PINK OTC MARKETS ANNUAL REPORT

Phoenix Footwear Group, Inc.

(Report prepared on March 10, 2015 for the 53-week period ended January 3, 2015)

All information contained in this Annual Report has been compiled to fulfill the OTC Pink Basic Disclosure Guidelines to qualify for the OTC Pink Current Information tier.

1) Name of the Issuer and its predecessors (if any).

Phoenix Footwear Group, Inc. (herein referred to as the "Issuer" or "Company"), incorporated in the State of Delaware.

2) Address of the Issuer's principal executive offices:

Company Headquarters
5937 Darwin Court, Suite 109
Carlsbad, CA 92008
Telephone: (760) 602-9688
Facsimile: (760) 602-9619
www.phoenixfootwear.com
www.softwalkshoes.com
www.trotters.com

Investor relations Contact:
Greg W. Slack
5937 Darwin Court, Suite 109
Carlsbad, CA 92008
(760) 602-9688
E-mail: gslack@phxg.com

3) Security Information

Trading Symbol: PXFG
Exact title and class of securities outstanding: Phoenix Footwear Group, Inc. common stock
CUSIP: 71903M209
Par or stated value: $0.01 per share
Total shares authorized: 50,000,000 common shares, as of March 10, 2015
Total shares outstanding: 8,358,362 common shares, as of March 10, 2015

Transfer Agent
Computershare Investor Services
P.O. Box 43078
Providence, RI 02940-3078
(877) 282-1168

Is the Transfer Agent registered under the Exchange Act? Yes: X No: __

List any restrictions on the transfer of security: The Company's common stock is generally subject to securities laws restrictions on transfer. As described below under section "4) Issuance History", the Notes (defined below) issued by the Company to the Greenwood Investors (defined below), and the underlying shares, are restricted from transfer, and contain a customary restrictive legend. In addition, in accordance with the 2011 Plan (defined below), the Company issued restricted stock certificates to its non-employee directors which contain a customary restrictive legend and are restricted from transfer subject to compliance with securities laws.

Describe any trading suspension orders issued by the SEC in the past 12 months. None.

List any stock split, stock dividend, recapitalization, merger, acquisition, spin-off or reorganization either currently anticipated or that occurred within the past 12 months. None.

4) Issuance History

For the previous two fiscal years ended January 3, 2015 and December 28, 2013, and up to the filing of this Annual Report, there have been the following events that resulted or could have resulted in changes in total shares outstanding by the issuer:

On April 1, 2014, the Company issued an aggregate of 60,000 shares of restricted common stock to three non-employee directors, Steven DePerrior, Stephanie Pianka and Frederick Port, in transactions exempt from registration pursuant to Rule 701 under the Securities Act of 1933, as amended (the "Securities Act"), pursuant to awards granted under the 2011 Long-Term Incentive Plan of Phoenix Footwear Group, Inc. (the "2011 Plan"), upon the satisfaction of vesting criteria which required that the recipients maintain continued membership on the Company's Board of Directors through March 31, 2014. The shares are restricted from transfer unless in compliance with applicable securities laws and the certificates representing the shares contain a customary restrictive legend.

On April 1, 2013, the Company issued an aggregate of 60,000 shares of restricted common stock to three non-employee directors, Steven DePerrior, Stephanie Pianka and Frederick Port, in transactions exempt from registration pursuant to Rule 701 under the Securities Act of 1933, as amended (the "Securities Act"), pursuant to awards granted under the 2011 Long-Term Incentive Plan of Phoenix Footwear Group, Inc. (the "2011 Plan"), upon the satisfaction of vesting criteria which required that the recipients maintain continued membership on the Company's Board of Directors through March 31, 2013. The shares are restricted from transfer unless in compliance with applicable securities laws and the certificates representing the shares contain a customary restrictive legend.

With the exception of the offerings described above, there have been no securities offerings and share issuances for services of the Company's securities in the previous two fiscal years ended January 3, 2015 and December 28, 2013 or in the interim period following fiscal year ended January 3, 2015 to the date of this Pink OTC Markets Annual Report.

5) Financial Statements

The following audited consolidated financial statements are attached at the end of this Annual Report as Exhibit A and management's discussion and analysis as Exhibit B are attached at the end of this Annual Report and are hereby incorporated by reference:

1. Independent Auditors' Report
2. Audited Consolidated Balance Sheets as of January 3, 2015, and December 28, 2013.
3. Audited Consolidated Statements of Income for the fiscal years ended January 3, 2015 and December 28, 2013.
4. Audited Consolidated Statements of Stockholder's Equity for the fiscal years ended January 3, 2015 and December 28, 2013.
5. Audited Consolidated Statements of Cash Flows for the fiscal years ended January 3, 2015 and December 28, 2013.
6. Notes to the Audited Consolidated Financial Statements.
7. Financial Statement Schedule II Consolidated Valuation and Qualifying Accounts
8. Management's Discussion and Analysis of Financial Condition and Results of Operations as of and for the fiscal years ended January 3, 2015 and December 28, 2013

6) Describe the Issuer's Business, Products and Services

A. **Description of the Issuer's business operations**;

The Company specializes in quality comfort women's footwear. The Company designs, develops, markets and sells footwear in a wide range of sizes and widths under the brands Trotters® and SoftWalk®. The Company has been engaged in the manufacture or importation and sale of quality footwear since 1882.

Trotters and SoftWalk are the Company's two core brands, which make up its women's footwear business. These products are designed for fit, quality and value for the consumer. The Company specializes in comfort footwear and manufactures each style in a large range of sizes and widths to ensure proper fit. The Company maintains an "open stock" inventory, which provides our customers with the ability to replenish their inventory at retail and support special consumer orders.

B. **Date and State (or Jurisdiction) of Incorporation**: Phoenix Footwear Group, Inc. was incorporated under the laws of the State of Delaware on March 15, 2002.

C. **The Issuer's primary and secondary SIC Codes**: The Company's primary SIC Code is 3140 - Footwear, except rubber

D. **The Issuer's fiscal year end date**; The Company's operating and reporting period is on a 52-53 week fiscal year ending on the Saturday nearest to December 31.

E. **Principal products or services, and their markets**;

The Company's products emphasize quality, fit and comfort with classic styling. These products compete predominately in the moderate-priced categories of the market.

Trotters. Competing primarily in the traditional women's dress, tailored and casual classifications, Trotters provides retail price points from $79 to $129. The broad selection of sizes and widths for this brand fills an important need for the Company's customers by emphasizing quality and fit with the continuity of style from season to season.

SoftWalk. SoftWalk competes in the women's comfort footwear segment at moderate retail price points from $89 to $159. Utilizing its patented footbed that fundamentally differentiates SoftWalk from its competitors, the Company believes SoftWalk's consumer acceptance and popularity is attributable to its unique combination of comfort and contemporary styling. By molding multiple layers of high density materials together, the Company's patented "egg-crate" technology allows for an insole construction that creates raised cushioning elements of a height, size and spacing so as to be self-adjusting to the foot. These elements combine to create a shoe that provides ultimate comfort and supports the foot similar to a mattress. The Company's patented footbed technology provides the consumer with exceptional comfort without compromising style and is utilized in all of its SoftWalk products.

During the fiscal years ended January 3, 2015 ("fiscal 2014") and December 28, 2013 ("fiscal 2013"), the Company had one reportable segment consisting of its continuing operations of Trotters and SoftWalk.

Distribution methods of Issuer's products

Trotters and SoftWalk products are sold by the Company's own dedicated employee sales force that covers the U.S. market. Beginning in April of 2013, the Company entered into a three year licensing agreement with Touchstone Television Productions, LLC. ("ABC Studios"), to design, market and distribute footwear for the medical community under the Grey's Anatomy brand. Concurrent with the ABC Studios license agreement, the Company entered into a three year joint marketing agreement with Barco Uniforms, Inc. ("Barco"). Under the terms of the joint marketing agreement, footwear produced under the ABC Studios licensing agreement are sold in the U.S. market by Barco's employed sales force. The Company distributes its products in Canada under an exclusive distribution agreement with Canada Shoe Corp, who is the sole importer and distributor of the Company's Trotters and SoftWalk brands in Canada.

During fiscal 2014 and fiscal 2013, the Company's products were carried by approximately 858 customers in over 1,417 retail locations throughout the United States. The Company's distribution channels include leading specialty and independent retail stores, mail order catalogues, and internet retailers. The Company also operates its own direct to consumer internet retail business for all of its brands. Ten significant customers represented approximately 61%, 61%, and 54% of net sales from continuing operations for fiscal 2014, fiscal 2013 and fiscal 2012, respectively. Zappos.com, accounted for 15.4%, 18.2%, and 15.7% of net sales in the 53-week period of fiscal 2014 and the 52-week periods of fiscal 2013 and fiscal 2012, respectively.

Consumer Direct

The Company believes its e-commerce web sites complement the Company's existing wholesale business by increasing consumer awareness of the Company's brands. Sales through the Company's internet web sites represented approximately 2.5%, 2.6%, and 2.6% of its net sales for the 53-week period of fiscal 2014 and the 52-week periods of fiscal 2013 and fiscal 2012, respectively. The products marketed through the Company's web sites are sold at their suggested retail price, enabling the Company to maintain the full retail margins on in-line products. The Company's footwear can be purchased at *www.SoftWalkshoes.com* and *www.trotters.com*.

Competitive business conditions, the Issuer's competitive position in the industry, and methods of competition.

The Company faces intense competition in the footwear industry from numerous domestic and foreign designers and marketers. Many of the Company's competitors have greater financial, distribution or marketing resources than the Company, as well as greater brand recognition. Important elements of competition in the footwear industry include:

- anticipating and responding to changing consumer demands in a timely manner;
- maintaining brand reputation and authenticity;
- developing high quality products that appeal to consumers;
- appropriately pricing products;
- providing strong and effective product marketing support;
- ensuring product availability; and
- maintaining and effectively accessing the Company's distribution channels.

Trotters primarily competes with the Naturalizer®, EasySpirit®, Munro America® and Ros Hommerson® brands, as well as with retailers' private label footwear. SoftWalk primarily competes with the Sofft®, Born®, Dansko®, and ECCO® brands.

The Company believes that all of its brands are positioned to compete effectively in the footwear industry. By emphasizing traditional style, quality and fit, the Company believes these product lines will continue to maintain a loyal consumer following that is less susceptible to fluctuations due to changing fashions and changes in consumer preferences.

Product Development

The Company has a team of development specialists who commercialize product designs and procure footwear that adheres to the Company's fit, quality and constructions standards. They closely manage the production and quality processes with the Company's independent manufacturers in China to ensure timely delivery of goods to the marketplace. The development and commercialization of new product designs include capital outlays for the tooling of dies, molds and lasts, the cost of which is amortized into cost of goods sold over a twelve month period beginning in the season the new design is first distributed. The Company incurred product design and development costs of approximately $318,000 and $255,000 during fiscal 2014 and 2013, respectively.

Sources and availability of raw materials and the names of principal suppliers.

Factories. The Company's footwear is produced by independent contract manufacturers located in China. The Company does not own or operate any manufacturing facilities. The Company believes that the use of independent manufacturers increases its production flexibility and capacity while substantially reducing capital expenditures and avoiding the costs of managing a large production work force.

In an effort to ensure continuity of product quality and fit, as well as control of production costs, the Company uses manufacturers the Company has previous experience with when possible. The Company attempts to ensure that no one manufacturer is responsible for a disproportionate amount of its merchandise and allocates production between factories to achieve a balance between quality, cost and capability. The Company does not have any long-term contracts with any of its manufacturers; however, the Company has long-standing relationships with its manufacturers and believes its relationships are good.

Production Oversight. To maintain product quality and consistency, the Company oversees the key steps of production from manufacturing of initial prototypes to final manufacturing runs. Monitoring of all production is performed by the Company's in-house production team in the U.S., with closer inspection from its staff located in China. The Company believes this local presence allows it to negotiate supplier and manufacturer arrangements more effectively, decrease product turnaround time, manage quality control and ensure prompt delivery of finished footwear.

Quality Control. Quality control is an important and effective means of maintaining the high standards and reputation of the Company's products. The Company's staff in China performs multiple inspection procedures at various stages of the production process. These include examining key raw materials prior to manufacture, samples and materials at various stages of production and final products prior to shipment. The Company's staff is often on site at each of its manufacturers to oversee production.

