DELTA APPAREL, INC
Form 10-Q
February 05, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended December 29, 2012

OR

o 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	58-2508794
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
322 South Main Street	
Greenville, SC	29601
(Address of principal executive offices)	(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 þ No o

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 þ No o

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

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

As of January 25, 2013, there were outstanding 8,167,810 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 29, 2012	June 30, 2012
Assets		
Current assets:		
Cash and cash equivalents	$940	$467
Accounts receivable, less allowances of $1,845 and $2,312 respectively	56,751	73,856
Income tax receivable	8,852	8,796
Inventories, net	168,357	161,633
Prepaid expenses and other current assets	4,994	3,770
Deferred income taxes	3,500	4,964
Total current assets	243,394	253,486
Property, plant and equipment, net	39,549	39,425
Goodwill	16,812	16,812
Intangibles, net	6,493	6,797
Other assets	3,691	3,874
Total assets	$309,939	$320,394
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$44,913	$46,320
Accrued expenses	17,062	16,608
Current portion of long-term debt	3,529	3,529
Total current liabilities	65,504	66,457
Long-term debt, less current maturities	101,351	110,949
Deferred income taxes	3,128	3,803
Other liabilities	190	218
Total liabilities	$170,173	$181,427
Commitments and contingencies	—	—
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 8,227,593 and 8,424,709 shares outstanding as of December 29, 2012 and June 30, 2012, respectively	96	96
Additional paid-in capital	60,444	60,367
Retained earnings	94,437	90,830
Accumulated other comprehensive loss	(134)	(129)
Treasury stock —1,419,379 and 1,222,263 shares as of December 29, 2012 and June 30, 2012, respectively	(15,077)	(12,197)
Total shareholders' equity	139,766	138,967

Total liabilities and shareholders' equity	$309,939	$320,394

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended		Six Months Ended	
	December 29, 2012	December 31, 2011	December 29, 2012	December 31, 2011
Net sales	$106,750	$ 105,486	$236,864	$ 229,009
Cost of goods sold	83,995	105,345	182,256	197,613
Gross profit	22,755	141	54,608	31,396
Selling, general and administrative expenses	21,875	20,182	47,736	44,744
Other expense (income), net	34	(52)	190	(59)
Operating income (loss)	846	(19,989)	6,682	(13,289)
Interest expense, net	887	992	1,963	1,885
(Loss) earnings before (benefit) provision for income taxes	(41)	(20,981)	4,719	(15,174)
(Benefit) provision for income taxes	(87)	(7,389)	1,109	(5,996)
Net earnings (loss)	$46	$ (13,592)	$3,610	$ (9,178)
Basic earnings (loss) per share	$0.01	$ (1.61)	$0.43	$ (1.09)
Diluted earnings (loss) per share	$0.01	$ (1.61)	$0.42	$ (1.09)
Weighted average number of shares outstanding	8,302	8,465	8,350	8,458
Dilutive effect of stock options and awards	311	—	282	—
Weighted average number of shares assuming dilution	8,613	8,465	8,632	8,458

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ending		Six Months Ending	
	December 29, 2012	December 31, 2011	December 29, 2012	December 31, 2011
Net earnings (loss)	$46	$ (13,592)	$3,610	$ (9,178)
Other comprehensive income (loss)	25	53	(5)	(67)
Comprehensive income (loss)	$71	$ (13,539)	$3,605	$ (9,245)

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Six Months Ended	
	December 29, 2012	December 31, 2011
Operating activities:		
Earnings (loss) from continuing operations	$3,610	$ (9,178)
Adjustments to reconcile earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,971	3,642
Amortization of deferred financing fees	180	180
Excess tax benefits from exercise of stock options	(21)	(529)
Provision for deferred income taxes	789	(1,173)
Non-cash stock compensation	244	1,043
Loss on disposal of property and equipment	59	45
Inventory write down	—	16,195
Changes in operating assets and liabilities:		
Accounts receivable	17,105	25,432
Inventories	(6,726)	(39,904)
Prepaid expenses and other current assets	(1,223)	(811)
Other non-current assets	4	124
Accounts payable	(1,407)	(9,046)
Accrued expenses	453	(8,073)
Income taxes	(35)	(7,176)
Other liabilities	(33)	61
Net cash provided by (used in) operating activities	16,970	(29,168)
Investing activities:		
Purchases of property and equipment, net	(3,850)	(3,054)
Net cash used in investing activities	(3,850)	(3,054)
Financing activities:		
Proceeds from long-term debt	248,580	302,878
Repayment of long-term debt	(258,178)	(269,143)
Repurchase of common stock	(3,039)	(2,289)
Proceeds from stock options	(31)	(54)
Excess tax benefits from exercise of stock options	21	529
Net cash (used in) provided by financing activities	(12,647)	31,921
Net increase (decrease) in cash and cash equivalents	473	(301)
Cash and cash equivalents at beginning of year	467	656
Cash and cash equivalents at end of year	$940	$ 355
Supplemental cash flow information:		
Cash paid during the year for interest	$1,799	$ 929
Cash paid during the year for income taxes, net of refunds received	$352	$ 2,308

