenants, and we intend to re-borrow funds, subject to the objective covenants, the amounts have been classified as long-term debt. As of December 28, 2013, we had \$4.6 million outstanding under the revolving portion of the credit facility.

In October 2013, we entered into two new term loan agreements with Banco Ficohsa to finance our Honduran expansion project. These also are not guaranteed by the U.S. entity and are secured by a first-priority lien on the assets of our Honduran operations. The first loan, an eighteen month agreement for \$1.8 million with a 7% fixed interest rate, is denominated in U.S. dollars, and has ratable monthly principal and interest payments due through the end of the term. As of December 28, 2013, we had \$1.5 million outstanding on this loan agreement. The second loan, a seven year agreement for \$4.2 million with a 7% fixed interest rate, is denominated in U.S. dollars, and has ratable monthly principal and interest payments due through the end of the term. As of December 28, 2013, we had \$4.2 million outstanding on this loan agreement. The carrying value of these term loans approximates the fair value.

#### **Note G—Selling, General and Administrative Expense**

We include in selling, general and administrative (“SG&A”) expenses costs incurred subsequent to the receipt of finished goods at our distribution facilities, such as the cost of stocking, warehousing, picking and packing, and shipping goods for delivery to our customers. Distribution costs included in SG&A expenses totaled \$3.9 million and \$4.2 million for the three months ended December 28, 2013, and December 29, 2012, respectively. In addition, SG&A expenses include costs related to sales associates, administrative personnel cost, advertising and marketing expenses, royalty payments on licensed products and other general and administrative expenses.

#### **Note H—Stock-Based Compensation**

On November 11, 2010, the Delta Apparel, Inc. shareholders approved the Delta Apparel, Inc. 2010 Stock Plan (“2010 Stock Plan”). Upon shareholder approval of the 2010 Stock Plan, no additional awards have been or will be granted under either the Delta Apparel Stock Option Plan (“Option Plan”) or the Delta Apparel Incentive Stock Award Plan (“Award Plan”); instead, all stock awards have and will be granted under the 2010 Stock Plan. The aggregate number of shares of common stock that may be delivered under the 2010 Stock Plan is 500,000 plus any shares of common stock subject to outstanding awards under the Option Plan or Award Plan that are subsequently forfeited or terminated for any reason before being exercised. We expense stock compensation costs in the cost of sales and SG&A expense line items of our Condensed Consolidated Statements of Operations over the vesting periods of each grant. Total stock-based compensation for the three months ending December 28, 2013 was \$0.5 million. For the three months ended December 29, 2012, we reduced stock based compensation expense by \$0.3 million in connection with our outstanding awards due to adjustments to the expected vesting of the performance units and estimated forfeiture rate.

##### 2010 Stock Plan

As of December 28, 2013, there was \$1.2 million of total unrecognized compensation cost related to non-vested awards granted under the 2010 Stock Plan. This cost is expected to be recognized over a period of 1.7 years. No awards were granted under the 2010 Stock Plan during the quarter ended December 28, 2013.

### Option Plan

All options granted under the Option Plan have vested. As such, no expense was recognized during the period or the prior year quarter. During the quarter ended December 28, 2013, vested options representing 28,000 shares of our common stock were exercised, and the shares issued, in accordance with their respective agreements.

### Award Plan

All awards granted under the Award Plan have vested and been exercised, and no awards remain outstanding.

### **Note I—Purchase Contracts**

We have entered into agreements, and have fixed prices, to purchase yarn, natural gas, finished fabric, and finished apparel and headwear products. At December 28, 2013, minimum payments under these contracts were as follows (in thousands):

Yarn	\$	3,866
Natural Gas		800
Finished fabric		793
Finished products		22,020
	\$	<u>27,479</u>

### **Note J—Business Segments**

We operate our business in two distinct segments: branded and basics. Although the two segments are similar in their production processes and regulatory environments, they are distinct in their economic characteristics, products and distribution methods.

The branded segment is comprised of our business units focused on specialized apparel garments and headwear to meet consumer preferences and fashion trends, and includes Soffe, Junkfood, To The Game and Art Gun. These branded embellished and unembellished products are sold through specialty and boutique shops, upscale and traditional department stores, mid-tier retailers, sporting goods stores, college bookstores and the U.S. military. Products in this segment are marketed under our lifestyle brands of Soffe®, Intensity Athletics®, Junk Food®, The Game®, American Threads by The Game, and Salt Life®, as well as other labels.

The basics segment is comprised of our business units primarily focused on garment styles that are characterized by low fashion risk, and includes our Delta Activewear undecorated catalog tees and private label products. We market, distribute and manufacture unembellished knit apparel under the main brands of Delta Pro Weight® and Delta Magnum Weight® for sale to a diversified audience ranging from large licensed screen printers to small independent businesses. We also manufacture private label products for major branded sportswear companies, retailers, corporate industry programs, and sports licensed apparel marketers. Typically these products are sold with value-added services such as embellishment, hangtags, ticketing, and hangers so that they are fully ready for retail.

