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HUFFY CORP  
Form 10-Q  
July 25, 2002

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For Quarter Ended June 29, 2002

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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 1-5325  
-----

Huffy Corporation  
-----

(Exact name of registrant as specified in its charter)

Ohio 31-0326270  
-----  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

225 Byers Road, Miamisburg, Ohio 45342  
-----  
(Address of principal executive offices) (Zip Code)

(937) 866-6251  
-----  
(Registrant's telephone number, including area code)

No Change  
-----  
(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 X No  
-----

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents

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and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes                      No  
-----                      -----

### APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Outstanding Shares:      10,461,965                      as of                      July 19, 2002  
-----                      -----

### PART I - FINANCIAL INFORMATION

#### ITEM 1. FINANCIAL STATEMENTS COMPANY FOR WHICH REPORT IS FILED:

HUFFY CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS  
(Dollar Amounts in Thousands, Except Per Share Data)  
(Unaudited)

	Three Months Ended		S
	June 29, 2002	June 30, 2001	June 29,
Net sales	\$ 93,413	\$ 86,864	\$ 163,
Cost of sales	76,382	74,787	134,
Gross profit	17,031	12,077	29,
Selling, general and administrative expenses	13,847	11,089	24,
Operating income	3,184	988	4,
Other expense (income)			
Interest expense	326	348	
Interest income	(7)	(262)	
Other expense (income)	762	(337)	
Earnings before income taxes	2,103	1,239	3,
Income tax expense	828	471	1,
Net earnings	\$ 1,275	\$ 768	\$ 1,
Earnings per common share:			
Basic:			
Weighted average number of common shares	10,429,836	10,255,057	10,409,

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Net earnings per common share	\$ 0.12	\$ 0.07	\$ 0
Diluted:			
Weighted average number of common shares	10,736,459	10,502,865	10,715,
Net earnings per common share	\$ 0.12	\$ 0.07	\$ 0

HUFFY CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Dollar Amounts In Thousands)

	June 29, 2002 (Unaudited)	December 31, 2001
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 36,255	\$ 26,541
Accounts and notes receivable, net	45,795	48,934
Inventories	26,211	12,483
Prepaid expenses and federal income taxes	18,181	17,803
Total current assets	126,442	105,761
Property, plant and equipment, at cost	40,515	39,320
Less: Accumulated depreciation and amortization	31,559	30,053
Net property, plant and equipment	8,956	9,267
Excess of cost over net assets acquired, net	13,115	8,038
Other assets	23,060	22,419
	\$ 171,573	\$ 145,485
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Notes payable	\$ --	\$ --
Current installments of long-term obligations	--	--
Accounts payable	55,155	31,161
Accrued expenses and other current liabilities	28,879	30,224
Total current liabilities	84,034	61,385

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Long-term obligations, less current installments	--	--
Other long-term liabilities	19,398	18,498
	-----	-----
Total liabilities	103,432	79,883
	-----	-----
Shareholders' equity:		
Common stock	16,969	16,931
Additional paid-in capital	67,259	67,226
Retained earnings	77,048	75,147
Accumulated other comprehensive loss	(3,369)	(3,421)
Treasury shares, at cost	(89,766)	(90,281)
	-----	-----
Total shareholders' equity	68,141	65,602
	-----	-----
	\$ 171,573	\$ 145,485
	=====	=====

HUFFY CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Dollar Amounts in Thousands)  
(Unaudited)

	Six ----- June 29, 2 -----
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net earnings	\$ 1,899
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:	
Depreciation and amortization	1,818
Gain on sale of property, plant and equipment	(2)
Deferred federal income tax expense	858
Changes in assets and liabilities:	
Accounts and notes receivable, net	4,260
Inventories	(13,728)
Prepaid expenses and federal income taxes	(1,331)
Other assets	(543)
Accounts payable	23,837
Accrued expenses and other current liabilities	(2,562)
Other long-term liabilities	954
	-----
Net cash provided by operating activities	15,460
=====	
CASH FLOWS FROM INVESTING ACTIVITIES:	
Capital expenditures	(1,432)
Acquisition of businesses	(4,900)

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Proceeds from sale of property, plant and equipment	--
	-----
Net cash used in investing activities	(6,332)
=====	
CASH FLOWS FROM FINANCING ACTIVITIES:	
Net decrease in short-term borrowings	--
Issuance of common shares	586
	-----
Net cash provided by (used in) financing activities	586
=====	
Net change in cash and cash equivalents	9,714
Cash and cash equivalents:	
Beginning of the year	26,541
	-----
End of the six month period	\$ 36,255
=====	

### NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar Amounts in Thousands, except per share data)

(Unaudited)

Note 1: Footnote disclosure, which would substantially duplicate the disclosure contained in the Annual Report to Shareholders for the year ended December 31, 2001, has not been included. The unaudited interim condensed consolidated financial statements reflect all adjustments, which, in the opinion of management, are necessary to a fair statement of the results for the periods presented and to present fairly the consolidated financial position of Huffy Corporation as of June 29, 2002. All such adjustments are of a normal recurring nature.

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

Note 2: Inventories of Huffy Bicycle Company and Huffy Sports Company are at cost (not in excess of market) determined by the FIFO method. The components of inventories are as follows:

	June 29, 2002	December 31, 2001
	-----	-----
Finished Goods	\$24,165	\$10,768
Work-in-Progress	105	105
Raw Materials & Supplies	1,941	1,610
	-----	-----
	\$26,211	\$12,483
	=====	=====

Note 3: On March 27, 2002, Huffy Service First acquired the stock of McCalla Company and its subsidiaries, Creative Retail Services and Creative Retail Services Canada, ("McCalla") for \$5,400, less \$500 net cash acquired, subject to certain post-closing adjustments. Of the total

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purchase price, \$4,792 was recorded as goodwill and \$300 was recorded as a covenant not-to-compete. McCalla provides merchandising, including cycle and periodic product resets, stocking and sales training for a number of well-known manufacturers serving the Home Center channel, including, among others, Philips Lighting, Duracell, and The Stanley Works.

The Company announced its intention to acquire Gen-X Sports, Inc. ("Gen-X") on June 17, 2002. Under the terms of the proposed merger agreement, the Company will acquire Gen-X for cash and the issuance of 5,000,000 shares of Class A common stock to the stockholders of Gen-X. Gen-X, headquartered in Toronto, Ontario, Canada, with offices in Geneva, Switzerland and Minneapolis, Minnesota, is a diversified sporting goods company that designs, markets, and distributes a wide range of branded sporting goods across multiple channels. Gen-X markets products under numerous well-known brands, including: for golf, Tommy Armour (R), RAM(R), Zebra(R) and Teardrop(R); for snowboards: Sims(R), Lamar(R) and Limited(R); for action sports and inline skates: Rage(R), Dukes(R), Oxygen(R), Ultra-Wheels(R), Street Attack(R) and Skate Attack(R); for skis: Volant(R); and for hockey: Hespeler(R). Gen-X also supports separate product lines dedicated to licensing and the sale of opportunity and excess inventory. Merger consideration is estimated to be \$57,435 for the common stock of Gen-X and Gen-X Ontario, \$4,970 to purchase and redeem Gen-X preferred stock, \$44,661 to retire a portion of Gen-X's existing debt and \$3,340 for fees and expenses. The acquisition, which is expected to close during the fourth quarter of 2002, is subject to shareholder approval and satisfaction of certain conditions prior to close. The terms of the proposed merger are included in the Company's

Form S-4 Registration Statement filed with the Securities and Exchange Commission on July 5, 2002.

Note 4: The Company classifies its operations into a single integrated business segment.

Note 5: The Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" ("SFAS 141"), and SFAS No. 142, "Goodwill and Other Intangible Assets", as of January 1, 2002 ("SFAS 142"). SFAS 141 addresses financial accounting and reporting for business combinations requiring the use of the purchase method of accounting and reporting for goodwill and other intangible assets. In accordance with the provisions of SFAS 142, goodwill and intangible assets with indefinite useful lives will no longer be amortized, but instead will be tested for impairment at least annually. SFAS 142 also requires intangible assets with defined useful lives be amortized over their estimated useful life to their estimated residual values, and reviewed for impairment at least annually.

As of June 29, 2002, the Company had \$13,115 of goodwill and other intangibles, including \$4,792 of goodwill and \$285 related to a covenant not-to-compete associated with the McCalla acquisition. The covenant not-to-compete was valued at \$300 as of the acquisition date and is being amortized over its expected useful life of five years.