See accompanying Notes to Condensed Consolidated Financial Statements.

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

Note A—Basis of Presentation and Description of 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 ("US GAAP") for complete financial statements. We believe these condensed consolidated financial statements reflect all adjustments (consisting of only normal recurring accruals) considered necessary for a fair presentation. Operating results for the six months ended December 29, 2012, are not necessarily indicative of the results that may be expected for our fiscal year ending June 29, 2013. 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 fourth fiscal quarter generally being the highest and sales in our second fiscal 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 30, 2012, 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 w 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 branded activewear and headwear, and produces high-quality private label programs. We specialize in selling casual and athletic products through a variety of distribution channels. Our products are sold across distribution tiers and in most store types, including specialty stores, boutiques, department stores, and mid and mass channels. We also have niche distribution at college bookstores and the U.S. military. Our products are made available direct-to-consumer on our websites at www.soffe.com, www.junkfoodclothing.com, www.saltlife.com and www.deltaapparel.com. Additional products can be viewed at www.2thegame.com and www.thecottonexchange.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 June 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 30, 2012, filed with the United States Securities and Exchange Commission.

Note C—New Accounting Standards
Recently Adopted Standards
In June 2011, the Financial Accounting Standards Board ("FASB"), issued Accounting Standards Update ("ASU") No. 2011-05, Comprehensive Income (Topic 220) - Presentation of Comprehensive Income ("ASU 2011-05"). This new guidance gives companies two choices on how to present items of net income, items of other comprehensive income and total comprehensive income: companies can create one continuous statement of comprehensive income or two separate consecutive statements. Other comprehensive income is no longer allowed to be presented solely in the statement of stockholders' equity. Earnings per share continues to be based on net income. ASU 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and applied on a

retrospective basis. ASU 2011-05 was adopted on July 1, 2012, and the Condensed Consolidated Statements of Comprehensive Income herein comply with this guidance.
In December 2011, the FASB issued No. ASU 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 ("ASU 2011-12"). ASU 2011-12 indefinitely defers the new provisions under ASU 2011-05, which required entities to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented for both interim and annual financial statements. ASU 2011-12 is effective for the years beginning after December 15, 2011. ASU 2011-12 was adopted on July 1, 2012, and the Condensed Consolidated Statements of Comprehensive Income comply with this guidance.

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In September 2011, the FASB issued ASU No. 2011-08, Intangibles - Goodwill and Other (Topic 350), Testing Goodwill for Impairment ("ASU 2011-08"). FASB decided to simplify how companies are required to test goodwill for impairment. Companies now have the option to first assess qualitative factors to determine whether it is more likely than not (likelihood of more than 50%) that the fair value of a reporting unit is less than its carrying amount. If after considering the totality of events and circumstances a company determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it will not have to perform the two-step impairment test. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. ASU 2011-08 was adopted on July 1, 2012, and the adoption had no impact on our financial statements.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS ("ASU 2011-04"). The new guidance results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and International Financial Reporting Standards. Additional disclosure requirements in ASU 2011-04 include: (a) for Level 3 fair value measurements, quantitative information about unobservable inputs used, a description of the valuation processes used, and a qualitative discussion about the sensitivity of the measurements to changes in the unobservable inputs; (b) for the use of a nonfinancial asset that is different from the asset's highest and best use, the reason for the difference; (c) for financial instruments not measured at fair value but for which disclosure of fair value is required, the fair value hierarchy level in which the fair value measurements were determined; and (d) the disclosure of all transfers between Level 1 and Level 2 of the fair value hierarchy. ASU 2011-04 is effective for interim periods beginning after December 15, 2011, and applied on a prospective basis. ASU 2011-04 was adopted on January 1, 2012, and did not have a material effect on our financial statements.