Robert W. Humphreys, our chief operating decision maker, and management evaluate performance and allocate resources based on profit or loss from operations before interest, income taxes and special charges (“segment operating earnings (loss)”). Our segment operating earnings (loss) may not be comparable to similarly titled measures used by other companies. Intercompany transfers between operating segments are transacted at cost and have been eliminated within the segment amounts shown in the following table.

Information about our operations as of and for the three months ended December 28, 2013, and December 29, 2012, by operating segment, is as follows (in thousands):

	<u>Basics</u>	<u>Branded</u>	<u>Consolidated</u>
<b>Three months ended December 28, 2013</b>			
Net sales	\$ 58,578	\$ 41,434	\$ 100,012
Segment operating earnings (loss)	2,447	(3,121)	(674)
Segment assets *	163,084	182,311	345,395
<b>Three months ended December 29, 2012</b>			
Net sales	\$ 58,802	\$ 47,948	\$ 106,750
Segment operating earnings (loss)	3,641	(2,795)	846
Segment assets *	164,992	144,947	309,939

\* All goodwill and intangibles on our balance sheet are included in the branded segment.

The following reconciles the segment operating (loss) earnings to the Company's consolidated loss before benefit from income taxes before income taxes (in thousands):

	Three Months Ended	
	December 28, 2013	December 29, 2012
Segment operating (loss) earnings	\$ (674)	\$ 846
Unallocated interest expense	1,458	887
Consolidated loss before benefit from income taxes	<u>\$ (2,132)</u>	<u>\$ (41)</u>

#### Note K—Income Taxes

Our effective income tax rate for the three months ended December 28, 2013 was 25.1%, compared to an effective rate of 212.2% for the same period in the prior year and an effective rate of 7.3% for the fiscal year ended June 29, 2013. The effective tax rate for the quarter ended December 29, 2012, resulted from a reduction in the annualized effective tax rate expected for the 2013 fiscal year combined with a pre-tax loss during the quarter. We benefit from having income in foreign jurisdictions that are either exempt from income taxes or have tax rates lower than the United States.

Based on our current projected pre-tax income and the anticipated amount of U.S. taxable income compared to profits maintained in the offshore taxable and tax-free jurisdictions, our estimated effective income tax rate for the fiscal year ending September 27, 2014, should be approximately 24% to 25%; however, changes in the mix of U.S. taxable income compared to profits maintained in tax-free jurisdictions can have a significant impact on our overall effective tax rate.

We file income tax returns in the U.S. federal jurisdiction and various state, local and foreign jurisdictions. In the second quarter of fiscal year 2013, the Internal Revenue Service commenced an examination of our U.S. income tax returns for our fiscal year 2010 (tax year 2009). Upon filing the carryback of our net operating losses from fiscal year 2012 to our fiscal years 2011 and 2010 (tax years 2011 and 2010) and receiving a cash refund of the taxes previously paid, the Internal Revenue Service expanded the examination to include our U.S. income tax returns for our 2011 and 2012 fiscal years. This examination was concluded in January 2014, and no tax deficiency was found. Based on the conclusion of the audit, these returns are no longer subject to further examination by the Internal Revenue Service. However, net operating loss carryforwards remain subject to examination to the extent they are carried forward and impact a year that is open to examination by taxing authorities. The tax years 2009 to 2012, according to statute and with few exceptions, remain open to examination by various state, local and foreign jurisdictions.

#### Note L—Derivatives and Fair Value Measurements

From time to time, we may use interest rate swaps or other instruments to manage our interest rate exposure and reduce the impact of future interest rate changes. These financial instruments are not used for trading or speculative purposes.

	Effective Date	Notational Amount	Fixed LIBOR Rate	Maturity Date
Interest Rate Swap	September 9, 2013	\$15 million	1.1700%	September 9, 2016
Interest Rate Swap	September 9, 2013	\$15 million	1.6480%	September 11, 2017
Interest Rate Swap	September 19, 2013	\$15 million	1.0030%	September 19, 2016
Interest Rate Swap	September 19, 2013	\$15 million	1.4490%	September 19, 2017
Interest Rate Swap	September 1, 2011	\$10 million	1.0700%	September 1, 2014
Interest Rate Swap	September 1, 2011	\$10 million	0.9025%	March 1, 2014

FASB Codification No. 820, *Fair Value Measurements and Disclosures* (“ASC 820”), defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Assets and liabilities measured at fair value are grouped in three levels. The levels prioritize the inputs used to measure the fair value of the assets or liabilities. These levels are:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 – Inputs other than quoted prices that are observable for assets and liabilities, either directly or indirectly. These inputs include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are less active.
- Level 3 – Unobservable inputs that are supported by little or no market activity for assets or liabilities and includes certain pricing models, discounted cash flow methodologies and similar techniques.

The following financial liabilities are measured at fair value on a recurring basis (in thousands):

Period Ended	Total	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Interest Rate Swaps</b>				
December 28, 2013	\$ 767	—	\$ 767	—
September 28, 2013	\$ 906	—	\$ 906	—
<b>Contingent Consideration</b>				
December 28, 2013	\$ 3,400	—	—	\$ 3,400
September 28, 2013	\$ 3,400	—	—	\$ 3,400

The fair value of the interest rate swap agreements were derived from discounted cash flow analysis based on the terms of the contract and the forward interest rate curves adjusted for our credit risk, which fall in Level 2 of the fair value hierarchy.