In the second quarter of 2001, \$181 (\$112 after-tax), or \$0.01 per common share, of goodwill amortization was included in selling, general and administrative expenses. Second quarter 2001 net earnings excluding goodwill amortization was \$880, or \$0.08 per common share.

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Goodwill amortization in the first half of 2001 of \$362, or \$0.02 per common share, was included in selling, general and administrative expenses. First half 2001 net earnings without goodwill amortization were \$1,986, or \$0.19 per common share. The Company charged selling, general and administrative expense for \$726 (\$477 after tax), or \$0.05 per common share, for the amortization of goodwill for the year ended December 31, 2001. The full year 2001 net loss without goodwill amortization was \$7,933, or \$0.77 per common share. No goodwill amortization was incurred in 2002. The Company tested each reporting unit's unamortized goodwill for impairment and found the assets unimpaired as of the date of adoption. In accordance with SFAS 142, the Company will test each reporting unit's goodwill annually as of end of the fiscal year.

Effective January 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 retained many of the fundamental provisions of SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("SFAS 121"), but resolved certain implementation issues associated with that Statement. SFAS 144 also requires the results of operations of a component entity that is classified as held for sale or has been disposed of to be reported as discontinued operations in the Condensed Consolidated Statements of Earnings if certain conditions are met. These conditions include elimination of the operations and cash flows of the component entity from the ongoing operations of the Company, and no significant continuing involvement by the Company in the operations of the component entity after the disposal transaction. The adoption of SFAS 144 did not have a material impact on the Company's consolidated results of operations.

Note 6. In August 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"), which will be effective for the Company beginning January 1, 2003. SFAS 143 addresses the financial accounting and

reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS 145"), which will be effective for the Company beginning January 1, 2003. SFAS 145 rescinds FASB Statement No. 4, 44, 64 and amends SFAS No. 13, "Accounting for Leases", to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions.

The Company has assessed the impact of SFAS 143 and 145, and estimates that the impact of these standards will not be material.

Note 7: Critical Accounting Policies

Allowance for Doubtful Accounts

The Company evaluates the collectibility of its accounts receivable based upon an analysis of historical trends, aging of accounts receivable, write-off experience and expectations of future

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performance. Delinquent accounts are written off to selling, general and administrative expense when circumstances make further collection unlikely. In the event of a customer bankruptcy or reorganization, specific reserves are established to write down accounts receivable to the level of anticipated recovery. The Company may consult with third-party purchasers of bankruptcy receivables when establishing specific reserves. Non-specific reserves for doubtful accounts are based upon a historical bad debt write-off of approximately 0.2% of net sales. At June 29, 2002, a 0.1 percentage point change in bad debts as a percentage of net sales would impact the reserve for doubtful accounts by \$164.

In January 2002, Kmart Corporation filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Pre-bankruptcy receivables from Kmart were sold during the second quarter 2002 and cash recovered consistent with previously established reserves.

### Inventory Valuations

Inventories are valued at cost (not in excess of market) determined by the first-in, first-out (FIFO) method. Management regularly reviews inventory for salability and establishes obsolescence reserves to absorb estimated losses. The Company also maintains reserves against inventory shrinkage. On an annual basis, the Company takes a physical inventory verifying the units on hand and comparing its perpetual records to physical counts. Periodic cycle counting procedures are used to verify inventory accuracy between physical inventories. In the interim periods, a reserve for shrinkage is established based upon historical experience and recent physical inventory results. Inventory obsolescence and shrinkage are charged to cost of sales.

### Self-Insurance Reserves

The Company is self-insured for workers compensation, medical insurance and product liability claims up to certain maximum liability amounts. Medical insurance reserves are determined

based upon historical expense experience and loss reporting trends. Workers compensation and product liability reserves are determined based upon actuarial analysis of historical trends of losses, settlements, litigation costs and other factors. The amounts accrued for self-insurance are based upon management's best estimate and the amounts the Company will ultimately disburse could differ from such accrued amounts. The majority of workers compensation and medical insurance expense is charged to cost of sales with the remainder charged to selling, general and administrative expense.

### Environmental

Environmental expenditures that relate to current operations are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated.