Standards Not Yet Adopted

In July 2012, FASB issued 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, 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 2011-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. ASU 2012-02 is therefore effective for our fiscal year ending June 28, 2014.

Note D—Inventories

Inventories, net of reserves, consist of the following (in thousands):

	December 29, 2012	June 30, 2012
Raw materials	$11,629	$11,759
Work in process	16,520	18,986
Finished goods	140,208	130,888
	$168,357	$161,633

Raw materials include finished yarn and direct materials for the basics segment and include direct embellishment materials for the branded segment as well as undecorated garments and headwear for the Junkfood and To The Game business units. 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 E—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 “Amended Loan Agreement”) with the financial institutions named in the Amended 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.

Pursuant to the Amended Loan Agreement, the line of credit is $145 million (subject to borrowing base limitations), and matures on May 26, 2016. 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.

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At December 29, 2012, we had $94.9 million outstanding under our U.S. credit facility at an average interest rate of 2.3%, and had the ability to borrow an additional $29.3 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 29, 2012. At December 29, 2012 and June 30, 2012, there was $13.6 million and $14.8 million, respectively, of retained earnings free of restrictions to make cash dividends or stock repurchases.

The credit facility 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 facility as long-term debt.

In March 2011, we extinguished our existing debt with Banco Ficohsa, a Honduran bank, and entered into a new credit facility with them. As of December 29, 2012, we had $5.0 million outstanding on the installment portion of this loan and $5.0 million outstanding under the revolving portion of the agreement. The new 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 criteria, the amounts have been classified as long-term debt.

Note F—Selling, General and Administrative Expense

We include in selling, general and administrative 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 selling, general and administrative expenses totaled $4.2 million and $3.8 million for the second quarter of fiscal years 2013 and 2012, respectively. Distribution costs included in selling, general and administrative expenses totaled $8.5 million and $7.6 million for the first six months of fiscal years 2013 and 2012, respectively. In addition, selling, general and administrative 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. We expensed a one-time charge of $1.2 million in the fiscal 2013 first quarter for legal and professional fees related to the Audit Committee internal investigation that was completed during the first quarter.

Note G—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 selling, general and administrative expense line items of our Consolidated Statements of Operations over the vesting periods of each grant.

2010 Stock Plan

During the second quarter of fiscal year 2013, we reduced 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. The Board of Directors previously granted 96,450 performance-based share units to certain executives. These share awards vest only upon achieving specified return on capital employed (as defined) performance targets over fiscal years 2012 and 2013. During the three months ended December 29, 2012, we determined that the ability to achieve the performance criteria related to these awards is no longer probable. As a result, we reversed $0.4 million of related share-based expense previously recognized and recognized no additional expense related to these awards during the quarter. In

addition, during the second quarter of fiscal 2013, we realized a benefit of $0.1 million from an actual forfeiture experience that was higher than previously estimated on restricted stock units, resulting primarily from an executive's departure from the Company. Accordingly, we increased the estimated forfeiture rate used in recognizing stock-based compensation expense on restricted stock units from a 5% forfeiture rate to a 16.5% forfeiture rate. The impact of these events resulted in a $0.3 million net benefit recorded during the quarter ended December 29, 2012, and $0.2 million of expense recorded during the first six months of fiscal year 2013. During the three and six months ended December 31, 2011, we recognized $0.3 million and $0.8 million, respectively, in expense in connection with outstanding awards made under the 2010 Stock Plan. These amounts were included in selling, general, and administrative expenses in the condensed consolidated statement of operations.

During the first six months of fiscal years 2013 and 2012, we expensed $0.2 million and $0.8 million, respectively, in connection with outstanding awards made under the 2010 Stock Plan. As of December 29, 2012, there was $1.3 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 2.7 years. During the quarter ended December 29, 2012, no stock awards were granted under the 2010 Stock Plan.

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Option Plan

All options granted under the Option Plan have vested. As such, no expense was recognized during the first six months of fiscal year 2013. During the second quarter and first six months of fiscal year 2012, we expensed $43 thousand and $86 thousand, respectively, in connection with the Option Plan. During the quarter ended December 29, 2012, vested options representing 13,334 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. As such, no expense was recognized during the second quarter or first six months of fiscal year 2013. During the second quarter of fiscal year 2012, no expense was recognized. During the first six months of fiscal year 2012 we expensed $0.1 million in connection with the Award Plan.