The Salt Life Acquisition included contingent consideration payable in cash after the end of calendar year 2019 if financial performance targets involving the sale of Salt Life-branded products are met during the 2019 calendar year. We used the historical results and projected cash flows based on the contractually defined terms, discounted as necessary, to estimate the fair value of the contingent consideration for Salt Life, as well as to remeasure the contingent consideration related to the acquisition of Art Gun. Accordingly, the fair value measurement for contingent consideration falls in Level 3 of the fair value hierarchy.

The following table summarizes the fair value and presentation in the Condensed Consolidated Balance Sheets for derivatives as of December 28, 2013, and June 29, 2013.

	December 28, 2013	September 28, 2013
Accrued expenses	\$ 67	\$ 100
Deferred tax liabilities	(295)	(349)
Other liabilities	700	806
Accumulated other comprehensive loss	\$ 472	\$ 557

Assets Measured at Fair Value on a Non-Recurring Basis

Intangible assets acquired in connection with the Salt Life Acquisition are identified by type in Note D—Salt Life Acquisition and have been valued on a preliminary basis. These preliminary valuations included significant unobservable inputs (Level 3).

**Note M—Legal Proceedings**

Consumer Product Safety Commission

We previously received an inquiry from the U.S. Consumer Product Safety Commission (“Commission”) regarding a children’s drawstring hoodie product sourced, distributed and sold by Junkfood and its compliance with applicable product safety standards. The Commission subsequently investigated the matter, including whether Junkfood complied with the reporting requirements of the Consumer Product Safety Act (“CPSA”), and the garments in question were ultimately recalled. On or about July 25, 2012, Junkfood received notification from the Commission staff alleging that Junkfood knowingly violated CPSA Section 15(b) and that it will recommend to the Commission a \$900,000 civil penalty. We contend that the Commission’s allegations are without merit.

On August 27, 2012, Junkfood responded to the Commission staff regarding its recommended penalty, setting forth a number of defenses and mitigating factors that could result in a much lower penalty, if any, ultimately imposed by a court should the matter proceed to litigation. On March 27, 2013, and on several subsequent occasions, the Commission requested additional information from Junkfood regarding the matter. While we will continue to defend against these allegations, we believe a risk of loss is probable. Based upon the terms of previously published CPSC settlements and related product recall notices, we believe if we settle the matter the minimum settlement amount would be \$25,000. Should the Commission seek enforcement of the recommended civil penalty and ultimately prevail on its claims at trial, we could be required to pay amounts exceeding \$900,000, along with interest and the Commission’s costs and fees. During the quarter ended June 30, 2012, we recorded a liability for the most likely outcome within this range, and this liability remains recorded as of December 28, 2013.

### California Wage and Hour Litigation

We were served with a complaint in the Superior Court of the State of California, County of Los Angeles, on or about March 13, 2013, by a former employee of our Activewear business unit at our Santa Fe Springs, California distribution facility alleging violations of California wage and hour laws and unfair business practices with respect to meal and rest periods, compensation and wage statements, and related claims (the "Complaint"). The Complaint is brought as a class action and seeks to include all of our Activewear business unit's current and certain former employees within California who are or were non-exempt under applicable wage and hour laws. The Complaint also names as defendants Junkfood, Soffe, an independent contractor of Soffe, and a former employee, and seeks to include all current and certain former employees of Junkfood, Soffe and the Soffe independent contractor within California who are or were non-exempt under applicable wage and hour laws. The Complaint seeks injunctive and declaratory relief, monetary damages and compensation, penalties, attorneys' fees and costs, and pre-judgment interest. The discovery process in this matter is ongoing and the issue of class certification remains pending.

While we will continue to vigorously defend this action and believe we have a number of meritorious defenses to the claims alleged, we believe a risk of loss is probable. Based upon current information, we believe there is a range of likely outcomes between approximately \$15,000 and \$975,000. During the transition period ended September 28, 2013, we recorded a liability for the most likely outcome within this range. However, depending upon the scope and size of any certified class and whether any of the claims alleged are ultimately prevailed upon at trial, we could be required to pay amounts exceeding \$975,000.

In addition, at times we are party to various legal claims, actions and complaints. We believe that, as a result of legal defenses, insurance arrangements, and indemnification provisions with parties believed to be financially capable, such actions should not have a material effect on our operations, financial condition, or liquidity.

### **Note N—Repurchase of Common Stock**

As of June 29, 2013, our Board of Directors had authorized management to use up to \$30.0 million to repurchase Delta Apparel stock in open market transactions under our Stock Repurchase Program.

We did not purchase any shares during the quarter ended December 28, 2013. During the prior year quarter, we purchased 139,797 shares of our common stock for a total cost of \$2.0 million. As of December 28, 2013, we have purchased 2,043,571 shares of our common stock for an aggregate of \$24.1 million since the inception of the Stock Repurchase Program. All purchases were made at the discretion of management and pursuant to the safe harbor provisions of SEC Rule 10b-18. As of December 28, 2013, \$5.9 million remained available for future purchases under our Stock Repurchase Program, which does not have an expiration date.