Third party manufacturers located in China have produced 100% of the Company's footwear products over the last three fiscal years. The Company depends on the ability of these manufacturers to finance the production of goods ordered, maintain adequate manufacturing capacity and meet the Company's quality standards. The Company competes with other companies for the production capacity of these third party manufacturers, and the Company does not exert direct control over the manufacturers' operations. As such, the Company has experienced at times, delays or inabilities to fulfill customer demand and orders. The Company cannot guarantee that any third party manufacturer will have sufficient production capacity, meet the Company's production deadlines or meet its quality standards.

In addition, from time to time, these manufacturers may and have terminated their relationship with the Company. As a result, the Company is not always assured of an uninterrupted supply of products of an acceptable quality and price from its third party manufacturers. Any disruption in the supply of products from the Company's third party manufacturers may harm its business and could result in a loss of sales and an increase in production costs, which would adversely affect the Company's results of operations.

The Issuer's dependence on one or a few major customers.

Ten significant customers represented approximately 61%, 61% and 54% of net sales from continuing operations for the 53-week period of fiscal 2014, and 52-week periods of fiscal 2013 and fiscal 2012, respectively. Zappos.com accounted for 15.4% and 18.2% of net sales in the 53-week period of fiscal 2014 and the 52-week period of fiscal 2013, respectively.

Although the Company has enjoyed long-term relationships with many of its customers, they do not have a contractual obligation to purchase the Company's products. The Company cannot be certain that it will be able to retain its existing major customers. The retail industry can be uncertain due to changing customer buying patterns and consumer preferences. These factors could cause the Company to lose one or more of these customers, which could adversely affect its business.

Patents, trademarks, licenses, franchises, concessions, royalty agreements or labor contracts.

The Company regards its proprietary rights as valuable assets and important to its competitive advantage. The Company's trademarks which have been registered in the U.S. and a number of foreign countries include; Trotters and SoftWalk. The Company's SoftWalk brand contains a proprietary technology in the footbed of the shoe, for which the Company owns a patent in the U.S. The Company vigorously protects its intellectual property against infringement. The Company's patents expire at various times through August 2020. The Company cannot be sure, however, that its activities do not, and will not, infringe on the proprietary rights of others.

The need for any government approvals of principal products or services.

The Company is subject to various laws, ordinances and regulations, including those relating to the general operation of a business. The Company believes that it is in compliance with all laws, ordinances and regulations which have a material effect on the operation of its business. The Company is currently not aware of any need for government approval of its principal product or services.

7) **Describe the Issuer's Facilities**

The general location, use and approximate size of the Company's principal properties are set forth below:

Facility/Location	Own/Lease	Description	Approximate Square Footage
Carlsbad, California	Lease	Office Space	5,195
Old Town, Maine	Lease	Warehouse	75,000
Dongguan, People's Republic of China	Lease	Office Space	2,000
Dolgeville, New York	Own	Vacant Land	30 acres

The Company leases facilities under operating lease agreements expiring through June 2023. The Company's corporate headquarters are located in Carlsbad, California and consists of approximately 5,195 square feet. The lease expires in April 2016.

On July 1, 2013, the Company completed the sale of the land and warehouse (the "Property") located in Old Town, Maine to Old Town Partners, LLC ("Old Town Partners") for $620,000. Concurrent with the sale, the Company entered into a 10 year lease with Old Town Partners. The sale and leaseback of the Property was classified as a capital lease as the present value of the future minimum lease payments using the Company's incremental borrowing rate, exceeded the selling price of the Property. As a result, the Company recorded a capital leased asset and corresponding capital leased obligation at a fair value of $620,000, equal to the selling price of the Property. The $224,000 gain on the sale of the Property was deferred, and will be recognized in proportion to depreciation of the capital leased asset over the initial term of the lease. Payments under the lease agreement reduce the lease obligation, and the imputed interest is recorded to interest expense in the Company's consolidated statements of operations. The lease of the Old Town, Maine Warehouse expires in June 2023.

The Company believes that its current facilities are in good operating condition and are adequate for its current and foreseeable future operating requirements.

8) Officers, Directors, and Control Persons

A. Names of Officers, Directors, and Control Persons.

The names of each of the Company's executive officers, directors and control persons as of the date of this Annual Report are as follows:

Changes in Executives during Fiscal 2014

Executive Officers:

James R. Riedman, Chairman, President and Chief Executive Officer
Bruce Kaplan, Executive Vice President
Greg W. Slack, Chief Financial Officer, Treasurer and Secretary

Directors:

James R. Riedman
Steve M. DePerrior
Frederick R. Port
Stephanie E. Pianka

Control Persons (defined as beneficial owners of more than five percent of the Company's common stock):

Riedman Corporation and James R. Riedman
Greenwood Investments, Inc. and Steven Tannenbaum
Greenwood Capital LP
MGPLA LP

For additional information pertaining to the number of shares of common stock beneficially owned by persons known to the Company to beneficially own more than ten percent of the outstanding share of common stock as of March 10, 2015, see the discussion included in section 8) (C) below under the subheading "Beneficial Shareholders".

B. Legal/Disciplinary History

None of the Company's directors, executive officers or control persons were convicted in a criminal proceeding during the past five years or have been named as a defendant in a pending criminal proceeding. Additionally, none of these persons were a party to any judicial, self-regulatory organization, or other administrative proceeding during the past five years that resulted in a judgment, decree or final order barring, enjoining, suspending or otherwise limiting such persons involvement in any type of business, securities, commodities or banking activities or enjoining the person from future violations of, or prohibiting activities subject to, federal or state securities or commodities laws, or a finding of any violation of federal or state securities or commodities laws.

C. Beneficial Shareholders

The following table shows the number of shares of common stock beneficially owned by persons known to the Company to beneficially own more than ten percent of the outstanding shares of common stock as of March 10, 2015. For the purposes of computing a person's beneficial ownership, shares of common stock issuable upon the exercise of securities exercisable or convertible into common stock within 60 days of March 10, 2015 are deemed outstanding for the purposes of computing the share ownership and percentage ownership of the person holding such securities, but are not deemed outstanding for the purposes of computing the percentage ownership of any other person.

Percentage of beneficial ownership is calculated assuming 8,358,362 shares of the Company's common stock (net of treasury shares) were outstanding as of March 10, 2015. Except as otherwise indicated, to the Company's knowledge, the beneficial owners of common stock listed below have sole or shared investment and voting power with respect to such shares.

Beneficial Owners of 10% or More	Amount and Nature of Beneficial Ownership (1)	Percent of Class
James R. Riedman and Riedman Corporation (2), (3), (4)	9,739,002	67.4%
Greenwood Investments, Inc. and Steven Tannenbaum (2), (3), (4)	9,739,002	67.4%

(1) Unless otherwise noted, and subject to applicable community property laws, each person has sole or shared voting and dispositive power with respect to all shares of common stock beneficially shown as owned by that person.

(2) On June 10, 2013, Mr. Riedman and MGPLA and Greenwood Capital LP (individually, and as the survivor by merger of Greenwood Investors LP with and into Greenwood Capital LP, "Capital"), each acquired 150,000 shares of the Company's common stock in private transactions from WEDBUSH, Inc., Edward W. Wedbush, and Wedbush Securities, Inc.

(3) Includes 593,808 shares owned directly or indirectly through CE Capital, LLC, an affiliated entity, and the following shares and shares issuable upon exercise of outstanding stock options of which Mr. Riedman disclaims beneficial ownership: 382,710 shares and 50,000 stock options beneficially owned by Riedman Corporation, of which Mr. Riedman is a director and a shareholder; 87,337 shares owned by his children; and 139,975 shares held by the Company's 401(k) Plan, not including 16,957 shares allocated to his account. Mr. Riedman is a member of the Board's Retirement Plan Committee, which serves as fiduciary for the Company's 401(k) Plan, and through that committee he shares voting control over such shares. The plan's mailing address is c/o Phoenix Footwear Group, Inc., 5937 Darwin Court, Suite 109, Carlsbad, California 92008.

(4) On July 30, 2012, the Company entered into a Securities Purchase Agreement (the "Purchase Agreement") with MGPLA which provided for the sale of the 2012 Note by the Company to MGPLA and also amended and restated certain agreements previously executed and delivered in connection with its sale of $1.0 million of subordinated secured 1% convertible notes (the "2011 Notes", and collectively with the 2012 Note, the "Notes") to Capital and Greenwood Investors LP ("Investors", together with Capital, the "Greenwood Purchasers", and collectively, with MGPLA, the "Greenwood Investors") on July 21, 2011, including, without limitation, the Voting Agreement (the

"Voting Agreement"), by and between Steven Tannenbaum, Greenwood Investments, Inc. ("General Partner"), the Greenwood Investors (collectively, the "Greenwood Parties"), and James R. Riedman and Riedman Corporation (collectively the "Riedman Parties"). As a result of the Voting Agreement, and based solely on the information provided in the Schedule 13D jointly filed by the Greenwood Parties with the Securities and Exchange Commission ("SEC") on August 1, 2011, and the Schedule 13D, as amended, jointly filed by the Riedman Parties with the SEC on August 1, 2011, in addition to the shares that are beneficially owned by the Riedman Parties and the Greenwood Parties (i) the Riedman Parties may be deemed to beneficially own 7,481,615 shares (including up to 5,869,565 shares issuable upon conversion of the original aggregate principal amount of the Notes) beneficially owned by the Greenwood Parties and (ii) the Greenwood Parties may be deemed to beneficially own 2,257,387 shares beneficially owned by the Riedman Parties. Both the Riedman Parties and Greenwood Parties expressly disclaim being a member of a Section 13(d)(3) "group" with any of the reporting persons of the other party, and further expressly disclaim any beneficial ownership of the shares of the other. Riedman Corporation acts as its own resident agent and may be contacted at 45 East Avenue, Rochester, New York 14604. The name and address of the General Partner's resident agent is Incorporating Services, Ltd., 3500 S Dupont Hwy, Dover, Delaware, 19901.

(5) As a result of the Voting Agreement, and based solely on the information provided in the Schedule 13D, jointly filed by the Greenwood Parties with the SEC on August 1, 2011, such reporting persons may be deemed to beneficially own 9,739,002 shares (including 5,869,565 shares issuable upon conversion of the original aggregate principal amount of the Notes, and 2,257,387 shares beneficially owned by the Riedman Parties (the "Riedman Shares"), which such beneficial ownership is expressly disclaimed by each of the Greenwood Parties). Mr. Tannenbaum is the President of the General Partner, which is the sole general partner of each of the Greenwood Investors. Excluding the Riedman Shares, the beneficial ownership of the Greenwood Parties is as follows: (i) MGPLA beneficially owns 1,521,739 shares issuable upon the conversion of the original principal amount of the 2012 Note); (ii) Capital beneficially owns 5,959,876 shares (including 2,173,913 shares issuable upon the conversion of $500,000 of the original principal amount of the 2011 Notes issued to Capital and 2,173,913 shares issuable upon the conversion of $500,000 of the original principal amount of the 2011 Note issued to Greenwood Investors LP); (iii) Investors beneficially owns 2,895,463 (including 2,173,913 shares issuable upon conversion of $500,000 of the original principal amount of the 2011 Notes); and (iv) each of the General Partner, as the sole general partner of each of the Greenwood Investors, and Mr. Tannenbaum, as the president of the General Partner, beneficially owns 7,481,615 shares (including 5,869,565 shares issuable upon conversion of the original aggregate principal amount of the Notes). Each of the Greenwood Investors has the power to vote and dispose of their shares beneficially owned by such entity (as described above). The General Partner, as the sole general partner of each of the Greenwood Investors, has the authority to vote and dispose of all of the shares. Mr. Tannenbaum, by virtue of his position as president of the General Partner, has the authority to vote and dispose of all of the shares of the Greenwood Investors. The Greenwood Parties each have a principal business address at 222 Berkeley Street, 17th Floor, Boston, MA 02116.

9) Third Party Providers

There are no outside providers that advise the issuer on matters relating to the operations or business development of the Company.

Legal Counsel:

Woods Oviatt Gilman LLP
700 Crossroads Building
2 State Street
Rochester, NY 14614
(585) 987-2800
administrator@woodsoviatt.com

Woods Oviatt Gilman, LLP has been engaged by the Company to review certain legal matters in connection with management's preparation of this disclosure statement.