The Company, along with others, has been designated as a potentially responsible party (PRP) by the U.S. Environmental Protection Agency (the "EPA") with respect to claims involving the discharge of



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hazardous substances into the environment in the Baldwin Park operable unit of the San Gabriel Valley Superfund site. The Company, along with other PRPs, the Main San Gabriel Basin Watermaster (Watermaster), the San Gabriel Water Quality Authority (WQA), and numerous local water districts (Water Districts), have worked with the EPA on a mutually satisfactory remedial plan, with the end result being a joint water supply/clean up Project Agreement which settles four different lawsuits filed by the WQA and the Water Districts. The Project Agreement was signed on March 28, 2002 and was approved by the court and became effective May 9, 2002. In developing its estimate of environmental remediation costs, the Company considers, among other things, currently available technological solutions, alternative cleanup methods, and risk-based assessments of the contamination and, as applicable, an estimation of its proportionate share of remediation costs. The Company may also make use of external consultants and consider, when available, estimates by other PRPs and governmental agencies and information regarding the financial viability of other PRPs. Based upon information currently available, the Company believes it is unlikely that it will incur substantial previously unanticipated costs as a result of failure by other PRPs to satisfy their responsibilities for remediation costs.

The Company has recorded environmental accruals, based upon the information available, that are adequate to satisfy known remediation requirements. The total accrual for estimated environmental remediation costs related to the Superfund site and other potential environmental liabilities was \$3,506 at June 29, 2002. In addition, the Company has a deposit of \$1,656 that is held in escrow under the terms of the settlement agreement. Amounts in escrow will be used to fund future costs and will serve as a long-term performance assurance pending the completion of remediation.

Note 8: The components of comprehensive income are immaterial and are therefore not disclosed.

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

THREE AND SIX MONTHS ENDED JUNE 29, 2002  
COMPARED TO THE  
THREE AND SIX MONTHS ENDED JUNE 30, 2001  
(Dollar Amounts in Thousands, Except Per Share Data)

#### NET EARNINGS

For the second quarter of 2002, Huffly Corporation ("Huffly" or "Company") had net earnings of \$1,275, or \$0.12 per common share, versus \$768 or \$0.07 for the same period last year. For the six months ended June 29, 2002, net earnings were \$1,899, or \$0.18 per common share, compared to \$1,762, or \$0.17 per common share, in the first half of 2001.

#### NET SALES

Consolidated net sales for the quarter ended June 29, 2002 were \$93,413, an increase of 7.5% over net sales of \$86,864 for the same quarter in 2001. Backboard and ball sales climbed 26.3% over the second quarter 2001 contributing most of the sales growth. Strong sales growth from bicycle and other wheeled

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products was offset by decreased demand for merchandising at Kmart. The McCalla companies acquired at the end of the first quarter added \$2,924 of incremental merchandising revenue.

For the six months ended June 29, 2002, consolidated net sales were \$163,798, a decrease of 2.5% from \$168,107 in the same period last year. This sales decrease was primarily the result of Kmart's first quarter bankruptcy, which interrupted shipments of product, and unfavorably impacted consumer sales. Strong demand for backboards was not sufficient to offset weakness in merchandising and the mix shift to opening price point bicycles. In addition, during the first half of 2001 sales of closeout scooters enhanced the net sales line but added only minimal margin contribution.

### GROSS PROFIT

Gross profit for the quarter ended June 29, 2002 was \$17,031, or 18.2% of net sales, compared to \$12,077, or 13.9% of net sales, for the quarter ended June 30, 2001. Bicycles and basketball backboards provided strong margin contribution during the second quarter, up 5.6 points over the same quarter last year. Lower merchandising activity coupled with higher field labor costs in assembly weakened the favorable contributions from product sales. Margin contributions from the McCalla companies were \$895 in the quarter.

For the first six months of 2002, gross profit was \$29,032, or 17.7% of net sales, compared to \$23,712, or 14.1% of net sales, last year. Strong margin improvement in wheeled products and basketball backboards were offset by declining margin associated with lower merchandising volume and higher assembly field labor costs.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses were \$13,847 for the second quarter of 2002, compared to \$11,089 for the same period in 2001. Higher pension expenses and the addition of McCalla's selling, general administrative costs were the primary reasons for the year-to-year increase.

Selling, general and administrative expenses for the first half of 2002 were \$24,375 versus \$21,132 in the first six months of 2001. Increased pension expenses and the added selling, general and administrative expenses associated with the recent McCalla acquisition were the primary reasons for the increase.