### **Note O—License Agreements**

We have entered into license agreements that provide for royalty payments of net sales of licensed products as set forth in the agreements. These license agreements are within our branded segment. We have incurred royalty expense (included in SG&A expenses) of approximately \$2.4 million for the quarter ended December 28, 2013, and \$3.7 million for the prior year quarter.

At December 28, 2013, based on minimum sales requirements, future minimum royalty payments required under these license agreements were as follows (in thousands):

<b>Fiscal Year</b>	<b>Amount</b>
2014	\$ 955
2015	721
2016	195
2017	21
	<u>\$ 1,892</u>

**Note P—Goodwill and Intangible Assets**

Components of intangible assets consist of the following (in thousands):

	December 28, 2013			September 28, 2013			Economic Life
	Cost	Accumulated Amortization	Net Value	Cost	Accumulated Amortization	Net Value	
Goodwill	\$ 36,729	\$ —	\$ 36,729	\$ 36,729	\$ —	\$ 36,729	N/A
<b>Intangibles:</b>							
Tradename/trademarks	\$ 17,530	\$ (824)	\$ 16,706	\$ 17,530	\$ (672)	\$ 16,858	20 – 30 yrs
Customer relationships	7,220	(3,027)	4,193	7,220	(2,937)	4,283	20 yrs
Technology	1,220	(490)	730	1,220	(459)	761	10 yrs
License agreements	2,100	(36)	2,064	2,100	(10)	2,090	15 – 30 yrs
Non-compete agreements	1,287	(483)	804	1,287	(442)	845	4 – 8.5 yrs
Total intangibles	\$ 29,357	\$ (4,860)	\$ 24,497	\$ 29,357	\$ (4,520)	\$ 24,837	

Amortization expense for intangible assets was \$0.3 million for the three months ended December 28, 2013, and \$0.1 million for the three months ended December 29, 2012. Amortization expense is estimated to be approximately \$1.4 million each for fiscal years 2014 and 2015 and \$1.3 million for fiscal years 2016, 2017 and 2018.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**Cautionary Note Regarding Forward Looking Statements

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by or on behalf of the Company. We may from time to time make written or oral statements that are “forward-looking,” including statements contained in this report and other filings with the SEC in our press releases, in oral statements, and in other reports to our shareholders. All statements, other than statements of historical fact, which address activities, events or developments that we expect or anticipate will or may occur in the future are forward-looking statements. The words “estimate”, “project”, “forecast”, “anticipate”, “expect”, “intend”, “believe” and similar expressions, and discussions of strategy or intentions, are intended to identify forward-looking statements.

The forward-looking statements in this Form 10-Q are based on our expectations and are necessarily dependent upon assumptions, estimates and data that we believe are reasonable and accurate but may be incorrect, incomplete or imprecise. Forward-looking statements are also subject to a number of business risks and uncertainties, any of which could cause actual results to differ materially from those set forth in or implied by the forward-looking statements. The risks and uncertainties include, among others:

- the volatility and uncertainty of cotton and other raw material prices;
- the general U.S. and international economic conditions;
- deterioration in the financial condition of our customers and suppliers and changes in the operations and strategies of our customers and suppliers;
- the competitive conditions in the apparel and textile industries;
- our ability to predict or react to changing consumer preferences or trends;
- pricing pressures and the implementation of cost reduction strategies;
- changes in the economic, political and social stability of our offshore locations;
- our ability to retain key management;
- the effect of unseasonable weather conditions on purchases of our products;
- significant changes in our effective tax rate;
- any restrictions on our ability to borrow capital or service our indebtedness;
- interest rate fluctuations increasing our obligations under our variable rate indebtedness;
- the ability to raise additional capital;
- the ability to grow, achieve synergies and realize the expected profitability of recent acquisitions;
- the volatility and uncertainty of energy and fuel prices;
- any material disruptions in our information systems related to our business operations;

- any data security or privacy breaches;
- any significant interruptions within our distribution network;
- changes in or our ability to comply with safety, health and environmental regulations;
- any significant litigation in either domestic or international jurisdictions;
- the ability to protect our trademarks and other intellectual property;
- the ability to obtain and renew our significant license agreements;
- the impairment of acquired intangible assets;
- changes in e-commerce laws and regulations;
- changes to international trade regulations;
- changes in employment laws or regulations or our relationship with our employees;
- cost increases and reduction in future profitability due to recent healthcare legislation;
- foreign currency exchange rate fluctuations;
- violations of manufacturing or employee safety standards, labor laws, or unethical business practices by our suppliers and independent contractors;
- the illiquidity of our shares;
- price volatility in our shares and the general volatility of the stock market; and
- the costs required to comply with the regulatory landscape regarding public company governance and disclosure.

A detailed discussion of significant risk factors that have the potential to cause actual results to differ materially from our expectations is described under the subheading "Risk Factors" in our Form 10-K for our fiscal year ended June 29, 2013, filed with the SEC. Any forward-looking statements in this Form 10-Q do not purport to be predictions of future events or circumstances and may not be realized. Any forward-looking statements are made only as of the date of this Form 10-Q and we do not undertake publicly to update or revise the forward-looking statements even if it becomes clear that any projected results will not be realized.