Accountant:

Mayer Hoffman McCann P.C.
10616 Scripps Summit Court
San Diego, CA 92131
(858) 795-2017
Stuart Starr, Engagement Partner
sstarr@cbiz.com

Mayer Hoffman McCann P.C. ("MHM") is an independent registered public accounting firm who has audited the Company's books and accounts for fiscal 2013 and fiscal 2014, which were prepared by the Company's management, including its Chief Financial Officer. MHM's audits are conducted in accordance with auditing standards generally accepted in the United States of America. Those standards require MHM to plan and perform their audit to obtain reasonable assurance about whether the Company's financial statements are free of material misstatements. MHM's audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements including assessing the accounting principles used and significant estimates made by the Company, as well as evaluating the overall financial statement presentation. The preparation of the consolidated financial statements, financial schedules and footnotes are the responsibility of the Company.

Except as noted above, there are no other outside advisors that assisted, advised, prepared or provided information with respect to this disclosure statement.

10) Issuer Certifications

I, James R. Riedman, President and Chief Executive Officer, certify that:

1. I have reviewed this annual disclosure statement of Phoenix Footwear Group, Inc.;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

March 10, 2015

/s/ James R. Riedman
President and Chief Executive Officer

I, Gregory W. Slack, Chief Financial Officer, Secretary and Treasurer, certify that:

1. I have reviewed this annual disclosure statement of Phoenix Footwear Group, Inc.;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

March 10, 2015

/s/ Gregory W. Slack
Chief Financial Officer, Secretary and Treasurer

Exhibit A

PHOENIX FOOTWEAR GROUP, INC.

AUDITED FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JANUARY 3, 2015

Audited Financial Statements

Independent Auditors' Report

Consolidated Balance Sheets
As of January 3, 2015 and December 28, 2013

Consolidated Statements of Income For the fiscal years ended January 3, 2015 and December 28, 2013

Consolidated Statements of Stockholders Equity
For the fiscal year ended January 3, 2015 and December 28, 2013

Consolidated Statements of Cash Flows
For the fiscal year ended January 3, 2015 and December 28, 2013

Notes to the Consolidated Financial Statements

Financial Statement Schedule II Consolidated Valuation and Qualifying Accounts

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of
Phoenix Footwear Group, Inc.
Carlsbad, California

We have audited the accompanying consolidated financial statements of **Phoenix Footwear Group, Inc.** which comprise the consolidated balance sheets as of January 3, 2015 and December 28, 2013, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements. Our audit also included the financial statement schedule listed in Item 5.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of **Phoenix Footwear Group, Inc.** as of January 3, 2015 and December 28, 2013, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule referred to above, presents fairly, in all material respects, the information set forth therein.

/s/ Mayer Hoffman McCann P.C.
San Diego, CA
March 10, 2015

PHOENIX FOOTWEAR GROUP, INC.

CONSOLIDATED BALANCE SHEETS
(In thousands, except for per share data)

	January 3, 2015	December 28, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 328	$ 141
Accounts receivable (less allowances of $1,108 and $1,024 in 2014 and 2013, respectively)	2,449	2,671
Inventories (less provision of $300 and $344 in 2014 and 2013, respectively)	8,150	7,646
Other current assets	514	753
Income tax receivable	—	30
Total current assets	11,441	11,241
PROPERTY, PLANT AND EQUIPMENT, net	71	73
Capital leased asset, net	527	589
OTHER ASSETS	50	75
TOTAL ASSETS	$ 12,089	$ 11,978
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Revolving line of credit and note payable, current (Note 6)	$ 3,831	$ 4,169
Accounts payable	2,601	2,733
Accrued expenses	1,137	646
Current portion of long term debt	534	220
Total current liabilities	8,103	7,768
OTHER LONG-TERM LIABILITIES		
Term notes payable, net of current portion (Note 6)	124	618
Convertible notes payable	1,350	1,350
Capital lease obligation, net of current portion	543	577
Other non-current liabilities	230	286
Total liabilities	10,350	10,599
Commitments and contingencies (Note 4)		
STOCKHOLDERS' EQUITY:		
Common stock, $0.01 par value — 50,000 shares authorized; 8,575 and 8,515 shares issued and outstanding in 2014 and 2013	87	86
Additional paid-in-capital	46,179	46,147
Accumulated deficit	(41,884)	(42,211)
Treasury stock at cost, 217 shares in 2014 and 2013	(2,643)	(2,643)
Total stockholders' equity	1,739	1,379
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 12,089	$ 11,978

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

PHOENIX FOOTWEAR GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

	Year Ended	
	January 3, 2015	December 28, 2013
Net sales	$ 21,995	$ 19,218
Cost of goods sold	13,914	12,097
Gross profit	8,081	7,121
Operating expenses:		
Selling, general and administrative	6,949	6,299
Total operating expenses	6,949	6,299
Operating income	1,132	822
Other (income)/expense, net	—	(121)
Interest expense, net	773	772
Earnings before income taxes and discontinued operations	359	171
Income tax expense	18	28
Earnings from continuing operations	341	143
Loss from discontinued operations, net of tax	(14)	(73)
Net earnings	$ 327	$ 70
Net earnings (loss) per share, Basic:		
Continuing Operations	$ 0.04	$ 0.02
Discontinued Operations	(0.00)	(0.01)
Net earnings per share	$ 0.04	$ 0.01
Net earnings (loss) per share, Diluted:		
Continuing operations	$ 0.02	$ 0.01
Discontinued operation	(0.00)	(0.01)
Net earnings (loss) per share	$ 0.02	$ —
Weighted average shares outstanding used to calculate per share information:		
Basic	8,343	8,283
Diluted	14,726	14,826
Net earnings	$ 327	$ 70

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

PHOENIX FOOTWEAR GROUP, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Treasury Stock		Total
	Shares	Amount			Shares	Amount	
BALANCE — December 29, 2012	8,455	$ 85	$ 46,104	$ (42, 281)	(217)	$ (2,643)	$ 1,265
Issuance of Common Stock	60	1	13	—	—	—	14
Stock-based compensation for services	—	—	30	—	—	—	30
Net earnings	—	—	—	70	—	—	70
BALANCE — December 28, 2013	8,515	86	46,147	(42,211)	(217)	(2,643)	1,379
Issuance of common stock	60	1	13	—	—	—	14
Stock-based compensation for services	—	—	19	—	—	—	19
Net earnings	—	—	—	327	—	—	327
BALANCE — January 3, 2015	8,575	$ 87	$ 46,179	$ (41,884)	(217)	$ (2,643)	$ 1,739

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

PHOENIX FOOTWEAR GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	For the Fiscal Years Ended	
	January 3, 2015	December 28, 2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	$ 327	$ 70
Loss from discontinued operations	(14)	(73)
Earnings from continuing operations	341	143
Adjustments to reconcile earnings from continuing operations to net cash provided by (used in) operating activities:		
Depreciation and amortization	84	113
Provision for losses on accounts receivable	85	230
(Gain) on disposal of property and equipment	—	(224)
(Gain) on settlement of litigation	—	(121)
Non-cash stock-based compensation	54	44
Amortization of deferred debt issuance costs	135	129
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	138	(1,133)
Inventories, net	(504)	(672)
Other current assets	129	252
Income taxes receivable	30	119
Increase (decrease) in:		
Accounts payable	(132)	159
Accrued expenses	470	54
Other long-term liabilities	(56)	95
Net cash provided by (used in) operating activities from continuing operations	774	(812)
Loss from discontinued operations, net of tax	(14)	(73)
Net cash used in operating activities from discontinued operations	(14)	(73)
Net cash provided by (used in) operating activities	760	(885)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Leasehold Improvements	(20)	(46)
Proceeds from sale of building and land, net	—	533
Net cash (used in) provided by investing activities	(20)	487
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes payable and line of credit	21,612	19,572
Payments of notes payable, capital lease and line of credit	(22,165)	(19,250)
Notes and issuance of subordinated convertible notes	—	200
Payment of debt issuance costs	—	(26)
Net cash (used in) provided by financing activities	(553)	496
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	187	98
CASH AND CASH EQUIVALENTS — Beginning of period	141	43
CASH AND CASH EQUIVALENTS — End of period	$ 328	$ 141
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest	610	577
Income taxes	28	—
Supplemental disclosure of non-cash financing activities:		
Issuance of restricted stock grants	14	14
Capital lease obligation	—	620

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

PHOENIX FOOTWEAR GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL

Definitions

As used in this report, unless the context suggests otherwise, "Phoenix Footwear," "the Company," "its", "our," "us", and "we" means Phoenix Footwear Group, Inc. and consolidated subsidiaries, Penobscot Shoe Company, "Chambers" means Belt Company (f/k/a Chambers Belt Company), "the FASB" means the Financial Accounting Standards Board, "SFAS" means Statement of Financial Accounting Standards, "ASC" means the "FASB Accounting Standards Codification™", "ASU" means "Accounting Standards Update" and "SEC" means the Securities and Exchange Commission.

Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP").

Accounting Period

The Company's operating and reporting period is on a 52-53 week fiscal year ending on the Saturday nearest to December 31. The Company refers to the fiscal year ended December 28, 2013 as "fiscal 2013," the fiscal year ending January 3, 2015 as "fiscal 2014," and the fiscal year ending January 2, 2016 as "fiscal 2015." The 52-week fiscal years consist of four equal quarters of 13 weeks each, and the 53-week fiscal years consist of three 13-week fiscal quarters and one 14-week fiscal quarter. The financial results for the 53-week fiscal years and 14-week fiscal quarters will not be exactly comparable to the 52-week fiscal years and 13-week fiscal quarters. Fiscal 2014 ended January 3, 2015 included 53 weeks, while Fiscal 2013 consisted of 52 weeks.

Principles of Consolidation

The consolidated financial statements consist of Phoenix Footwear Group, Inc. and its wholly-owned subsidiaries, Penobscot Shoe Company, and Belt Company (f/k/a Chambers Belt Company). Intercompany accounts and transactions have been eliminated in consolidation. Belt Company was dissolved on April 1, 2014.

Management Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Management believes that the estimates, judgments and assumptions made when accounting for items and matters such as, but not limited to, the allowances for doubtful accounts, sales returns, impairment assessments and charges, recoverability of assets (including deferred tax assets), uncertain tax provisions, share-based compensation expense, the assessment of lower of cost or market on inventory, useful lives assigned to long-lived assets, and depreciation are reasonable based on the information available at the time they were made. Management also makes estimates in the assessments of potential losses in relation to tax matters, and threatened or pending legal proceedings. Actual results could materially differ from those estimates. For matters not related to income taxes, if a loss is considered probable and the amount can be reasonably estimated, the Company recognizes an expense for the estimated loss. If there is the potential to recover a portion of the estimated loss from a third party, management makes a separate assessment of recoverability and reduces the estimated loss if the recovery is deemed probable.

Segments

The Company determines operating segments on the same basis that it evaluates the performance internally. The operating segments have been aggregated and are reported as one reportable financial segment. The Company aggregates its operating segments for financial reporting purposes because they are similar in each of the following areas: economic characteristics; type of customer; nature of products; nature of production processes; and distribution methods.

The Company had only one reportable segment in both fiscal 2014 and 2013 consisting of Trotters and SoftWalk.

Business and Credit Concentrations

The Company maintains cash in U.S. bank accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant cash risk.

The Company sells much of its footwear to 858 customers across the United States, comprised of leading specialty and independent retail stores, mail order catalogues, uniform, and internet retailers. A decision by the controlling owner of a group of stores or any significant customer to decrease the amount of merchandise purchased from the Company or to cease carrying the Company's products could have an adverse effect on the Company's results of operations in future periods. Additionally, the financial difficulties of a customer could cause the Company to curtail business with that customer or the customer to reduce its business with the Company and cancel orders. Ten significant customers represented approximately 61% and 61% of our net sales from continuing operations in fiscal 2014 and fiscal 2013, respectively, including one customer, which comprised 15.4% of net sales in fiscal 2014.