Note H—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 29, 2012, minimum payments under these contracts were as follows (in thousands):

Yarn	$7,304
Natural Gas	700
Finished fabric	1,473
Finished products	21,370
	$30,847

Note I—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 (which includes The Cotton Exchange as the bookstore division of 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®, The Cotton Exchange®, Junk Food®, and The Game®, licensed brands of Salt Life® and Realtree Outfitters®, 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 Catalog and FunTees businesses. Within the Delta Catalog business, we market, distribute and manufacture unembellished knit apparel under the main brands of Delta Pro Weight® and Delta Magnum Weight®. Delta Catalog products are sold to a diversified audience ranging from large licensed screen printers all the way 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 hangtags, ticketing, hangers, and embellishment so that they are fully ready for retail. The majority of the private label products are sold through the FunTees business.

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 Income”). Our Segment Operating Income 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. We expensed a one-time charge of $1.2 million in the fiscal 2013 first quarter for legal and professional fees related to the previously disclosed Audit Committee internal investigation that was completed during the quarter. This one-time charge is included in the basics segment.

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Information about our operations as of and for the three and six months ended December 29, 2012, and December 31, 2011, by operating segment, is as follows (in thousands):

	Basics	Branded	Consolidated
Three months ended December 29, 2012			
Net sales	$58,802	$47,948	$106,750
Segment operating income (loss)	3,641	(2,795)	846
Segment assets *	164,992	144,947	309,939
Three months ended December 31, 2011			
Net sales	$57,555	$47,931	$105,486
Segment operating loss	(18,692)	(1,297)	(19,989)
Segment assets *	171,336	146,992	318,328

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

	Basics	Branded	Consolidated
Six months ended December 29, 2012			
Net sales	$125,383	$111,481	$236,864
Segment operating income (loss)	6,806	(124)	6,682
Six months ended December 31, 2011			
Net sales	$110,152	$118,857	$229,009
Segment operating (loss) income	(17,106)	3,817	(13,289)

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

	Three Months Ended		Six Month Ended	
	December 29, 2012	December 31, 2011	December 29, 2012	December 31, 2011
Segment operating income (loss)	$846	$(19,989)	$6,682	$(13,289)
Unallocated interest expense	887	992	1,963	1,885
Consolidated (loss) earnings before taxes	$(41)	$(20,981)	$4,719	$(15,174)

Note J—Income Taxes

We had an effective income tax rate of 23.5% for the six months ended December 29, 2012, compared to an effective rate of 39.5% for the same period in the prior year and an effective rate of 76.4% for the fiscal year ended June 30, 2012. The effective tax rate for the fiscal year ended June 30, 2012, was impacted by the operating losses driven by the inventory markdown during that fiscal year, lowering our U.S. taxable income while maintaining profits in the offshore taxable and tax-free jurisdictions. 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 ended June 29, 2013 is 23.5%, a 160 basis point reduction from the expected effective income tax as of September, 29, 2012.

We file income tax returns in the U.S. federal jurisdiction and various state, local and foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state, local or non-U.S. income tax examinations by tax authorities for our tax years before 2008. 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 authorities.

Note K—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.

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	Effective Date	Notational Amount	Fixed LIBOR Rate		Maturity Date
Interest Rate Swap	September 1, 2011	$10 million	0.7650	%	September 1, 2013
Interest Rate Swap	September 1, 2011	$10 million	0.9025	%	March 1, 2014
Interest Rate Swap	September 1, 2011	$10 million	1.0700	%	September 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 market 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):

	Fair Value Measurements Using			
Period Ended	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest Rate Swaps				
December 29, 2012	$217	—	$217	—
June 30, 2012	$209	—	$209	—

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. 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 Art Gun. Accordingly, the fair value measurement for contingent consideration falls in level 3 of the fair value hierarchy. The contingent consideration for Art Gun is remeasured at the end of each reporting period.

The following table summarizes the fair value and presentation in the consolidated balance sheets for derivatives as of December 29, 2012, and June 30, 2012.

	December 29, 2012	June 30, 2012
Accrued expenses	$31	$—
Deferred tax liabilities	(83)	(80)
Other liabilities	186	209
Accumulated other comprehensive loss	$134	$129

Note L—Legal Proceedings

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 our Junkfood division and its compliance with applicable product safety standards. The Commission subsequently investigated the matter, including whether we 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. While we will continue to defend against these allegations, we believe it is probable that a liability has been incurred. 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.

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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 29, 2012.