The risks described in our Form 10-K for our fiscal year ended June 29, 2013, and in this Form 10-Q are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition, and/or operating results.

#### Business Outlook

Due to the seasonality of our business, the December quarter is historically our weakest revenue quarter. This was true for our most recent December quarter, and was exaggerated somewhat by other internal and external factors. Net sales for the quarter were weaker than we targeted at \$100.0 million, down from \$106.8 million in the prior year quarter. The lower sales, coupled with higher costs associated with operational initiatives that were completed during the quarter, produced a net loss of \$1.6 million, or \$0.20 loss per diluted share, during the quarter. This compares to net income of \$46 thousand, or \$0.01 earnings per diluted share, in the prior year quarter. Although our first quarter results did not meet our goals, we did make progress during the quarter on our strategic objectives that should grow sales and earnings over time.

Net sales in our basics segment were \$58.6 million in the first quarter, a slight decrease from \$58.8 million in the prior year period. Demand for undecorated tees, which was weak in the September quarter, continued to be soft through most of the quarter, but we did see some strengthening in demand in December. While the late upswing is encouraging, it is too early to determine the trend that demand will take as we move into our traditionally strong spring selling season. Sales of catalog tees were bolstered by new offerings of decorated, full package programs using catalog blanks, which have gained traction and nearly doubled from a year ago. We are able to provide these offerings using our fully integrated basics ERP platform that we completed in fiscal year 2013. The ERP conversion, intended to streamline the operation and reduce general and administrative costs, is working well for the business and we are seeing the benefit in our cost structure. Healthy demand for our private label products helped to offset the 5% decline in catalog tees.

During our first quarter, we completed our manufacturing expansion, which we expect will increase production levels, reduce costs and provide us with a new revenue opportunity through the sale of incremental products. We also completed the modernization of our Fayetteville screen printing operations. This provides us with improved printing technology and increases our capacity. Although both of these initiatives should serve to lower our costs going forward, the start up expenses associated with them unfavorably impacted our results by about \$0.02 per share in the December quarter.

Sales in the branded segment declined 13.6% to 41.4 million in the quarter ended December 28, 2013. Soffe sales declined by 16% from the prior year quarter, but were stronger than we expected. Soffe products will be back on the shelves at certain mid-tier retailers for spring 2014. We have received positive feedback from retailers and focus groups on our new spring 2014 line and we are encouraged by retailer forecasts. We believe Soffe will produce positive operating profits for the upcoming quarters and end fiscal 2014 with a profit.

The Game business, excluding Salt Life, experienced a 15% net sales decline during the December quarter from lower college bookstore sales. This weakness was primarily due to product replenishment challenges stemming from the closing of the Wendell decoration facility

in the September quarter. We are now in the process of rebuilding that revenue as we gain new bookstore programs for the upcoming selling season. Preparation for the new back-to-school offerings are already underway and should be able to provide improved levels of service for the upcoming season. We have already won several new college bookstore programs for the upcoming season, which we should see in our results in our fourth fiscal quarter. The sales decline in college apparel was partially offset by double-digit sales growth in The Game's branded headwear and private-label corporate headwear programs.

Junkfood sales were down 27% in the December quarter compared to last year, primarily due to a shift in timing of shipments. In addition, general weakness at department stores unfavorably impacted re-orders and "chase" business during the holiday season. However, they do have several new test programs that performed well and are being expanded for the spring and summer seasons. Junkfood has initiated new programs with specialty and other retailers by offering its creative and merchandising capabilities. The retailers then source the product themselves and pay Junkfood a royalty based on the designs. Junkfood continues to expand its international presence driven primarily by programs that we have developed for The Gap. In calendar year 2013, international sales made up approximately 16% of Junkfood's revenue, and we see continued opportunities for international growth.

Art Gun reached nearly \$4.0 million in revenue during the December quarter, a 52% increase over the prior year period, shipping more than 200,000 uniquely printed shirts in November and December alone. While Art Gun is still a small piece of our business, demand for direct to garment printing is growing which should allow Art Gun to become more significant in both sales and profit over time.

Our newest acquisition, Salt Life, had a 30% increase in net sales, driven by door growth, product expansion and increased consumer demand. Salt Life products are now on the shelves in over 2,200 retail doors across the United States, a 35% growth in doors from calendar year 2012. We anticipate a strong continuation of Salt Life's growth based on the orders shipping in January and orders already booked for the remainder of the quarter. The Salt Life Acquisition continues our strategy of building lifestyle brands that take advantage of our creative capabilities, vertical manufacturing platform and international sourcing competencies. We are increasing our consumer marketing spend for Salt Life this spring. This will include more in-store build-outs in both department stores and independent retailers, advertisements in key magazines, sponsorships of events, and other marketing strategies.

While we have many reasons to be optimistic, it is only prudent to balance our optimism against potential risks that may put additional pressure on our results for fiscal year 2014. The most significant risk relates to the potential impact of cotton costs. Cotton prices are volatile and have been on the rise over the last several weeks, increasing by over \$0.10 per pound. Further adding to the increase in cotton cost is the basis, which is the cost to actually obtain the cotton, which has also been steadily increasing due to concerns about the supply of cotton in the U.S. It is still too early to know if selling prices will reflect these higher raw material costs or what the potential impact on unit volumes may be.