The Company extends credit to these customers based on an evaluation of each customer's financial condition. The Company monitors its exposure for credit losses on all receivables and maintains allowances for anticipated losses. Credit risk is impacted by conditions or occurrences within the economy and the retail industry and is principally dependent on each customer's financial condition. Four of the Company's customers constituted 55% of trade accounts receivable outstanding at January 3, 2015. The Company's inability to collect on its trade accounts receivable from any of its major customers could adversely affect the Company's results of operation and financial condition.

The Company currently buys all its products from seven independent contract manufacturers located in China. As of January 3, 2015, three of the Company's vendors constituted 53% of its accounts payable. The Company does not have long-term written agreements with any of its manufacturers. The Company could experience difficulties with these manufacturers, including reductions in the availability of production capacity, failure to meet the Company's quality control standards, failure to meet production deadlines or increased manufacturing costs. If the Company's current manufacturers cease doing business with it, the Company could experience an interruption in the manufacture of the Company's products. Although the Company believes that it could find alternative manufacturers, the Company may be unable to establish relationships with alternative manufacturers that will be as favorable as the relationships that exist currently. If the Company is unable to provide products consistent with its standards or the manufacture of the Company's footwear is delayed or becomes more expensive, this could result in customers canceling orders, refusing to accept deliveries or demanding reductions in purchase prices, any of which could have a material adverse effect on the Company's business and results of operations. In addition, the Company's operations are subject to the customary risks of doing business abroad, including but not limited to currency fluctuations and revaluations, custom duties and related fees, various import controls and other monetary barriers, restrictions on the transfer of funds, labor unrest and strikes and, in certain parts of the world, political instability.

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, accounts and other receivables, accounts payable, accrued expenses, the revolving credit facility and term note and convertible notes. The carrying amount of cash, cash equivalents, accounts receivable, other receivables, accounts payables and accrued liabilities approximates fair value due to the relatively short maturity of such instruments. The carrying amount of the Company's notes payable outstanding under the revolving credit facility, long term notes and convertible notes approximates its fair value based upon current rates and terms available to the Company for similar debt.

Cash Equivalents

The Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Accounts Receivable

The Company provides a reserve against its accounts receivable for estimated losses that may result from non-collection due to the financial position of its customers. To minimize the likelihood of uncollectibility, customers' credit-worthiness is reviewed periodically based on external credit reporting services and the Company's experience with the account, and is adjusted accordingly. When a customer's account becomes significantly past due, the Company generally places a hold on the account and discontinues further shipments to that customer, minimizing further risk of loss. The Company determines the amount of the reserve by analyzing known uncollectible accounts, aged receivables, historical losses and its customers' credit-worthiness. Amounts later determined and specifically identified to be uncollectible are charged or written off against this reserve. In addition to these individual assessments, in general, outstanding trade accounts receivable amounts that are greater than 365 days are fully reserved for and amounts greater than 120 days are 75% reserved for. The Company's levels of reserves fluctuate depending upon all of the factors mentioned above. The Company also reserves for potential trade discounts and deductions for co-op advertising normally taken by its customers. These trade allowances provided to its retail customers enhances the flow of goods through the retail channels while reducing the level of sales returns.

Historically, actual results in these areas have not been materially different than the Company's estimates, and the Company does not anticipate that its estimates and assumptions are likely to materially change in the future. However, if the Company incorrectly anticipates trends or unexpected events occur, its results of operations could be materially affected.

Inventories and Cost of Goods Sold

Inventories, principally finished goods, are valued at the lower of cost (based on the first-in, first-out method) or market. The cost elements included in inventory consist of all direct costs of products (net of purchase discounts and vendor allowances), allocated overhead (primarily sourcing and indirect production costs), inbound freight and merchandise acquisition costs such as import fees. The Company reduces the carrying cost of inventories for obsolete or slow moving items as necessary to properly reflect inventory value. Reserves are estimated based upon inventory on hand, historical sales activity and the expected net realizable value. The Company's analysis includes a review of inventory quantities on hand at period end in relation to year-to-date sales, existing orders from customers and projections for sales in the near future. The net realizable value, or market value, is determined using the Company's estimate of sales prices of such inventory based upon historical sales experience on a style by style basis or, if necessary, through off-price or discount store channels.

Cost of goods sold includes the inventory cost elements listed above as well as outbound shipping and handling. The Company's cost of goods sold may not be comparable to those of other entities, since some entities include all of the costs associated with their distribution functions in cost of goods sold while the Company includes these costs in SG&A expenses.

Deferred Financing Costs

Deferred financing costs are amortized over the term of the related debt instrument. Amortization expense associated with deferred financing costs is recorded as interest expense and totaled $135,000 and $129,000 in fiscal 2014 and fiscal 2013, respectively. The amortization expense during fiscal 2014 and fiscal 2013 is associated with the Company's revolving line of credit with AloStar Bank and Economic Recovery Loan Agreement with the Financial Authority of Maine.

Property, Plant, Equipment, Depreciation and Amortization

Property, plant and equipment are recorded at cost. Repair and maintenance costs that do not improve service potential or extend economic life are expensed as incurred. Depreciation is computed by the straight-line method over the estimated useful lives of the assets. Land is not depreciated, and construction in progress is not depreciated until ready for service. Leasehold improvements recorded at the inception of a lease are amortized using the straight-line method over the life of the lease or the useful life of the improvement, whichever is shorter. For improvements made during the lease term, the amortization period is the shorter of the useful life or the remaining lease term (including any renewal periods that are deemed to be reasonably assured). Property under capital leases is amortized over the lives of the respective leases or the estimated useful lives of the assets, whichever is shorter.

The following tables summarize the Company's major classes of property, plant and equipment and capital leased assets:

	January 3, 2015	December 28, 2013	Useful Lives (Years)
	(In thousands)		
Machinery, furniture and equipment	$ 289	$ 289	4 - 10 years
Leasehold improvements	65	45	2 - 10 years
Computer hardware and software	539	539	2 - 5 years
	893	873	
Less accumulated depreciation and amortization	(822)	(800)	
Property, plant and equipment, net	$ 71	$ 73	

	January 3, 2015	December 28, 2013	Useful Lives (Years)
	(In thousands)		
Capital leased asset (land and building)	$ 620	$ 620	10 years
Less accumulated depreciation and amortization	(93)	(31)	
Capital leased asset, net	$ 527	$ 589	

As described in Note 6, "Debt", on July 1, 2013, the Company completed the sale and contemporaneous leaseback of the land and warehouse facility (collectively, the "Property") located in Old Town, Maine owned by Penobscot Shoe Company, a Maine corporation and wholly owned subsidiary ("Penobscot"), to Old Town Partners, LLC (the "Buyer") pursuant to the terms of a purchase and sale agreement for $620,000. The transaction was accounted for as a capital lease resulting in the recording of a capital leased asset and capital leased obligation equal to the Property's selling price. A gain of $224,000 on the sale of the Property was deferred and is being recognized in proportion to depreciation of the capital leased asset over the initial 10 year term of the lease.

Depreciation associated with the capital lease asset during fiscal 2014 and fiscal 2013 was $62,000 and $31,000, respectively. Depreciation expense specifically associated with the Company's property, plant, and equipment for fiscal 2014 and fiscal 2013 was $22,000 and $82,000, respectively. The decrease in depreciation expense in 2014 from 2013 is related to the disposal of assets associated with the leaseback sale of the Company's shipping facility in Maine as well as other assets which were fully depreciated during 2013.

Long-lived Assets Impairments

The Company reviews the carrying value of its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Identification of any impairment would include a comparison of estimated future undiscounted operating cash flows anticipated to be generated during the remaining life of the assets with their net carrying value. An impairment loss would be recognized as the amount by which the carrying value of the assets exceeds their fair value. For fiscal 2014 and fiscal 2013, no impairment loss was recognized as a result of this review.

Revenue Recognition

The Company recognizes revenue from product sales when persuasive evidence of an arrangement exists, products are shipped and the customer takes title and assumes risk of loss, the sales price charged is fixed and determinable and collectability is reasonably assured. Product sales and shipping revenues, net of sales allowances, discounts and return allowances, are recorded when the products are shipped or, in certain situations, upon acceptance by the customer. Allowances for estimated returns are accounted for as reductions to sales, cost of goods sold, accounts receivable and an

increase in inventory to the extent such product is resalable. The Company bases its estimates on historical rates of customer returns and allowances, as well as the specific identification of outstanding returns and allowances, which are known to the Company but which have not yet been received or paid. Sales taxes collected from e-commerce customers are excluded from reported sales.

Shipping Activities

Amounts billed to customers related to shipping and handling costs incurred in delivering product to the customer are included in net sales. Related costs incurred are included in cost of goods sold. Shipping and handling costs incurred in bringing products to the Company's warehouse are capitalized as part of inventory. Costs associated with the Company's own distribution and warehousing are recognized as expense as incurred and are included in SG&A.

Product Design and Development Costs

Expenditures relating to the design of new products and processes, including significant improvements and refinements to existing products, are expensed as incurred and included in SG&A. The amounts charged to expense were $318,000 and $255,000 in fiscal 2014 and fiscal 2013, respectively.

Advertising Programs

The Company capitalizes direct-response advertising costs when (1) it can be shown that customers responded to a specific advertisement and (2) there is a probable future economic benefit. Direct-response advertising costs, such as those for our catalogues, are capitalized and amortized over their useful lives (generally two to four months). As of January 3, 2015, the Company had no capitalized advertising costs. The Company expenses non direct-response advertising production costs as incurred and records communication costs as an expense when the advertisement first takes place. Catalogue and other advertising costs totaled $160,000 and $120,000 during fiscal 2014 and fiscal 2013, respectively.

The Company participates in certain cooperative advertising programs to reimburse a portion of advertising and marketing costs that its customers may incur. Such costs include mailing expenses for catalogues and advertisement runs in newspapers, magazines, radio and television. The Company records cooperative advertising costs as an expense when the advertising first takes place. Total cooperative advertising expense, which was included in SG&A, was $70,000 and $98,000 for fiscal 2014 and fiscal 2013, respectively.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes, in accordance with ASC 740-10, Income Taxes, which requires that the Company recognize deferred tax liabilities for taxable temporary differences and deferred tax assets for deductible temporary differences and operating loss carry-forwards using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit or expense is recognized as a result of changes in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when it is more likely than not that some or all of any deferred tax assets will not be realized.

The Company applies the provisions of ASC 740-10, which contains a two-step process for recognizing and measuring uncertain tax positions. The first step is to determine whether or not a tax benefit should be recognized. A tax benefit will be recognized if the weight of available evidence indicates that the tax position is more likely than not to be sustained upon examination by the relevant tax authorities. The recognition and measurement of benefits related to the Company's tax positions requires significant judgment, as uncertainties often exist with respect to new laws, new interpretations of existing laws, and rulings by taxing authorities. Differences between actual results and our assumptions or changes in our assumptions in future periods are recorded in the period they become known.

Earnings (Loss) Per Share

Basic earnings per common share is calculated by dividing earnings allocated to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect, in periods in which they have a dilutive effect, the effect of unvested restricted stock not classified as participating securities and common shares issuable upon exercise of stock options or warrants and other convertible securities. The difference between reported

basic and diluted weighted-average common shares results from the assumption that all dilutive stock options and warrants and other convertible securities outstanding were exercised and all outstanding restricted shares have vested.

Options, stock rights and convertible notes outstanding to purchase 636,548 and 616,701 shares of common stock were excluded from the computation of diluted earnings per share for fiscal 2014 and fiscal 2013, respectively, because their inclusion would have been anti-dilutive.

Reconciliation of the numerators and denominators of basic and diluted loss per share for fiscal 2014 and fiscal 2013 is as follows:

	2014	2013
	(In thousands, except per share data)	
Earnings per share from continuing operations, basic and diluted:		
Earnings from continuing operations	$ 341	$ 143
1% Subordinated convertible notes interest	44	14
Earnings adjusted for assumed conversion	$ 385	$ 157
Basic: Weighted average common shares outstanding	8,343	8,283
Diluted: Weighted average common shares outstanding	14,726	14,826
Earnings per share from continuing operations, basic	$ 0.04	$ 0.02
diluted	$ 0.02	$ 0.01
Loss per share from discontinued operations, basic and diluted:		
Loss from discontinued operations	$ (14)	$ (73)
Basic: Weighted average common shares outstanding	8,343	8,283
Diluted: Weighted average common shares outstanding	8,343	8,283
Loss per share from discontinued, basic	$ (0.00)	$ (0.01)
diluted	$ (0.00)	$ (0.01)

2. LIQUIDITY & CAPITAL RESOURSES

Cash and cash equivalents at January 3, 2015 increased to $328,000 compared to $141,000 at December 28, 2013. The cash and cash equivalents balance fluctuates throughout the year due in part to the seasonal change in working capital requirements. Cash outflows supporting inventory purchasing, selling activities and distribution typically increase from December to February, and again, between June and August each year.