### ACQUISITIONS

The Company announced its intention to acquire Gen-X Sports, Inc. ("Gen-X") on June 17, 2002. Under the terms of the proposed merger agreement, the Company will acquire Gen-X for cash and the issuance of 5,000,000 shares of Class A common stock to the stockholders of Gen-X. Gen-X, headquartered in Toronto, Ontario, Canada, with offices in Geneva, Switzerland and Minneapolis, Minnesota, is a diversified sporting goods company that designs, markets, and distributes a wide range of branded sporting goods across multiple channels. Gen-X markets products under numerous well-known brands, including: for golf, Tommy Armour (R), RAM(R), Zebra(R) and Teardrop(R); for snowboards: Sims (R), Lamar (R) and Limited(R); for action sports and inline skates: Rage (R), Dukes (R), Oxygen (R), Ultra-Wheels (R), Street Attack (R) and Skate Attack (R); for skis: Volant (R); and for hockey: Hespeler (R). Gen-X also supports separate product lines dedicated to licensing and the sale of opportunity and excess inventory. Merger consideration is estimated to be \$57,435 for the common stock of Gen-X and Gen-X Ontario, \$4,970 to purchase and redeem Gen-X preferred stock, \$44,661 to retire a portion of Gen-X's existing debt and \$3,340 for fees and expenses. The acquisition, which is expected to close during the fourth quarter of 2002, is subject to

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shareholder approval and satisfaction of certain conditions prior to close. The terms of the proposed merger are included in the Company's Form S-4 Registration Statement filed with the Securities and Exchange Commission on July 5, 2002.

On March 27, 2002, Huffy Service First acquired the stock of McCalla Company and its subsidiaries, Creative Retail Services and Creative Retail Services Canada, ("McCalla") for \$5,400, less \$500 net cash acquired, subject to certain post-closing adjustments. Of the total purchase price, \$4,792 was recorded as goodwill and \$300 was recorded as a covenant not-to-compete. McCalla provides merchandising, including cycle and periodic product resets, stocking and sales training for a number of well-known manufacturers serving the Home Center channel, including, among others, Philips Lighting, Duracell, and The Stanley Works.

### LIQUIDITY AND CAPITAL RESOURCES

The Company's \$75,000 revolving credit facility is secured by all assets of the Company and its affiliates and will expire on December 31, 2002, with a 12-month renewal at the Company's option. As of June 29, 2002, the Company had \$32,430 available on its revolving credit facility and had no outstanding balance. Huffy is negotiating an amendment with its existing lender to incorporate Gen-X in the credit facility.

Pre-bankruptcy receivables from Kmart were sold during the second quarter 2002 with cash recovered consistent with previously established reserves. Inventory levels are \$26,211 at June 29, 2002, up seasonally from \$12,483 at December 31, 2001, but down from the June 30, 2001 levels of \$35,654. The

June 2001 inventory investment was inflated by scooter inventory. Accounts payable are higher in the second quarter of 2002 at \$55,155, up from \$31,161 at December 31, 2001 and \$27,408 at June 30, 2001. The increase in accounts payable from December 31, 2001 and June 30, 2001, is due to seasonality as well as increased payment terms from Huffy's network of global suppliers.

The Company expects existing cash, cash flow from operations, and its revolving credit facility will be sufficient to finance seasonal working capital needs and capital expenditures throughout the coming year.

### CRITICAL ACCOUNTING POLICIES

#### Allowance for Doubtful Accounts

The Company evaluates the collectibility of its accounts receivable based upon an analysis of historical trends, aging of accounts receivable, write-off experience and expectations of future performance. Delinquent accounts are written off to selling, general and administrative expense when circumstances make further collection unlikely. In the event of a customer bankruptcy or reorganization, specific reserves are established to write down accounts receivable to the level of anticipated recovery. The Company may consult with third-party purchasers of bankruptcy receivables when establishing specific reserves. Non-specific reserves for doubtful accounts are based upon a historical bad debt write-off of approximately 0.2% of net sales. At June 29, 2002, a 0.1 percentage point change in bad debts as a percentage of net sales would impact the reserve for doubtful accounts by \$164.

In January 2002, Kmart Corporation filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Pre-bankruptcy receivables from Kmart were sold during the second quarter 2002 and cash recovered consistent with previously established reserves.