For the last several quarters, demand for undecorated tees has been soft, leading to price discounting to drive unit sales. While it is encouraging that since mid-December, the market seems to have picked up; it is too early to determine the trend that demand will take as we move into our traditionally strong spring selling season.

While we have good projections from retailers of their expectations for orders of our branded products, the retail environment remains unsettled and the potential level of consumer spending for apparel is undetermined. We feel this creates a higher than normal risk to the sales and profitability in our branded business units.

We are committed to key strategic initiatives that include maintaining a cost effective and flexible manufacturing platform, growing our branded apparel business organically and through strategic acquisitions, and focusing on those markets that show the best promise for profitable growth. We believe we have excellent brands and products that consumers desire. This, coupled with high customer satisfaction and increasingly efficient operation, should result in long-term growth and profitability for Delta Apparel.

## **EARNINGS GUIDANCE**

While we believe the opportunity remains for us to achieve our original goals if certain growth catalysts prove positive and market risks become inconsequential or are successfully mitigated, we remain cautious until the extent of such risks can be better determined. Much of the uncertainty and speculation regarding consumer spending trends should be clarified as spring products reach retail shelves and the selling season begins. As such, we expect to be in a better position when we report our results for the quarter ending March 29, 2014, to either confirm or update our previously issued guidance of revenue in the \$500 to \$510 million range and earnings in the range of \$2.00 to \$2.10 per diluted share issued for the fiscal year ending September 27, 2014.

## **Results of Operations**

Net sales for the first quarter of fiscal year 2014 were \$100.0 million compared to the prior year quarter net sales of \$106.8 million. We had a net loss for the quarter of \$1.6 million, or \$0.20 per diluted share, compared with net earnings of \$46 thousand or \$0.01 per diluted share, in the prior year quarter.

Sales within the branded segment were \$41.4 million compared with \$47.9 million for the quarter ended December 29, 2012. The decline resulted from lower sales of Soffe, Junk Food and The Game branded products. Soffe sales declined by 16% from the prior year quarter but were slightly better than expected. Junkfood sales were down 27% from the prior year December quarter as retailers placed larger

orders for professional sports products that shipped in the September quarter this year but in the prior year shipped in the December quarter. Our college bookstore apparel line, which was consolidated within The Game business during the September quarter, experienced sales declines during the December quarter due to product replenishment challenges stemming from the previously announced closing of the Wendell decoration facility. Salt Life continued its strong revenue growth, with a 30% sales increase over the prior year quarter. Art Gun also continued its consistent growth, with revenue increasing more than 50% during the December quarter compared to the prior year period.

Net sales in our basics segment were \$58.6 million in the first quarter, a slight decrease from \$58.8 million in the prior year period. A healthy demand for private label products was offset by a sales decline in undecorated catalog tees. Sales of catalog tees were, however, bolstered by the new offerings of decorated, full package programs using catalog blanks, which have gained traction and nearly doubled from a year ago.

SG&A expenses were \$19.8 million, or 19.8% of sales, for the first quarter 2014, compared to \$21.9 million, or 20.5% of sales, for the same period last year. This lower SG&A costs as a percentage of sales was primarily due to a lower mix of branded sales compared to basics sales. Partially offsetting the decline were higher legal defense costs incurred in connection with ongoing litigation matters, which increased SG&A as a percentage of sales by 20 basis points.

Our effective income tax rate for the three months ended December 28, 2013, was 25.1%, compared to an effective tax benefit of 212.2% for the same period last year. The effective tax rate for the quarter ended December 29, 2012, resulted from a reduction in the annualized effective tax rate expected for the 2013 fiscal year combined with a pre-tax loss during the quarter. We benefit from having income in foreign jurisdictions that are either exempt from income taxes or have tax rates lower than the United States.

At December 28, 2013, account receivables were \$49.8 million, compared to \$56.8 million in the prior year December. Days sales outstanding decreased to 49 days as of December 28, 2013, compared to 50 days in the prior year December.

Inventory levels increased \$5.8 million to \$174.2 million at December 28, 2013, compared to \$168.4 million at December 29, 2012. This increase is due to softer than expected sales in the December quarter.

Capital expenditures were \$4.0 million during the first quarter 2014. These expenditures primarily related to our manufacturing expansion as well as information technology system enhancements. Depreciation and amortization, including non-cash compensation, was \$2.5 million for the quarter.

Total debt at December 28, 2013, was \$132.8 million compared to \$104.9 million a year ago. The increase is primarily due to the Salt Life Acquisition. Current debt increased from same quarter last year. This increase is primarily related to the seller note from the Salt Life Acquisition, which has \$9.0 million due on September 30, 2014.

#### Liquidity and Capital Resources

Our primary cash needs are for working capital and capital expenditures, as well as to fund share repurchases under our stock repurchase program. In addition, we may use cash in the future to pay dividends.