NewStar Loan and Security Agreement

As described in Note 9, "Subsequent Events", on February 2, 2015, the Company and Penobscot entered into a Loan and Security Agreement with NewStar Business Credit, LLC, a Delaware limited liability company as administrative agent ("NewStar"), and the lenders party thereto from time to time (the "NewStar Loan Agreement"). The NewStar Loan Agreement provides for up to $9.0 million in borrowing capacity consisting of a revolving line of credit facility of up to $8.0 million (subject to a borrowing base as defined in the NewStar Loan Agreement) with a five-year maturity (the "RLOC") and a term loan of $1.0 million (the "Term Loan"). Interest on the principal amount outstanding under the RLOC accrues at a rate equal to the greater of (i) the rate per annum published on each Business Day in the "Money Rates" table of *The Wall Street Journal* as the one-month LIBOR rate, adjusted daily, and (ii) 1.0% (such greater amount, the "LIBOR Rate") plus 3.75%. Interest on the amount outstanding under the Term Loan accrues at the rate equal to the LIBOR Rate plus 5%. The principal amount of the Term Loan is payable in 36 equal monthly installments of $27,778, together with accrued interest, on the first day of each calendar month beginning March 1, 2015. The obligations of the Company as the borrower under the NewStar Loan Agreement have been guaranteed by Penobscot. As security for the obligations of the Company and Penobscot under the NewStar Loan Agreement, the Company and Penobscot have each granted NewStar (for the benefit of the lenders party to the NewStar Loan Agreement) a security interest in all of their personal property.

Proceeds from the NewStar Loan Agreement were used to pay in full the obligations outstanding under that Loan and

Security Agreement dated July 30, 2012 between the Company and AloStar Bank of Commerce, which carried an annual interest rate equal to the LIBOR Rate plus 5.5% and that Loan and Security Agreement dated July 30, 2012 between the Company and Gibraltar Business Capital which carried an annual interest rate of 18.0%.

As a condition to the closing under the NewStar Loan Agreement, the Company also extended from October 30, 2015 until July 2020 the maturity date of the $1,350,000 in aggregate principal amount of its subordinated secured 1% convertible notes held by Greenwood Capital LP and MGPLA LP.

Financial Authority of Maine Term Loan

As described in Note 6, "Debt", on November 11, 2013, the Company entered into an Economic Recovery Loan Agreement (the "Equipment Loan") with the Finance Authority of Maine for a five year term loan, collateralized by all machinery, equipment, furniture, furnishings, fixtures, tools and leasehold improvements located at the Company's Old Town, Maine warehouse and distribution center. The Equipment Loan, consisting of a secured five year term loan in the principal amount of $200,000, bears interest at a fixed per annum rate of 6.0%.

Sale-Leaseback

Also described in Note 6, "Debt", on July 1, 2013, the Company completed the sale and contemporaneous leaseback of the land and warehouse (the "Property") located in Old Town, Maine owned by Penobscot Shoe Company, a wholly-owned subsidiary of the Company ("Penobscot"), to Old Town Partners, LLC (the "Buyer"), pursuant to the terms of a purchase and sale agreement (the "PSA"). Under the PSA, the Company sold the Property to the Buyer for $620,000. Concurrently with the sale, the Company entered into a 10 year commercial lease of the Property with the Buyer.

In the absence of a decline in sales levels, the Company believes that cash flows from operations, the borrowing capacity of its revolving credit facility, and its access to capital will be sufficient to meet the ongoing needs of its business, anticipated growth, flow of inventory, investment requirements and working capital needs for the next twelve months. Additional future financing may be necessary and there can be no assurance that, if needed, the Company will be able to secure additional debt or equity financing with terms acceptable to it or even at all.

3. DISCONTINUED OPERATIONS

Chambers

On July 9, 2009, the Company sold to Tandy Brands Accessories, Inc. ("Tandy") substantially all of the assets used in the operation of Chambers' private label and Wrangler brand businesses. In partial payment of the purchase price due for the purchased assets, Tandy paid to the Company approximately $3.5 million in immediately available funds at closing. As additional purchase price consideration, during the first 12 months after the closing, Tandy was obligated to pay the Company on a monthly basis 21.5% of the net revenue that Tandy recognized from sales of private label products previously sold by Chambers, Chambers trademark branded products and Wrangler branded products to the mass merchandise market ("earn-out"), less $430,000 of prepaid earn-out received at closing.

As of the end of fiscal 2010, the Company had recorded $5.4 million of earn-out revenue, which included all of the twelve month earn-out period reported to the Company by Tandy. As of December 31, 2011, $75,000 was included in other current assets and $181,000 in other current accrued liabilities of continuing operations associated with the divestiture of the Chambers business. The reported earn-out was subject to audit by the Company which was finalized in the fourth quarter of fiscal 2010 and based on the results of the audit, the Company believed it had additional earn-out revenue.

On February 14, 2011, the Company filed suit against Tandy in Superior court of the State of Delaware in Newcastle County, seeking recovery of $524,000, representing an underpayment of the earn-out due under the purchase agreement between Chambers and Tandy, based on the results of the audit the Company performed during the fourth quarter of fiscal 2010.

On January 17, 2014 (the "Effective Date"), Chambers and Tandy entered into the Compromise Settlement Agreement and Release. Under the terms of the settlement, each of Chambers and Tandy agreed to fully and forever release

and discharge one another from and against any and all liabilities, and causes of action that either party has, had, or may have had as of the date of the settlement that are in an way related to the purchase agreement or the litigation. As part of the settlement, Tandy was required to make a payment to Chambers in the amount of $15,000.

As a result of the Settlement, the Company recognized a net gain of $121,000 recorded in "Other (income)/expense, net" from the extinguishment of $181,000 accrued liability and $60,000 of the accrued receivable due to/from Tandy, associated with the divestiture of Chambers, as of December 28, 2013.

For consolidated financial statement reporting purposes, commencing with the first quarter of fiscal 2009, the Company began reporting Chambers as discontinued operations.

Presentation of Discontinued Operations

The following table summarizes the results of the Chambers businesses for the twelve months ended January 3, 2015 and December 28, 2013:

	January 3, 2015	December 28, 2013
	(In thousands)	
Net sales	$ —	$ —
Cost of goods sold, operating expenses and other	(14)	(73)
Net gain on sale	—	—
Loss from discontinued operations	$ (14)	$ (73)

The net loss in 2014 and 2013 was primarily associated with legal fees incurred as a result of the suit filed against Tandy to recover what the Company believed to be an underpayment of the earn-out associated with the sales of Chambers inventory to Tandy.

Cash flows from operating activities from discontinued operations are summarized in the Consolidated Statements of Cash Flows.

4. COMMITMENTS AND CONTINGENCIES

The Company is party to a long-term operating lease for its corporate headquarters in Carlsbad through April 2016, consisting of approximately 5,195 square feet. Minimum lease payments, which take into account escalation clauses, are recognized on a straight-line basis over the minimum lease term. Rent expense included in continuing operations for fiscal 2014 and fiscal 2013 were $70,000 and $68,000, respectively.

Future minimum commitments under the facilities and equipment lease agreements are as follows:

	(In thousands)
Year ending December:	
2015	$ 96
2016	$ 26
Total	$ 122

As described in Note 6, "Debt", on July 1, 2013, the Company entered into a sale and leaseback agreement that was classified as a capital lease. The 10 year initial term of the lease includes a 5 year renewal option. Payments under the lease reduce the lease obligation, and the imputed interest is recorded to interest expense in the Company's consolidated statements of operations. The minimum lease payments under the lease beginning on July 1, 2013 to the end of fiscal 2014 were

$129,200.

Future minimum lease payments under the capital lease beginning January 3, 2015 are as follows:

	(In thousands)
Year ending December:	
2015	$ 90
2016	$ 94
2017	$ 98
2018	$ 101
2019	$ 104
Thereafter	$ 382
Total minimum lease payments	$ 869

During fiscal year 2014, the Company incurred $62,000 in depreciation expense associated with the amortization of the capital asset.

On April 2, 2013, the Company entered into a three years and nine months licensing agreement with Touchstone Television Productions, LLC ("ABC Studios"), to design, market and distribute footwear for the medical community under the Grey's Anatomy brand. Under the terms of the licensing agreement, the Company is required to pay a royalty fee on net invoiced sales at the end of each quarter over the term of the agreement. The licensing agreement guarantees a minimum royalty payment of $150,000 over its three year term expiring on December 31, 2016. In connection with the licensing agreement, the Company entered into a three year joint marketing agreement with Barco Uniforms, Inc. ("Barco"), an industry leading designer, manufacturer and distributor of uniforms including medical scrubs bearing the Grey's Anatomy label. Under the terms of the joint marketing agreement, the Company has agreed to pay a commission on all sales of its footwear trademarked under the licensing agreement with ABC Studios sold by Barco's sales representatives. Through the end of fiscal 2014, the Company has paid $122,300 in royalties to ABC Studios.

The Company, from time to time, may be subject to legal proceedings and claims arising in the normal course of business.

5. DEFINED CONTRIBUTION PLAN

The Company has a defined contribution 401(k) savings plan (the "Plan"), which covers substantially all employees. The Plan allows employees to elect to contribute a portion of their wages on a tax-deferred basis, and the Company may match, at its discretion, a portion of the employee contribution. The company contributed $13,000 and $12,000 during fiscal 2014 and fiscal 2013, respectively.

6. DEBT

Current Accounts Receivable and Inventory Loan and Security Agreements

On July 30, 2012, the Company and Penobscot entered into a Loan and Security Agreement with AloStar for a three-year revolving credit facility and a three-year term loan, collateralized by substantially all of the assets of the Company and its subsidiaries (as amended, the "AloStar Loan Agreement"). The AloStar Loan Agreement provides for up to $7.25 million in borrowing capacity consisting of a secured first lien revolving credit facility of up to $7.0 million (subject to a borrowing base as defined in the AloStar Loan Agreement) with a three-year maturity (the "AloStar Revolving Credit Facility") and a secured first lien term loan of $250,000 with a three-year maturity (the "AloStar Term Loan").

Concurrently with the execution of the AloStar Loan Agreement, and as a condition thereof, the Company also entered into that certain Subordinated Loan Agreement (as amended, the "Subordinated Loan Agreement") with Gibraltar for a three-year $700,000 term loan collateralized by substantially all of the assets of the Company and its subsidiaries. The Subordinated Loan Agreement provided for up to $700,000 in borrowing capacity consisting of a secured term loan of $700,000, with a maturity of three years and ninety days (the "Gibraltar Term Loan").

As an additional condition to the financing, the Company also concurrently completed the sale of $350,000 of a subordinated secured 1% convertible note (the "2012 Note") to MGPLA, an affiliate of the Greenwood Purchasers (defined below). The 2012 Note is initially convertible into 1,521,739 shares of the Company's common stock. The sale was made pursuant to a Securities Purchase Agreement dated July 30, 2012 between the Company and the MGPLA ("2012 Purchase Agreement").

In connection with the issuance of the 2012 Note, the Company also amended and restated certain agreements previously executed and delivered in connection with its sale of the $1.0 million of subordinated secured 1% convertible notes (the "2011 Notes" and collectively with the 2012 Note, the "Greenwood Notes") to Greenwood Investors LP and Greenwood Capital LP (individually, and as the survivor by merger of Greenwood Investors LP with and into Greenwood Capital LP, "Capital") and further, amended the terms of the 2011 Notes to extend the respective maturity dates thereof from July 30, 2014, to October 30, 2015, and provide for the increase in the applicable interest rate pursuant to the terms of the AloStar Loan Agreement commencing July 30, 2014, on terms consistent with the 2012 Note. As a result of the issuance of the 2012 Note, the conversion rate of the 2011 Notes was automatically adjusted from $0.334 per share to $0.23 per share.