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### Inventory Valuations

Inventories are valued at cost (not in excess of market) determined by the first-in, first-out (FIFO) method. Management regularly reviews inventory for salability and establishes obsolescence reserves to absorb estimated losses. The Company also maintains reserves against inventory shrinkage. On an annual basis, the Company takes a physical inventory verifying the units on hand and comparing its perpetual records to physical counts. Periodic cycle counting procedures are used to verify inventory accuracy between physical inventories. In the interim periods, a reserve for shrinkage is established based upon historical experience and recent physical inventory results. Inventory obsolescence and shrinkage are charged to cost of sales.

### Self-Insurance Reserves

The Company is self-insured for workers compensation, medical insurance and product liability claims up to certain maximum liability amounts. Medical insurance reserves are determined based upon historical expense experience and loss reporting trends. Workers compensation and product liability reserves are determined based upon actuarial analysis of historical trends of losses, settlements, litigation costs and

other factors. The amounts accrued for self-insurance are based upon management's best estimate and the amounts the Company will ultimately disburse could differ from such accrued amounts. The majority of workers compensation and medical insurance expense is charged to cost of sales with the remainder charged to selling, general and administrative expense.

### Environmental

Environmental expenditures that relate to current operations are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated.

The Company, along with others, has been designated as a potentially responsible party (PRP) by the U.S. Environmental Protection Agency (the "EPA") with respect to claims involving the discharge of hazardous substances into the environment in the Baldwin Park operable unit of the San Gabriel Valley Superfund site. The Company, along with other PRPs, the Main San Gabriel Basin Watermaster (Watermaster), the San Gabriel Water Quality Authority (WQA), and numerous local water districts (Water Districts), have worked with the EPA on a mutually satisfactory remedial plan, with the end result being a joint water supply/clean up Project Agreement which settles four different lawsuits filed by the WQA and the Water Districts. The Project Agreement was signed on March 28, 2002 and was approved by the court and became effective May 9, 2002. In developing its estimate of environmental remediation costs, the Company considers, among other things, currently available technological solutions, alternative cleanup methods, and risk-based assessments of the contamination and, as applicable, an estimation of its proportionate share of remediation costs. The Company may also make use of external consultants and consider, when available, estimates by other PRPs and governmental agencies and information regarding the financial viability of other PRPs. Based upon information currently available, the Company believes it is unlikely that it will incur substantial previously unanticipated costs as a result of failure by other PRPs to satisfy their responsibilities for remediation costs.

The Company has recorded environmental accruals, based upon the information available, that are adequate to satisfy known remediation requirements. The

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total accrual for estimated environmental remediation costs related to the Superfund site and other potential environmental liabilities was \$3,506 at June 29, 2002. In addition, the Company has a deposit of \$1,656 that is held in escrow under the terms of the settlement agreement. Amounts in escrow will be used to fund future costs and will serve as a long-term performance assurance pending the completion of remediation. Management expects that the majority of expenditures relating to costs currently accrued will be made over the next year. As a result of factors, such as the continuing evolution of environmental laws and regulatory requirements, the availability and application of technology, the identification of presently unknown remediation sites, and the allocation of costs among potentially responsible parties, estimated costs for future environmental compliance and remediation are necessarily imprecise and it is not possible to fully predict the amount or timing of future environmental remediation costs which may subsequently be determined.

### PART II - OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

The Company along with numerous California water companies and other potentially responsible parties ("PRPs") for the Baldwin Park Operable Unit of the San Gabriel Valley Superfund (see Note 10 to the Company's annual report regarding the Superfund in which a tentative remediation settlement has been reached) have been named in fourteen civil lawsuits which allege claims related to the contaminated groundwater in the Azusa, California area (collectively, the "San Gabriel Cases").

The cases had been stayed for a variety of reasons, including a number of demurrers and writs taken in the Appellate Division, relating primarily to the California Public Utilities Commission ("PUC") investigation described below. The resulting Appellate Division decisions were reviewed by the California Supreme Court, which ruled in February 2002. The cases have been reactivated as a result of the California Supreme Court's decision, with the trial level Coordination Judge holding a Status Conference on all of the cases on July 17, 2002, at which conference issues pertaining to the drafting of three master complaints (two of which will include the Company as a defendant), a case management order and a preliminary questionnaire to be responded to by all of the plaintiff's were discussed. A follow up conference with the Court to further address and reach resolution on these issues is scheduled for July 29, 2002. As noted by the matters being discussed with the Court, the toxic tort cases are in their initial stages. Thus, it is impossible to currently predict the outcome of any of the actions.