##### *Operating Cash Flows*

Operating activities provided \$8.0 million in cash for the first three months of fiscal year 2014, compared to \$1.0 million of cash provided by operating activities in the same period last year. The increase in operating cash flow compared to the prior year period resulted primarily from changes in working capital and the release of funds that were held in escrow associated with the Salt Life acquisition. There was also more cash collected this year from our accounts receivable than prior year that was partially offset by a larger investment in inventories than prior year.

##### *Investing Cash Flows*

Capital expenditures during the first quarter 2014 were \$4.0 million compared to \$2.2 million for the same period last year. These capital expenditures were primarily related to the expansion of our textile operations, along with investments in our information technology systems. We anticipate our fiscal year 2014 capital expenditures to be approximately \$15.0 million. Capital improvements are expected to primarily include additional expenditures associated with the expansion in both of our international and U.S. facilities, information technology projects and branding and point-of-sale displays for our branded products.

##### *Financing Activities*

During the first three months of 2014 cash used for financing activities was \$4.6 million compared to \$0.3 million provided by financing the same period last year. The cash used for our financing activities during the first quarter of 2014 was used primarily for the repayment of debt.

We believe that the cash flow generated by our operations and funds available under our credit facilities should be sufficient to service our debt payment requirements, satisfy our foreseeable working capital needs, and fund our planned capital expenditures and share repurchases. Any material deterioration in our results of operations, however, may result in our inability to borrow and to issue letters

of credit to suppliers under our revolving credit facility, or may cause the borrowing availability under our facility to be insufficient for our needs.

#### Purchases By Delta Apparel Of Its Own Shares

During the three months ended December 28, 2013, we did not purchase any shares of our common stock (see Note N-Repurchase of Common Stock). As of December 28, 2013, we had \$5.9 million of our share repurchase authorization remaining. We evaluate current leverage, working capital requirements, the free cash flow outlook, stock valuation and future business opportunities for capital to determine when we believe the repurchase of our stock is a sound investment opportunity that we can pursue without sacrificing future growth plans.

#### Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our Condensed Consolidated Financial Statements, which were prepared in accordance with U.S. GAAP. The preparation of our Condensed Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We base our estimates and judgments on historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The most significant estimates and assumptions relate to revenue recognition, accounts receivable and related reserves, inventory and related reserves, the carrying value of goodwill, and the accounting for income taxes.

A detailed discussion of critical accounting policies is contained in the Significant Accounting Policies included in Note 2 to the Audited Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended June 29, 2013, and there have been no changes in those policies since the filing of that Form 10-K with the SEC.

#### Environmental and Regulatory Matters

We are subject to various federal, state and local environmental laws and regulations concerning, among other things, wastewater discharges, storm water flows, air emissions and solid waste disposal. Our plants generate very small quantities of hazardous waste, which are either recycled or disposed of off-site. Most of our plants are required to possess one or more environmental permits, and we believe that we are currently in compliance with the requirements of those permits.

The environmental rules applicable to our business are becoming increasingly stringent and we incur capital and other expenditures annually to achieve compliance with environmental standards. We currently do not expect that the amount of expenditures required to comply with environmental laws will have a material adverse affect on our operations, financial condition or liquidity. There can be no assurance, however, that future changes in federal, state, or local regulations, interpretations of existing regulations or the discovery of currently unknown problems or conditions will not require substantial additional expenditures. Similarly, while we believe that we are currently in compliance with all applicable environmental requirements, the extent of our liability, if any, for past failures to comply with laws, regulations or permits applicable to our operations cannot be determined and could have a material adverse effect on our operations, financial condition and liquidity.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

#### Commodity Risk Sensitivity

We have a supply agreement with Parkdale Mills, Inc. and Parkdale America, LLC (collectively "Parkdale") to supply our yarn requirements until December 31, 2015. Under the supply agreement, we purchase from Parkdale all of our yarn requirements for use in our manufacturing operations, excluding yarns that Parkdale does not manufacture or cannot manufacture due to temporary capacity constraints. The purchase price of yarn is based upon the cost of cotton plus a fixed conversion cost. Thus, we are subject to the commodity risk of cotton prices and cotton price movements, which could result in unfavorable yarn pricing for us. We fix the cotton prices as a component of the purchase price of yarn, pursuant to the supply agreement, in advance of the shipment of finished yarn from Parkdale. Prices are set according to prevailing prices, as reported by the New York Cotton Exchange, at the time we elect to fix specific cotton prices.

Yarn with respect to which we have fixed cotton prices at December 28, 2013, was valued at \$3.9 million, and is scheduled for delivery between January 2014 and March 2014. At December 28, 2013, a 10% decline in the market price of the cotton covered by our fixed price yarn would have had a negative impact of approximately \$0.3 million on the value of the yarn. This compares to what would have been a negative impact of \$1.1 million at the 2013 fiscal year end based on the yarn with fixed cotton prices at June 29, 2013. The impact of a 10% decline in the market price of the cotton covered by our fixed price yarn would have been less at December 28, 2013, than at June 29, 2013, due to reduced commitments and lower average cost per pound fixed at December 28, 2013, compared to June 29, 2013.

We may use derivatives, including cotton option contracts, to manage our exposure to movements in commodity prices. We do not designate our options as hedge instruments upon inception. Accordingly, we mark to market changes in the fair market value of the options in cost of goods sold in our Condensed Consolidated Statement of Operations.