Proceeds from the borrowings made on July 30, 2012, were used to pay in full the outstanding balances of $3.72 million, including $115,000 of prepayment penalties, owed to the Company's prior lenders, Gibraltar and Westran Industrial Loan Co., LLC ("Westran", collectively "Prior Lenders"). As a result, all commitments under the Company's then existing Loan and Security Agreement (the "Prior Loan Agreement") between Gibraltar and Westran, and the related $3,250,000 revolving credit note with Gibraltar, $1,000,000 revolving credit note with Westran, $1,000,000 term loan note with Westran, $500,000 term loan note with Gibraltar, Intellectual Property Security Agreement, and Pledge Agreement each dated November 3, 2010, were terminated, all borrowings thereunder were repaid, and all liens thereunder were released, in each case effective July 30, 2012.

In connection with the AloStar Loan Agreement, the Subordinated Loan Agreement, and the Greenwood Notes, AloStar, Gibraltar, the Greenwood Investors and the Company entered into that certain Intercreditor and Subordination Agreement (as amended, the "Subordination Agreement"), pursuant to which Gibraltar and the Greenwood Investors agree to subordinate the Company's obligations with respect to the Subordinated Loan Agreement and the Notes to the Company's respective senior debt obligations.

AloStar Loan Agreement:

Borrowings under the AloStar Revolving Credit Facility bore interest at a rate equal to the Daily LIBOR rate, on any day, equal to the greater of (a) 1.0%, and (b) the LIBOR rate as published by the Wall Street Journal on such day for United States dollar deposits for the one month delivery of funds in amounts approximately equal to the principal amount of the loan for which such rate is being determined plus 5.50%. Borrowings under the AloStar Term Loan Facility bear interest at a rate equal to the LIBOR rate plus 7.50%. In addition, the Company was charged a $2,000 monthly loan servicing fee. A prepayment premium was due the lenders if the Company terminated the credit facility prior to the original three year term date. The prepayment premium is based on 3% of the outstanding credit facility for prepayments within the first year of closing, 2% of the outstanding credit facility for prepayments within the second year of closing, and 1% of the outstanding credit facility for prepayments within the third year of closing prior to the termination date. The AloStar Loan Agreement and related agreements were terminated in connection with the NewStar Loan Agreement entered into on February 2, 2015.

The AloStar Loan Agreement included various financial and other covenants with which the Company has to comply in order to maintain borrowing availability and avoid penalties, including maintaining required EBITDA amounts.

Other covenants included, but are not limited to, covenants limiting or restricting the Company's ability to incur indebtedness, incur liens, enter into mergers or consolidations, dispose of assets, make investments, pay dividends, enter into transactions with affiliates, or prepay certain indebtedness. The AloStar Loan Agreement also contains customary events of default including, but not limited to, payment defaults, covenant defaults, cross-defaults to other indebtedness, material judgment defaults, inaccuracy of representations and warranties, bankruptcy and insolvency events, defects in AloStar's security interests, change in control events and material adverse change. The occurrence of an event of default will increased

the interest rate by 2.0% over the rate otherwise applicable and could result in the acceleration of all obligations of the Company to AloStar with respect to indebtedness, whether under the AloStar Loan Agreement or otherwise.

In connection with the AloStar Loan Agreement, the Company also entered into the following additional agreements with AloStar on July 30, 2012: 1) a Patent Security Agreement and a Trademark Security Agreement in which it granted a continuing security interest in the Company's intellectual property, including its trademarks, goodwill, copyrights, trade secrets, and patents; 2) a Pledge Agreement under which it pledged the shares of its subsidiaries Phoenix Footwear II, Inc., Belt Company, Phoenix Delaware Acquisition, Inc. Penobscot and PXG Canada, Inc., as collateral for the loans; and 3) a Deposit Account Control Agreement with Pacific Western Bank, with respect to the security interest granted AloStar in the Company's deposit account with Pacific Western Bank.

Gibraltar Subordinated Loan Agreement:

Borrowings under Gibraltar's Term Loan Facility bore interest at a rate equal to the prime rate, with a floor of 3.25%, plus 14.75%. Interest only payments were due monthly until July 1, 2013, at which point monthly interest payments will continue while the principal balance will paid in quarterly installments of $30,000, with a balloon payment due at maturity. A prepayment premium of $28,000 was due to the lenders if the Company terminated the credit facility prior to the original three year term date. The Gibraltar Subordinated Term Loan Agreement was terminated and paid off in connection with the Company's entering into the NewStar Loan Agreement on February 2, 2015.

The Subordinated Loan Agreement included various financial and other covenants with which the Company had to comply in order to maintain borrowing availability and avoid penalties, including maintaining required EBITDA amounts.

Other covenants included, but were not limited to, covenants limiting or restricting the Company's ability to incur indebtedness, incur liens, enter into mergers or consolidations, dispose of assets, make investments, pay dividends, enter into transactions with affiliates, or prepay certain indebtedness. The Subordinated Loan Agreement also contained customary events of default including, but not limited to, payment defaults, covenant defaults, cross-defaults to other indebtedness, material judgment defaults, inaccuracy of representations and warranties, bankruptcy and insolvency events, defects in Gibraltar's security interests, change in control events and material adverse change. The occurrence of an event of default would have increased the interest rate by 4.0% over the rate otherwise applicable and could have resulted in the acceleration of all obligations of the Company to Gibraltar with respect to indebtedness, whether under the Subordinated Loan Agreement or otherwise.

In connection with the Subordinated Loan Agreement, the Company also entered into the following additional agreements with Gibraltar on July 30, 2012, in each case subject to the terms of the Subordination Agreement: 1) an Intellectual Property Security Agreement in which it granted a continuing security interest in the Company's intellectual property, including its trademarks, goodwill, copyrights, trade secrets, and patents; and 2) a Pledge Agreement under which it pledged the shares of its subsidiaries Phoenix Footwear II, Inc., Belt Company, Phoenix Delaware Acquisition, Inc. Penobscot and PXG Canada, Inc., as collateral for the loans.

2012 Purchase Agreement:

Convertible Subordinated Secured Notes

On July 21, 2011, the Company completed the sale of the 2011 Notes to the Greenwood Purchasers. Capital is an affiliate of and managed by General Partner, its sole general partner. Steven Tannenbaum is the President of General Partner (the Greenwood Investors, General Partner and Mr. Tannenbaum are referred to collectedly herein as the "Greenwood Parties"). The 2011 Notes were initially convertible into 2,994,011 shares of the Company's common stock. The 2011 Notes are due October 30, 2015, and bear interest at the rate of 1.0% per annum. The interest is payable in cash semiannually in arrears on October 31, and April 30 of each year, commencing October 31, 2011. No prepayment may be made by the Company without Greenwood Purchasers' consent. Capital may convert all or part of the 2011 Notes into common stock of the Company until the maturity date. As a result of the Company's issuance of the 2012 Note, the conversion price of the

2011 Notes was reduced to $0.23, at which price the 2011 Notes are convertible into 4,347,826 shares of the Company's common stock. The conversion price remains subject to adjustment in the event of certain corporate transactions, including but not limited to, certain issuances of common stock at a price below the conversion price of the 2011 Notes. The 2011 Notes also provide for mandatory conversion into common stock in the event certain market conditions are met for the trading of the Company's stock, including a trading price of at least $1.00 per share on each trading day during any period of 90 consecutive days ended within 10 days prior to determination, or in the event a change in control results from the sale of the Company in a merger, stock or asset sale for a cash price of at least $5.00 per share.

The 2011 Notes contain customary events of default including, but not limited to, payment defaults, failure to deliver shares on conversion, cross-defaults to other agreements in the transaction, cross defaults to other indebtedness of $50,000 or more in the aggregate, material judgment defaults, inaccuracy of representations and warranties, bankruptcy and insolvency events, and other occurrences including change in control. The occurrence of an event of default will increase the interest rate to 13.0% and could result in the acceleration of all obligations of the Company to Capital with respect to the 2011 Notes.

The obligation under the 2011 Notes is secured by a pledge of substantially all of the Company's assets, including its intellectual property and stock of its Penobscot. The security is provided under the Security Agreement, Intellectual Property Security Agreement and Pledge Agreement between the Company, the Greenwood Investors and Greenwood Investments, Inc., as agent for the Greenwood Investors, each of which were amended and restated as discussed herein.

As required under the terms of the transaction, the Board of Directors approved the Amended and Restated By-Laws of the Company to i) eliminate the restriction on stockholders ability to act by written consent in lieu of a meeting with less than unanimous consent; ii) permit holders of at least 15% of the outstanding stock eligible to vote at a meeting to call a special meeting of stockholders; and iii) to incorporate the reduction of the size of the board from 7 to 4. In addition, the Company entered into (1) an Amendment of the Employment Agreement with James Riedman, the Company's Chief Executive Officer to eliminate its automatic renewal so it will terminate by its terms on December 31, 2012, and to provide that no severance will be paid if the agreement expires by virtue of it reaching the end of its term, and (2) an indemnification agreement with Stephanie Pianka, as a director of the Company.

Other agreements entered into in connection with the transaction with the Greenwood Purchasers, which have each been subsequently replaced or amended and restated as set forth above, included: (1) a Subordination and Intercreditor Agreement, subordinating the security interest of the Greenwood Purchasers to the rights of the Prior Lenders, together with a related Waiver and Consent provided by the Prior Lenders to the Company with respect to certain provisions under its credit facility and related loan agreements, to permit the issuance of the 2011 Notes to the Greenwood Purchasers; (2) the Investors Agreement; and (3) the Voting Agreement.

2012 Convertible Note.

The 2012 Note is due October 30, 2015, and bears interest at the initial rate of 1.0% per year. The interest is payable in cash semi-annually in arrears on October 31 and April 30 of each year, commencing October 31, 2012, and the rate increases to the applicable interest rate under the Loan Agreement commencing July 30, 2014. No prepayment may be made by the Company without MGPLA's consent. MGPLA may convert all or part of the 2012 Note into common stock of the Company at a conversion price equal to $0.23 until the maturity date. The initial conversion price is subject to adjustment in the event of certain corporate transactions, including but not limited to, certain issuances of common stock at a price below the conversion price of the 2012 Note. The 2012 Note also provides for mandatory conversion into common stock in the event certain market conditions are met for the trading of the Company's stock, including a trading price of at least $1.00 per share on each trading day during any period of 90 consecutive days ending within 10 days prior to the date of determination, or in the event a change of control results from a sale of the Company in a merger, stock or asset sale for a cash price of at least $5.00 per share.

The maturity date of the Greenwood Notes was extended to July 31, 2020, in connection with the Company's entering into the NewStar Loan Agreement on February 2, 2015.

The 2012 Note contains customary events of default including, but not limited to, payment defaults, failure to deliver shares on conversion, cross-defaults to other agreements in the transaction, cross-defaults to other indebtedness of $50,000 or more in the aggregate, material judgment defaults, inaccuracy of representations and warranties, bankruptcy and insolvency events, defects in the security interests, unresolved judgments of $50,000 or more in excess of insurance coverage and change in control events. The occurrence of an event of default will increase the interest rate to 13.0% and could result in the acceleration of all obligations of the Company to MGPLA with respect to indebtedness.

In addition to the sale of the 2012 Note, the 2012 Purchase Agreement also required that the parties amend and restate the following additional agreements, subject to the Subordination Agreement, to include the MGPLA as a party:

Security Agreement, IP Security Agreement, Pledge Agreement. The obligation under the Notes is secured by a pledge of substantially all of the Company's assets, including its intellectual property assets and the stock of its wholly-owned subsidiary, Penobscot. The security interest is provided under the Security Agreement, Intellectual Property Security Agreement and Pledge Agreement between the Company, the Greenwood Investors and Greenwood Investments, Inc., as agent for the Greenwood Investors, each dated July 30, 2012.

Subordination Agreement. The security interest of the Greenwood Investors was subordinated to the rights of AloStar and Gibraltar under their respective $7.25 million credit facility and $700,000 term note, pursuant to the terms and conditions of the Subordination Agreement.