The Company, along with the other PRPs for the Baldwin Park Operable Unit of the San Gabriel Valley Superfund Site (the "BPOU"), has also been named in four civil lawsuits filed by water purveyors. The water purveyor lawsuits allege CERCLA, property damage, nuisance, trespass and other claims related to the contaminated groundwater in the BPOU (collectively, the "Water Entity Cases"). The Company was named as a direct defendant by the water purveyor in two of these cases, and was added as a third party defendant in the two others by Aerojet General Corporation, which, in those cases, was the only PRP sued by the water purveyors. As noted above, each of the Water Entity Cases have been settled through the entry of the Project Agreement. According to the terms of the Project Agreement, the Water Entity Cases, which are in their initial stages, will be dismissed within thirty days.

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On March 12, 1998, the PUC commenced an investigation in response to the allegations in the toxic tort actions that "drinking water delivered by the water utilities caused death and personal injury to customers." The PUC's inquiry addressed two broad issues central to these allegations: 1) "whether current water quality regulation adequately protects the public health;" and 2) "whether respondent utilities are (and for the past 25 years have been) complying with existing drinking water regulation." On November 2, 2000, the PUC issued its Final Opinion and Order Resolving Substantive Water Quality Issues. Significantly, the Order finds, in pertinent part, that: 1) "existing maximum contaminant level ("MCLs") and action level ("ALs") established by the DHS are adequate to protect the public health;" 2) "there is a significant margin of safety when MCLs are calculated so that the detection of carcinogenic contaminants above MCLs that were reported in this investigation are unlikely to pose a health risk;" 3) based upon its comprehensive review of 25 years of utility compliance records, that for all periods when MCLs and ALs for specific chemicals were in effect, the PUC regulated water companies complied with DHS testing requirements

and advisories, and the water served by the water utilities was not harmful or dangerous to health; and 4) with regard to the period before the adoption by DHS of MCLs and ALs, a further limited investigation by the PUC Water Division will be conducted.

Based upon information presently available, such future costs are not expected to have a material adverse effect on the Company's financial condition, liquidity, or its ongoing results of operations. However, such costs could be material to results of operations in a future period.

ITEM 5: OTHER INFORMATION

ITEM 6: EXHIBITS AND REPORTS ON FORM 8-K

- a. Exhibits - The exhibits, as shown in the "Index of Exhibits" attached hereto are applicable to be filed as a part of this report.
- b. The Company filed two reports on Form 8-K dated April 25, 2002 and June 18, 2002 with the Securities and Exchange Commission regarding remarks of the Chief Executive Officer at the Annual Shareholders Meeting and the press release issued announcing the acquisition of Gen-X Sports, Inc., respectively.

Please see the Company's meaningful cautionary statements regarding forward looking statements contained in the Company's report on Form 10-K filed with the Securities and Exchange Commission on February 21, 2002 which is hereby incorporated herein by reference.

### 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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HUFFY CORPORATION, Registrant

July 23, 2002	/s/ Timothy G. Howard
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Date	Timothy G. Howard Vice President - Corporate Controller (Principal Accounting Officer)

## INDEX OF EXHIBITS

Exhibit No.	Item
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(2)	Not applicable
(3)	Not applicable
(4)	Not applicable
(10)	(a) 1998 Key Employee Non-Qualified Stock Plan, approved June 12, 1997, and First Amendment, dated October 22, 1998, Second Amendment, dated December 13, 1998, and Third Amendment, dated December 9, 1999.
	(b) Share Purchase Agreement, dated June 5, 2002, by and among Hufffy Corporation, HSGC Canada Inc., Gen-X Sports, Inc., DMJ Financial Inc., K & J Financial, Inc., DLS Financial, Inc., Kenneth Finkelstein Family Trust, James Salter Family Trust, Osgoode Financial Inc., James Salter, and Kenneth Finkelstein, incorporated by reference to Exhibit 2(b) of Form S-4 filed July 5, 2002.
	(c) Agreement and Plan of Merger, dated June 5, 2002, by and among Hufffy Corporation, HSGC, Inc. and Gen-X Sports Inc., incorporated by reference to Annex A of Form S-4 filed July 5, 2002.
(11)	Not applicable
(15)	Not applicable
(18)	Not applicable
(19)	Not applicable
(22)	Not applicable
(23)	Not applicable
(24)	Not applicable
(99)	Not applicable