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 M—The Cotton Exchange Acquisition

On June 11, 2010, we formed a new North Carolina limited liability company, TCX, LLC, as a wholly-owned subsidiary of M.J. Soffe, LLC. Pursuant to an Asset Purchase Agreement dated July 5, 2010, on July 12, 2010, TCX acquired substantially all of the net assets of HPM Apparel, Inc. d/b/a The Cotton Exchange, including accounts receivable, inventory, and fixed assets, and assumed certain liabilities. The total purchase price, which included a post-closing working capital adjustment, was $9.9 million. We finalized the valuation for the assets acquired and liabilities assumed and have determined the final allocation of the purchase price. No goodwill or other intangible assets were recorded in conjunction with the acquisition of The Cotton Exchange. Effective January 1, 2012, TCX was merged into its parent entity, M.J. Soffe, LLC, for reasons of corporate simplification and as such, TCX no longer exists as a separate entity. The Cotton Exchange continues to operate as the bookstore division of Soffe.

Note N—Repurchase of Common Stock

As of June 30, 2012, our Board of Directors had authorized management to use up to $20.0 million to repurchase Delta Apparel stock in open market transactions under our Stock Repurchase Program. On January 23, 2013, the Board of Directors authorized an additional $10.0 million for share repurchases under the Stock Repurchase Program, bringing the aggregate total to $30.0 million. Prior to the Board of Director's action, $2.7 million remained available for future purchases.

During the second quarter of fiscal years 2013 and 2012, we purchased 139,797 shares and 49,948 shares, respectively, of our common stock for a total cost of $2.0 million and $0.9 million, respectively. As of December 29, 2012, we have purchased 1,582,298 shares of common stock for an aggregate of $17.3 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 29, 2012, $2.7 million remained available for future purchases under our Stock Repurchase Program, which does not have an expiration date.

The following table summarizes the purchases of our common stock for the quarter ended December 29, 2012:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Dollar Value of Shares that May Yet Be Purchased Under the Plans *	
September 30 to November 3, 2012	43,753	$14.63	43,753	$4.1	million
November 4 to December 1, 2012	40,807	$14.62	40,807	$3.5	million
December 2 to December 29, 2012	55,237	$14.08	55,237	$2.7	million
Total	139,797	$14.41	139,797	$2.7	million

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 selling, general and administrative expenses) of approximately $3.6 million and $3.3 million for the second quarter of fiscal years 2013 and 2012, respectively. Royalty expense was $8.8 million for the first six months of fiscal year 2013 and fiscal year 2012.

At December 29, 2012, based on minimum sales requirements, future minimum royalty payments required under these license agreements were as follows (in thousands):

Fiscal Year	Amount
2013	$1,307
2014	4,966
2015	2,845
2016	770
	$9,888

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Note P—Goodwill and Intangible Assets

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

	December 29, 2012			June 30, 2012			
	Cost	Accumulated Amortization	Net Value	Cost	Accumulated Amortization	Net Value	Economic Life
Goodwill	$16,812	$ —	$16,812	$16,812	$ —	$16,812	N/A
Intangibles:							
Tradename/trademarks	$1,530	$ (564)	$966	$1,530	$ (526)	$1,004	20 yrs
Customer relationships	7,220	(2,667)	4,553	7,220	(2,486)	4,734	20 yrs
Technology	1,220	(368)	852	1,220	(307)	913	10 yrs
Non-compete agreements	517	(395)	122	517	(371)	146	4 – 8.5 yrs
Total intangibles	$10,487	$ (3,994)	$6,493	$10,487	$ (3,690)	$6,797	

Amortization expense for intangible assets was $0.1 million and $0.3 million for the three months and six months ended December 29, 2012, respectively, and $0.6 million for the fiscal year ended June 30, 2012. Amortization expense is estimated to be approximately $0.6 million each for fiscal years 2013, 2014, 2015, 2016 and 2017.

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, 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 strateg intentions, are intended to identify forward-looking statements.