Investors Agreement:

Registration Rights. Under the Investors Agreement between the Company, the Greenwood Investors, James Riedman, and Riedman Corporation dated July 30, 2012, the Greenwood Investors received registration rights under which they may make a demand for registration of the shares underlying the Notes and other shares held by the Greenwood Investors and their affiliates. The demand may not be made until after the earlier of 3 years after July 21, 2011, or 180 days after the effective date of an initial public offering registration statement. The Company must thereafter file a registration statement within 60 days of a demand. The Greenwood Investors are limited to two demands for a Registration Statement on Form S-1. If the Company is eligible to use Form S-3, it must file a registration statement within 45 days of a demand and there is no limit on the number of such demands. The Greenwood Investors also obtained unlimited piggyback registration rights. Each of the categories of registration rights are subject to an underwriter's cutback. The agreement also obligates the Company make current information available to the public to meet the requirements of Rule 144.

Matters Requiring Investor Approval. Under the Investors Agreement, the Company may not take certain actions without the approval of Greenwood Investments, Inc., including but not limited to: increase or decrease its authorized capital stock, or authorize new classes or series of capital stock or securities convertible into common stock; amend its certificate of incorporation or by-laws; enter into a merger or sell all or substantially all of the properties or assets of the Company and its subsidiaries; dissolve; declare or pay any dividend; issue or obligate itself to issue any security, other than shares of common stock, except upon certain outstanding obligations; redeem any shares; increase or decrease the authorized size of the Board of Directors, except as expressly contemplated by the Voting Agreement; acquire all or any portion of any business or product line; enter into any material joint ventures, strategic alliances, or major partnerships; incur of any indebtedness outside the ordinary course of business other than under the agreements executed concurrently therewith; hire, terminate, or increase the compensation of James R. Riedman and any other person holding the position of chief executive of the Company; approve or authorize any transaction or series of related transactions outside the ordinary course of business involving $250,000 or more.

Matters Requiring Board Approval. Under the Investors Agreement, management may not take the following actions without approval of the board of directors, including but not limited to: materially modify any existing loans; approve or authorize any material modification to or material deviation from the Company's budget; increase the compensation of any director; approve the settlement by the Company of any material litigation or other proceedings relating to the Company; pay any capital expenditures in excess of $100,000 during any 12-month period other than a specific identifiable line item previously approved in the budget.

Standstill. Under the Investors Agreement, the Greenwood Investors and James R. Riedman and Riedman Corporation (the "Riedman Shareholders") each agreed to a standstill whereby they will not acquire any common stock or other securities of the Company in an open-market transaction unless approved in advance to do so by the Company's board of directors, and (i) in the case of the Riedman Shareholders, unless approved by Greenwood Investments, Inc. ("General Partner"), or (ii) in the case of the Greenwood Investors or any of their affiliates, by a director not appointed by or affiliated in any way with the Investors). The Riedman Shareholders are parties to the Investors Agreement solely for purposes of this standstill provision.

Participation Rights. The Greenwood Investors also obtained participation rights so that they shall be entitled to a right to purchase, on a pro rata basis, all or any part of any new securities issued by the Company, with certain exceptions for preexisting obligations by the Company to issue other securities.

Voting Agreement. The Company, the Greenwood Investors and the Riedman Shareholders also amended and restated that certain Voting Agreement dated July 21, 2011, as part of the transaction. The Riedman Shareholders agreed to elect one designee of the Investors as a member of the board of directors. The Investors agreed to elect one designee of the Riedman Shareholders to the Board. The parties also agreed to vote as necessary to ensure that the size of the board of directors shall be set and remain at four directors until the directors are next elected by stockholders, or at such earlier time as may be requested by the Greenwood Investors upon their written request, on which date the size of the board shall be reduced and set and remain at three directors.

Capital Lease Obligation

On July 1, 2013, the Company completed the sale and contemporaneous leaseback of the Property to the Buyer, pursuant to the terms of the PSA. Under the PSA, the Company sold the Property to the Buyer for $620,000. Concurrently with the sale, the Company entered into a 10 year commercial lease of the Property with the Buyer. In addition, the AloStar Loan Agreement and the Subordinated Loan Agreement were amended to permit the consummation of the transactions completed by the PSA. The proceeds of the transaction were used to pay off the balance of its $250,000 term loan with AloStar, and pay down its $700,000 subordinated term note with Gibraltar, and its $7.0 million revolving credit facility with AloStar.

The sale and leaseback transaction of the Property was classified as a capital lease as the present value of the minimum future lease payments using the Company's incremental borrowing rate, exceeded the selling price of the Property. As a result, the Company recorded a capital leased asset and corresponding capital leased obligation at a fair value of $620,000, equal to the selling price of the Property. The $224,000 gain on the sale of the Property was deferred and will be recognized in proportion to depreciation of the capital leased asset over the ten (10) year initial term of the lease. Payments under the lease agreement reduce the lease obligation, and the imputed interest is recorded to interest expense in the Company's consolidated statements of operations.

Financial Authority of Maine Term Loan

On November 11, 2013, the Company entered into an Equipment Loan with the Finance Authority of Maine ("FAME") for a five year term loan, collateralized by all machinery, equipment, furniture, furnishings, fixtures, tools and leasehold improvements located at the Company's Old Town, Maine warehouse and distribution center. The Equipment Loan, consisting of a secured five year term loan in the principal amount of $200,000, bears interest at a fixed per annum rate of 6.0%. Payments of principal and interest in the amount of $3,867 commencing one month from the date entered into and continuing on the same day of each month thereafter (except for any month not containing such a day, in which case it shall be due the last day of that month) until November 11, 2018 (the "Maturity Date"), when, unless sooner paid, the remaining principal and accrued and unpaid interest shall be due and payable in full. The AloStar Loan Agreement and the Subordinated Loan Agreement were amended in connection with the Equipment Loan to permit the transactions contemplated thereunder.

In addition, AloStar, Gibraltar, and the Greenwood Parties entered into a separate subordination letter agreement with FAME to permit the repayment of the Equipment Loan and the use of certain equipment as collateral.

As of January 3, 2015 and December 28, 2013, debt consisted of the following:

	January 3, 2015	December 28, 2013
	(In thousands)	
Term loan facility with Financial Authority of Maine; secured by the Company's personal property in the Maine warehouse and distribution center; interest payable monthly at a rate of 6% annum	$ 162	$ 197
Revolving line of credit with AloStar Bank of Commerce; secured by all of the Company's personal property; interest payable monthly and bears a rate equal to the greater of 1% or the Daily LIBOR rate plus 5.50% per annum (stated rate of 6.50% at January 3, 2015)	3,831	4,169
Subordinated term loan facility with Gibraltar Business Capital; secured by all of the Company's personal property; interest payable monthly and bears a stated rate of prime, with a floor of 3.25%, plus 14.75% per annum (stated rated of 18.0% at January 3,2015)	460	610
Subordinated secured 1% convertible notes with Greenwood Capital LP; secured by all of the Company's personal property; interest payable semi-annually on October 31st and April 30th at a rate of 1% per annum until July 29, 2014, after which the rate increased to the applicable interest rate under the AloStar Loan Agreement.	1,000	1,000
Subordinated secured 1% convertible note with MGPLA LP; secured by all of the Company's personal property; interest payable semi-annually on October 31st and April 30th at a rate of 1% per annum until July 30, 2014, after which the rate increased to the applicable interest rate under the AloStar Loan Agreement.	350	350
Capitalized leased obligation: 10 year capital lease with Old Town Partners, LLC terminating on June 30, 2023. Lease payments are allocated to the reduction of the capital lease obligation and the interest expense with an imputed per annum rate of 9.5%.	579	608
	$ 6,382	$ 6,934
Current portion of long term debt	4,365	4,389
Long term debt, net of current portion	$ 2,017	$ 2,545

The AloStar Loan Agreement and the Subordinated Loan Agreement include various financial and other covenants, with which the Company had to comply in order to maintain borrowing availability and avoid penalties including maintaining required minimum EBITDA amounts. As of January 3, 2015, the Company's rolling 12 month EBITDA, as defined in the Loan Agreement of $1,317,000 was in compliance with the minimum EBITDA covenant of the AloStar Loan Agreement and the Subordinated Loan Agreement.

On February 27, 2013 and March 4, 2013, the Company entered into the First Amendment to the Subordinated Loan Agreement with Gibraltar and the First Amendment to the Loan Agreement with AloStar, waiving the Company's non-compliance with the required minimum EBITDA covenant of those agreements as of December 29, 2012 and amending the required minimum EBITDA covenant for each of the first, second and third quarters for fiscal 2013.

As of January 3, 2015, the Company had $1,124,000 in available borrowing capacity under the Revolving Credit Facility.

During fiscal 2013, the Company incurred $26,000 in prepaid debt costs associated with the 5 year term loan agreement with the Financial Authority of Maine

7. STOCK-BASED COMPENSATION

On July 1, 2011, the Board of Directors adopted and approved the 2011 Long-Term Incentive Plan of Phoenix Footwear Group, Inc. (the "2011 Plan"), subject to stockholder approval which was obtained on June 29, 2012, to renew the Amended and Restated 2001 Long-Term Incentive Plan of the Company which had expired by its terms. Under the 2011 Plan the Company may grant stock options, stock appreciation rights, stock awards and other awards from time to time to key employees, officers, directors, advisors and independent consultants to the Company or to any of its subsidiaries. Shares available for future option and restricted stock grants totaled 1,017,204 as of January 3, 2015.

Total stock-based compensation expense recognized for fiscal 2014 and fiscal 2013 were as follows:

	Twelve Months ended	
	January 3, 2015	December 28, 2013
	(In thousands)	
Selling, general and administrative	$ 54	$ 44
Pre-tax stock-based compensation expense	54	44
Income tax benefit	—	—
Total stock-based compensation expense	$ 54	$ 44

Options

In general, options become exercisable over either a two- or three-year period from the grant date and expire 10 years after the date of grant. The fair value of each option award is estimated on the date of the grant using the Black-Scholes-Merton option pricing model. Expected volatilities are based on historical volatility of the Company's stock price and implied. The Company uses historical data to estimate an option's expected life; the expected life for grants to senior management-level employees and other employees are considered separately for valuation purposes. The risk-free interest rate input is based on the U.S. Treasury yield curve in effect at the time of the grant. Compensation cost, net of projected forfeitures, is recognized on a straight-line basis over the period between the grant and vesting dates, with compensation cost for grants with a graded vesting schedule recognized on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards.

During fiscal 2014 and fiscal 2013 the Company granted 0 and 1,160,000 option awards, respectively. On March 20th, June 18th, and July 8th of fiscal 2013, the Company's Board of Directors approved the issuance of performance based options under the 2011 Plan to its executive officers and a select group of other senior level managers pursuant to individual option award agreements (each, an "Option" and collectively, the "Options") for an aggregate of 910,000 shares, at an exercise price of $0.23, 30,000 shares, at an exercise price of $0.28 per share and 220,000 shares, at an exercise price of $0.26 per share. The vesting of the Options is subject to the Company meeting the following performance conditions:

- 50% of each Option vests upon the Company's achieving on a rolling 12 month basis net revenue of $20.0 million on or before March 20, 2018
- 100% of each Option vests upon the Company's achieving on a rolling 12 month basis net revenue of $22.5 million on or before March 20, 2018.

If the Company fails to satisfy the vesting performance conditions on or before March 20, 2018, such unvested portion of each Option will be immediately forfeited. The Company did not modify any outstanding stock awards during fiscal 2014 and 2013. The performance criteria of achieving on a rolling 12 month basis net revenue of $20.0 million on or before March 20, 2018 to vest 50% of the Option grants was met during fiscal 2014.

Options issued during fiscal 2013 were valued using the Black-Sholes-Merton option pricing model using the following assumptions.

	Twelve Months ended	
	January 3, 2015	December 28, 2013
Expected volatility	n/a	82%
Dividend yield	n/a	—
Risk-free interest rate	n/a	2.30%
Expected life (in years)	n/a	3.0

The weighted average fair value of options granted during fiscal 2014 and fiscal 2013 were approximately $0.00, and $0.09, respectively. The aggregate intrinsic value of options exercised during fiscal 2014 and fiscal 2013 was $0.00. The unrecognized compensation cost related to stock option awards at January 3, 2015, was $67,000 and is expected to be recognized over a weighted average period of 1.0 year.