If Parkdale's operations are disrupted and it is not able to provide us with our yarn requirements, we may need to obtain yarn from alternative sources. Although alternative sources are presently available, we may not be able to enter into short-term arrangements with substitute suppliers on terms as favorable as our current terms with Parkdale. In addition, the cotton futures we have fixed with Parkdale may not be transferable to alternative yarn suppliers. Because there can be no assurance that we would be able to pass along the higher cost of yarn to our customers, this could have a material adverse effect on our results of operations.

#### Interest Rate Sensitivity

Our U.S. revolving credit facility provides that the outstanding amounts owed shall bear interest at variable rates. If the amount of outstanding floating rate indebtedness at December 28, 2013, under the U.S. revolving credit facility had been outstanding during the entire three months ended December 28, 2013, and the interest rate on this outstanding indebtedness was increased by 100 basis points, our expense would have increased by approximately \$45 thousand, or 3.1% of actual interest expense, during the quarter. This compares to an increase of \$0.6 million, or 14.7%, for the 2013 fiscal year based on the outstanding floating rate indebtedness at June 29, 2013. The dollar amount, as well as the percentage, of actual interest expense is lower as of December 28, 2013, primarily due to the swap agreements that were entered into during the quarter ended September 28, 2013. The actual increase in interest expense resulting from a change in interest rates would depend on the magnitude of the increase in rates and the average principal balance of floating rate indebtedness.

#### *Derivatives*

From time to time, we may use interest rate swaps or other instruments to manage our interest rate exposure and reduce the impact of future interest rate changes as described in Note L—Derivatives and Fair Value Measurements.

### **Item 4. Controls and Procedures**

#### Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to reasonably assure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the United States Securities and Exchange Commission's requirements. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information that we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of December 28, 2013, and, based on their evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures were effective at the evaluation date.

#### Changes in Internal Control Over Financial Reporting

There was no change during the first quarter of fiscal year 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

See Note M—Legal Proceedings in Item 1, which is incorporated herein by reference.

### **Item 1A. Risk Factors**

As of December 28, 2013, there have been no material changes to the risk factors set forth in our Form 10-K for our fiscal year ended June 29, 2013.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

#### **(c) Repurchases of Common Stock**

See Note N—Repurchase of Common Stock and Note F—Debt, in Item 1, which are incorporated herein by reference.

**Item 6. Exhibits**

Exhibits

- 31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase
- 101.DEF XBRL Taxonomy Extension Definition Linkbase
- 101.LAB XBRL Taxonomy Extension Label Linkbase
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase

**SIGNATURES**

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

DELTA APPAREL, INC.  
(Registrant)

Date February 5, 2014

By: /s/ Deborah H. Merrill

Deborah H. Merrill  
Vice President, Chief Financial  
Officer and Treasurer

**EXHIBIT 31.1**

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO RULE 13a-14(a) OF THE  
SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, AS ADOPTED PURSUANT TO SECTION 302 OF THE  
SARBANES-OXLEY ACT OF 2002**

I, Robert W. Humphreys, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Delta Apparel, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 5, 2014

/s/ Robert W. Humphreys

Chairman and Chief Executive Officer

**EXHIBIT 31.2**

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO RULE 13a-14(a) OF THE  
SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, AS ADOPTED PURSUANT TO SECTION 302 OF THE  
SARBANES-OXLEY ACT OF 2002**

I, Deborah H. Merrill, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Delta Apparel, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 5, 2014

/s/ Deborah H. Merrill

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Vice President, Chief Financial  
Officer and Treasurer

**EXHIBIT 32.1**

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS  
ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

For purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Robert W. Humphreys, the Chief Executive Officer of Delta Apparel, Inc. (the "Company"), hereby certifies that to the best of his knowledge:

1. The Quarterly Report on Form 10-Q for the quarterly period ended December 28, 2013, of the Company, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 5, 2014

/s/ Robert W. Humphreys

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Robert W. Humphreys

Chairman and Chief Executive Officer

This certification is being furnished solely to comply with the provisions of § 906 of the Sarbanes-Oxley Act of 2002 and is not being filed as part of the accompanying Report, including for purposes of Section 18 of the Exchange Act, or as a separate disclosure document. A signed original of this written certification required by Section 906, or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written certification required by Section 906, has been provided to the Company and will be rendered by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**EXHIBIT 32.2**

**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS  
ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

For purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Deborah H. Merrill, the Chief Financial Officer of Delta Apparel, Inc. (the "Company"), hereby certifies that to the best of her knowledge:

1. The Quarterly Report on Form 10-Q for the quarterly period ended December 28, 2013, of the Company, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 5, 2014

/s/ Deborah H. Merrill

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Deborah H. Merrill  
Vice President, Chief Financial Officer  
and Treasurer

This certification is being furnished solely to comply with the provisions of § 906 of the Sarbanes-Oxley Act of 2002 and is not being filed as part of the accompanying Report, including for purposes of Section 18 of the Exchange Act, or as a separate disclosure document. A signed original of this written certification required by Section 906, or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written certification required by Section 906, has been provided to the Company and will be rendered by the Company and furnished to the Securities and Exchange Commission or its staff upon request.