The forward-looking statements in this 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;
- the financial difficulties encountered by our customers and suppliers and credit risk exposure;
- 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 at 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 to our ability to borrow capital or obtain financing;
- 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 with 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;
- the ability to obtain and renew our significant license agreements;
- the impairment of acquired intangible assets;
- changes in e-commerce laws and regulations;

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- changes to international trade regulations;
- changes in employment regulations;
- foreign currency exchange rate fluctuations;
- any negative publicity regarding domestic or international business practices;
- the illiquidity of our shares and volatility of the stock market;
- 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 ending June 30, 2012, 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 30, 2012, 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

Delta Apparel, Inc. had record revenue for the second quarter and first six months of fiscal year 2013 and was profitable in both periods despite continued weakness in the Soffe business. During this year's second quarter we benefited from solid year-over-year growth in our Delta Catalog, Junkfood, To The Game and Art Gun business. This growth was offset somewhat by continued softness in our Soffe business and lower selling prices within the FunTees and Catalog businesses. Net sales for the second quarter of fiscal year 2013 were $106.8 million, a 1.2% increase over fiscal year 2012 second quarter sales of $105.5 million. Net earnings for second quarter fiscal year 2013 was $46 thousand compared with a loss in second quarter fiscal year 2012 of $13.6 million, or $1.61 per diluted share. As previously reported, net earnings for the fiscal year 2012 second quarter and first half was negatively impacted by a one-time inventory markdown of $16.2 million resulting from record high cotton costs combined with selling price decreases in Delta's line of basic undecorated t-shirts.

For the first six months of fiscal year 2013, sales increased by 3.4% to $236.9 million compared to $229.0 million for the first six months of fiscal year 2012. Net earnings for the first six months of fiscal year 2013 was $3.6 million, or $0.42 per diluted share, compared to a loss of $9.2 million, or $1.09 per share in the prior-year six month period.

Second quarter fiscal year 2013 sales for the basics segment rose to $58.8 million, a 2.2% increase over second quarter fiscal year 2012. This increase resulted from a 13.1% rise in basics segment volume, which was offset by slightly lower average selling prices in both the Delta Catalog and FunTees businesses. The volume increase was primarily due to the addition of new customers in the blank and private-label business. Delta Catalog experienced 15% increase in unit volume which drove 7.8% sales growth. FunTees experienced a net sales decline of 7.3% despite a 6% increase in volume. During the quarter we initiated new print programs using catalog blanks which broadened our customer base, while also allowing us to better utilize our offshore printing capacity. This, along with the success of our lean manufacturing and Six Sigma initiatives, reduced manufacturing costs, driving improved margins for our basics segment.

The branded segment sales for the fiscal 2013 second quarter were $47.9 million, up slightly from the comparable 2012 quarter. Junkfood, To The Game and Art Gun each experienced double-digit net sales growth, which was offset by weakness in the Soffe business. While Soffe's strategic sporting goods business gained new distribution and better product placement, its independent sporting goods business remained slow. Soffe's juniors business with mid-tier department stores also remained slow but new girls and "missy" college programs will be shipping this spring and fall to mid-tier department stores. Junkfood added specialty retail customers and new design-for-fee business, and its professional sports license business continues to grow, largely through e-commerce channels. To The Game maintained good growth, led by Salt Life. The Salt Life brand continues to gain popularity. Our fall 2013 lines

received excellent reactions from buyers at the recent Surf Expo in Orlando, Florida. In addition, we are making progress establishing the Salt Life brand at the grass roots level on the West Coast. To The Game's basic tee products now employ a completely vertical production model extending from textiles through screen printing. This provides a low cost structure and facilitates rapid replenishment of products to our customers. Art Gun grew 83% in the second quarter and has been profitable the first six months of fiscal year 2013. Additional equipment was added to our Art Gun business and they went to a twenty-four hour/seven day operation to support holiday growth and provide quicker shipping to the end consumer, who are located in more than sixty-five countries.

The Soffe business offers one of our main challenges as well as one of our biggest opportunities. The weakness in Soffe stems from the sluggish economy, some of the new strategies that mid-tier national department stores are adopting to cope with changing business conditions, and our poor response to these changing conditions. Soffe is seizing a number of opportunities to leverage customer relationships through new and more creative sales and marketing programs. These programs should coincide with, as well as enhance, the quickly evolving marketing strategies of mid-tier retailers and independent sporting goods operators. We are also addressing Soffe's cost structure to bring it in line with that of our other business units.

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We are moving forward with our plans to bring all of our college bookstore business under To The Game's operation. This consolidation is expected to be completed by the end of fiscal year 2013. This consolidation should provide additional leverage to our bookstore relationships and reduce selling, general and administrative, and distribution costs in this part of our business.

Capital spending during the quarter was $2.2 million and is expected to be approximately $9 million during the fiscal year. Capital improvements will mostly focus on screen print modernization and expansion in both our international and U.S. facilities, and branding and point-of-sale displays for our branded products. Beginning in our fiscal 2013 third quarter and continuing into fiscal year 2014, we intend to expand our textile and sewing capacity by approximately 17% to allow us to satisfy increasing demand for our basic activewear products and support newly developed specialty products. For this expansion, we expect to spend approximately $12 million for new equipment in our U.S. and Honduran textile facilities and several of our existing sewing facilities.

EARNINGS GUIDANCE

We continue to believe that the guidance previously issued for fiscal year 2013 can be achieved. Based on our anticipated net sales growth and higher unit volume while leveraging fixed costs, we believe that we will reach record revenues in the range of $500 to $510 million for fiscal year 2013, or an approximately 3% increase compared to fiscal year 2012. For the fiscal year ending June 29, 2013, earnings are expected to be in the range of $1.65 to $1.80 per diluted share.

Results of Operations

Net sales for the second quarter fiscal year 2013 were $106.8 million, an increase of 1.2% compared to second quarter fiscal year 2012 net sales of $105.5 million. Sales in the basics segment increased 2.2% to $58.8 million during the second quarter fiscal year 2013 compared to $57.6 million for the same period of the prior year. The increase was due to a 13.1% rise in basics segment volume. During the second quarter, we experienced good volume growth and lower costs in the Catalog and FunTees businesses. This was offset somewhat by lower average selling prices in both Delta Catalog and FunTees businesses. Second quarter fiscal year 2013 sales within the branded segment were $47.9 million, up slightly from the same quarter prior year. The branded segment, while hampered by softness in the Soffe business, still had sales growth in the Junkfood, To The Game and Art Gun businesses driven by higher volumes.

Gross margins for the second quarter 2013 were 21.3% of sales compared to 0.1% of sales in the prior period second quarter. During the second quarter 2012, we recorded a one-time adjustment of $16.2 million during the quarter to lower the value of inventory on hand due to the record high cotton cost and discounts on selling prices. Our gross margins may not be comparable to other companies because some companies include costs associated with their distribution activities in cost of goods sold and we exclude a portion of those costs from gross margin and instead include them in selling, general and administrative expenses.

For the quarter ended December 29, 2012, selling, general and administrative expenses ("SG&A"), were $21.9 million, or 20.5% of sales, compared to 20.2 million, or 19.1% of sales, for the quarter ended December 31, 2011. For the first six months of fiscal year 2013, SG&A expenses were 20.2% of sales versus 19.5% fiscal year 2012. This increase in SG&A as a percentage of sales was driven by higher distribution costs from increased volumes with lower selling prices. In addition, compensation costs were higher driven from certain severance costs as well as higher incentive compensation on the improved performance over the prior year. The full year SG&A also includes the one-time charge of $1.2 million discussed in connection with the first fiscal quarter related to the previously disclosed Audit Committee internal investigation.

Operating income for the second quarter of fiscal year 2013 was $0.8 million compared to a $20.0 million loss in the second quarter of the prior year. Operating income in the second quarter 2012 was impacted by the one-time inventory markdown of $16.2 million resulting from the unprecedented record high cotton costs combined with declining selling prices in our line of basic undecorated t-shirts.

Net interest expense for the second quarter of fiscal year 2013 was $0.9 million, a decrease of $0.1 million compared to the second quarter of fiscal year 2012. The decrease in net interest expense was primarily from decreased credit facility borrowings as well as a slight decrease in the average interest rate.

Our effective income tax rate for the six months ended December 29, 2012, was 23.5%, compared to an effective tax rate of 39.5% for the same period in the prior year and an effective tax rate of 76.4% for the fiscal year ended June 30, 2012. The effective tax rate for the fiscal year ended June 30, 2012, was impacted by the operating losses driven by the above-referenced one-time inventory markdown during the fiscal year, which lowered our U.S. taxable income while maintaining profits in the offshore taxable and tax-free jurisdictions. We expect our fiscal year 2013 effective tax rate to be approximately 23.5%.

Accounts receivable as of December 29, 2012, were $56.8 million, a 10.5% increase from the prior year period. Days sales outstanding was 50 as of December 29, 2012, which is comparable with a year ago.

Inventories have increased by $6.7 million to $168.4 million as of December 29, 2012, compared to $161.6 million as of June 30, 2012, and are down $14.6 million from a year ago December. This decrease is primarily from the lower cost cotton in inventory. We expect inventory to levels to rise during the upcoming quarter due to our normal build of inventory to support our anticipated growth during the spring selling season.

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Capital expenditures were $2.2 million during the second quarter fiscal year 2013, and depreciation and amortization, including non-cash compensation, was $1.8 million. These expenditures primarily related to screen print modernization and expansion in both our international and U.S. facilities. We continued our share repurchases during the second quarter using $2.0 million to buy back 139,797 shares at an average of $14.41 per share. During the six months ended December 29, 2012, we have repurchased 212,651 shares for a total of $3.0 million, at an average price of $14.29 per share.

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 $17.0 million in cash for the first six months of fiscal year 2013 compared to $29.2 million of cash used by operating activities in the first six months of fiscal year 2012. The increase in operating cash flow during the first six months of fiscal year 2013 compared to the prior year period resulted primarily from lower working capital requirements and higher earnings compared to the prior year in the business. Higher working capital was required in the first six months of fiscal year 2012 primarily due to higher priced cotton. In addition, during the first quarter of fiscal year 2012, payments for employee incentive compensation associated with fiscal year 2011 Company performance were made.

Investing Cash Flows

Capital expenditures for the first six months of fiscal year 2013 were $3.9 million compared to $3.1 million for the first six months of the prior year. Such capital expenditures were primarily related to the modernization and expansion of our screen print operations, along with investments in our information technology systems.

Financing Activities

For the first six months of fiscal year 2013, cash used by financing activities was $12.6 million compared to $31.9 million provided for the first six months of fiscal year 2012. The cash used by our financing activities in the first six months of fiscal year 2013 reduced our total debt to $104.8 million, which is a decrease of $9.6 million from our fiscal 2012 year end. The cash provided by financing activities during the first six months of fiscal year 2012 funded the higher working capital needs and the repurchase of our common stock.

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

Our Board of Directors previously authorized management to use up to $20.0 million to repurchase Delta Apparel stock in open market transactions under our Stock Repurchase Program. As of December 29, 2012, $2.7 million remained available for future purchases (See Note N-Repurchase of Common Stock). On January 23, 2013, our Board of Directors authorized an additional $10.0 million for our share repurchase program, bringing the total authorized to $30.0 million.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which were prepared in accordance with U.S. GAAP. The preparation of our 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 30, 2012, and there have been no changes in those policies since the filing of that Form 10-K with the SEC.

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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 America, LLC ("Parkdale") to supply our yarn requirements until March 31, 2013. 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 29, 2012, was valued at $7.3 million, and is scheduled for delivery between January 2013 and March 2013. At December 29, 2012, a 10% decline in the market price of the cotton covered by our fixed price yarn would have had a negative impact of approximately $0.5 million on the value of the yarn. This compares to what would have been a negative impact of $1.6 million at the 2012 fiscal year end based on the yarn with fixed cotton prices at June 30, 2012. 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 29, 2012, than at June 30, 2012, due to reduced commitments at December 29, 2012, compared to June 30, 2012.

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 sales in our statements of operations. We did not own any cotton options contracts on December 29, 2012.

We are currently in discussions to secure a new agreement to supply our yarn requirements and do not believe a new agreement would change any competitive position we may currently have associated with the supply agreement. 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 29, 2012, under the U.S. revolving credit facility had been outstanding during the entire three months ended December 29, 2012, and the interest rate on this

outstanding indebtedness was increased by 100 basis points, our expense would have increased by approximately $0.2 million, or 18.3% of actual interest expense, during the quarter. This compares to an increase of $0.7 million, or 17.9%, for the 2012 fiscal year based on the outstanding floating rate indebtedness at June 30, 2012, or an average of $0.2 million per quarter. Although the dollar amount of the increase is fairly consistent between the second quarter of fiscal year 2013 and the quarterly average of fiscal year 2012, the higher percentage increase in the second quarter of fiscal year 2013 is due to the actual interest expense in the quarter being lower than the quarterly average interest expense in fiscal year 2012. 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 outstanding.

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 K—Derivatives and Fair Value Measurements.

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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 rules and forms. 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 29, 2012, 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 second quarter of fiscal year 2013 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 L—Legal Proceedings in Item 1, which is incorporated herein by reference.

Item 1A. Risk Factors

As of December 29, 2012, there have been no material changes to the risk factors set forth in our Form 10-K for our fiscal year ended June 30, 2012.

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 E—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.

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.

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DELTA APPAREL, INC.
(Registrant)

Date February 5, 2013

By: /s/ Deborah H. Merrill
Deborah H. Merrill
Vice President, Chief Financial Officer and Treasurer