The following table summarizes the stock option transactions during fiscal 2014 and fiscal 2013:

	Options	Weighted Average Exercise Price	Aggregate Intrinsic Value
	(In thousands, except exercise price)		
Options outstanding , December 29, 2012	287	3.41	
Options granted	1,160	0.24	
Options exercised	—	—	
Options cancelled	(377)	1.06	
Options outstanding, December 28, 2013	1,070	0.80	$ 155
Options granted	—	—	
Options exercised	—	—	
Options cancelled	(30)	13.33	
Options outstanding, January 3, 2015	1,040	$ 0.44	$ 654
Options exercisable, January 3, 2015	560	$ 0.61	$ 327

The outstanding stock options as of January 3, 2015 have an exercise price ranging from $0.23-$5.84 per share and expire at various dates through March 2023.

The following table summarizes information about employee stock options outstanding and exercisable at January 3, 2015.

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Number Outstanding at January 3, 2015	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at January 3, 2015	Weighted Average Exercise Price
	(In thousands, except years and exercise price)				
$0.23 to $0.28	960	8.2 years	$ 0.24	480	$ 0.24
$1.00	50	6.2 years	$ 1.00	50	$ 1.00
$5.84	30	0.4 years	$ 5.84	30	$ 5.84
Total	1,040	7.9 years	$ 0.44	560	$ 0.61

Restricted Stock Rights

In general, service-based stock rights vest over a two-year period from the grant date. Performance-based stock rights cliff vest based on specifically defined performance criteria consisting primarily of revenue, income and shareholder value targets and expire generally within a three to five-year period if the performance or service criteria have not been met. The Company deems stock rights to be equivalent to a stock option for the purpose of calculating dilutive shares.

Compensation cost for restricted stock rights is measured as the excess, if any, of the quoted market price of the Company's stock at the grant date over the amount the holder must pay to acquire the stock (which is generally zero). Compensation cost, net of projected forfeitures, is recognized over the period between the issue date and the date any restrictions lapse, with compensation cost for grants with a graded vesting schedule (service-based) recognized on a straight-line basis over the requisite service period for the total award. In any event, compensation expense is not recognized, if at all, until vesting is considered probable.

On April 1, 2014, the Company granted to each of its non-employee directors 20,000 service based restricted shares of common stock contingent upon the directors continued membership on the Company's Board through March 31, 2015.

As of January 3, 2015, the total compensation cost related to stock-based awards granted to non-employee directors but not yet recognized was $10,500.

The following table summarizes service-based and performance-based stock rights issued as of January 3, 2015:

	Stock Rights
	(In thousands)
Stock Rights outstanding December 29, 2012	—
Granted	120
Cancelled	—
Exercised	(60)
Stock Rights outstanding December 28, 2013	60
Granted	60
Cancelled	—
Exercised	(60)
Stock Rights outstanding January 3, 2015	60

In addition to the stock options and restricted stock rights outstanding under the 2011 Plan, the Company granted options to two separate major stockholders in consideration for debt and debt guarantees. Options outstanding and exercisable under these arrangements totaled 50,000 as of January 3, 2015. These options were granted July 17, 1997 with an exercise price of $2.38 per share.

8. INCOME TAXES

The Company uses the asset and liability method of accounting for income taxes, in accordance with ASC 740-10 (formerly SFAS 109), which requires that the Company recognize deferred tax liabilities for taxable temporary differences and deferred tax assets for deductible temporary differences and operating loss carry-forwards using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit or expense is recognized as a result of changes in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when it is more likely than not that some or all of any deferred tax assets will not be realized. As of January 3, 2015 and December 28, 2013, the Company had a full valuation allowance on its deferred tax assets.

The following summarizes the income tax expense (benefit) for fiscal 2014 and fiscal 2013:

	2014	2013
	(In thousands)	
Current:		
Federal	$ 17	$ 6
State	22	125
Foreign	—	—
	39	131
Deferred:		
Federal	—	
State	(21)	(103)
	(21)	(103)
Income tax expense (benefit)	18	$ 28

Current income taxes (benefits) are based upon the year's income taxable for federal, state and foreign tax reporting purposes. Deferred income taxes (benefits) are provided for certain income and expenses, which are recognized in different periods for tax and financial reporting purposes.

Deferred tax assets and liabilities are computed for differences between the financial statements and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the period in which the differences are expected to affect taxable income. The Company's policy is not to record deferred income taxes on the undistributed earnings of foreign subsidiaries that are indefinitely reinvested in foreign operations.

Income tax expense (benefit) on the Company's adjusted historical earnings differs from the amounts computed by applying the applicable federal statutory rates due to the following:

	2014	2013
	(In thousands)	
Benefit for federal income taxes at the statutory rate	117	$ 33
State and other taxes, net of federal benefit	7	9
Items not deductible	18	11
Decrease of the valuation allowances	(119)	(37)
Decrease in the FIN48 liability	(21)	(103)
Other, net	16	115
Income tax expense (benefit)	$ 18	$ 28

Components of the Company's deferred tax assets (liabilities) as of January 3, 2015 and December 28, 2013 are as follows:

	2014		2013	
	Current	Non-current	Current	Non-current
	(In thousands)		(In thousands)	
ASSETS				
Non-deductible allowances for doubtful accounts	$ 15	$ —	$ 18	$ —
UNICAP	78	—	67	—
Earn-out	—	—	26	—
Other accruals	1,052	27	791	42
Capital loss carryforward	—	—	—	244
Net operating loss carryforwards	—	12,963	—	13,338
Depreciation		2		70
Credits	—	17	—	5
LIABILITIES				
Depreciation	—	—	—	—
Deferred income tax asset (liability)	1,145	13,009	902	13,699
Valuation allowances	(1,145)	(13,009)	(902)	(13,699)
Net deferred tax asset (liability)	$ —	$ —	$ —	$ —

In assessing the realizability of deferred tax asset of $14.2 million at January 3, 2015, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company has determined it is more likely than not that its deferred tax assets will not be realized. Accordingly, a valuation allowance has been recorded at January 3, 2015 to fully offset the deferred tax asset of $14.2 million.

As of January 3, 2015, the Company had approximately $34.0 million of net operating loss carryforwards available for federal tax purposes which begin to expire in 2028. As of January 3, 2015, the Company also had approximately $23.0 million of net operating loss carryforwards for California and $6.0 million of net operating losses for other states. These net operating losses begin to expire in 2016. Additionally, the Company had approximately $0 of capital loss carryforwards remaining from the pre-tax sale of Altama. These loss carryforwards expired in 2014.

Utilization of the NOL carryforwards may be subject to a substantial annual limitation due to ownership change limitations that may have occurred or that could occur in the future, as required by Section 382 of the Internal Revenue Code of 1986, as amended (the "Code"), as well as similar state and foreign provisions. These ownership changes may limit the amount of NOL and R&D credit carryforwards that can be utilized annually to offset future taxable income and tax, respectively. In general, an "ownership change" as defined by Section 382 of the Code results from a transaction or series of transactions over a three-year period resulting in an ownership change of more than 50 percentage points of the outstanding stock of a company by certain shareholders.

The Company has not completed a study to assess whether an ownership change has occurred or whether there have been multiple ownership changes since the Company's formation due to the complexity and cost associated with such a study, and the fact that there may be additional such ownership changes in the future.

On January 3, 2015, the Company complied with Accounting for Uncertain Tax positions pursuant to ASC 740. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (excluding interest and penalties):

	(In thousands)
Unrecognized tax benefits, December 28 , 2013	$ 32
Increases for prior year tax positions	None
Decreases for prior year tax positions	None
Increases for current year tax positions	None
Settlements	None
Administrative practice relief	(12)
Unrecognized tax benefits, January 3, 2015	$ 20

Included in the balance of unrecognized tax benefits at January 3, 2015, are approximately $39,000 of tax benefits that, if recognized, would affect the effective tax rate (including interest and penalties). It is not anticipated that there will not be a significant change in unrecognized tax benefits over the next twelve months. The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense. As of January 3, 2015, the Company had approximately $18,000 of accrued interest and penalties related to uncertain tax positions. The Company has accrued interest and penalties of $10,000 during fiscal 2012 that are related to the uncertain tax benefits noted above.

The Company is subject to taxation in the U.S. and various state tax jurisdictions. As of January 3, 2015 the Company is no longer subject to federal examinations for the year before 2011; and for California and Canadian examinations before 2010. Generally the tax years remain open for examination by the tax authorities under a four year statute of limitations; however, certain states may keep their statute open for six to ten years.

9. SUBSEQUENT EVENTS

On February 2, 2015, the Company and Penobscot entered into a Loan and Security Agreement with NewStar Business Credit, LLC, a Delaware limited liability company as administrative agent ("NewStar"), and the lenders party thereto from time to time (the "NewStar Loan Agreement"). The NewStar Loan Agreement provides for up to $9.0 million in borrowing capacity consisting of up to $8.0 million (subject to a borrowing base as defined in the NewStar Loan Agreement) with a five-year maturity (the "RLOC") and a term loan of $1.0 million (the "Term Loan"). The principal amount of the Term Loan is payable in 36 equal monthly installments of $27,778, together with accrued interest, on the first day of each calendar month beginning March 1, 2015. The obligations of the Company as the borrower under the NewStar Loan Agreement have been guaranteed by Penobscot. As security for the obligations of the Company and Penobscot under the NewStar Loan Agreement, the Company and Penobscot have each granted NewStar (for the benefit of the lenders party to the NewStar Loan Agreement) a security interest in all of their personal property. The maturity dates of the RLOC and Term Note are February 2, 2020 and February 2, 2018, respectively.

Interest accrues on the principal amount outstanding under the Revolving Credit Facility at the rate equal to the greater of (i) the rate per annum published on each Business Day in the "Money Rates" table of *The Wall Street Journal* as the one-month LIBOR rate, adjusted daily, and (ii) 1.0% (such greater amount, the "LIBOR Rate") plus 3.75%. Interest accrues on the principal amount outstanding under the Term Loan at the rate equal to the LIBOR Rate plus 5.0%.

The obligations outstanding under the Revolving Credit Facility and the Term Loan may be prepaid at any time. Beginning with the Company's fiscal year ending December 31, 2016, the Term Loan is subject to a mandatory annual prepayment in an amount equal to the lesser of (i) 25.0% of aggregate excess cash flow (as defined in the NewStar Loan Agreement) of the Company and its subsidiaries for each fiscal year or (ii) $100,000. A prepayment premium will be payable to the lenders if the Company prepays the entire amount outsanding under and terminates the credit facility prior to the third anniversary thereof. The prepayment premium is equal to 3% of the RLOC plus the outstanding principal amount, if any, of the Term Loan in the case of a termination within the first year of the closing, 2% of such sum in the case of a termination within the second year of the closing, and 1% of such sum in the case of a termination within the third year of the closing.

The NewStar Loan Agreement includes various financial and other covenants with which the Company has to comply in order to maintain borrowing availability and avoid penalties, including maintaining minimum tangible net worth and minimum fixed charge coverage ratios

Other covenants include, but are not limited to, covenants limiting or restricting the Company's ability to incur indebtedness, incur liens, enter into mergers or consolidations, dispose of assets, make investments, pay dividends, enter into transactions with affiliates, or prepay certain indebtedness. The NewStar Loan Agreement also contains customary events of default including, but not limited to, payment defaults, covenant defaults, cross-defaults to other indebtedness, material judgment defaults, inaccuracy of representations and warranties, bankruptcy and insolvency events, defects in NewStar's security interests, change in control events and material adverse change.

At the closing under the NewStar Loan Agreement, the Company used proceeds from the Term Loan and the Revolving Credit Facility to pay in full the obligations outstanding under that Loan and Security Agreement dated July 30, 2012 between the Company, Penobscot and Alostar Bank of Commerce and that Loan and Security Agreement dated July 30, 2012 between the Company and Gibraltar Business Capital and those agreements were terminated.

As condition to the closing under the NewStar Loan Agreement, the Company also extended from October 30, 2015 until July 31, 2020 the maturity date of the $1,350,000 in aggregate principal amount of its subordinated secured 1% convertible notes held by Greenwood Capital LP and MGPLA LP.

The Company has evaluated subsequent events through March 10, 2015, which is the date the consolidated financial statements were available to be issued.

SCHEDULE II CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS
For The Years Ended January 03, 2015 and December 28, 2013

	Sales and Sales Returns Allowances and Allowance for Doubtful Accounts	Reserve for Obsolete Inventory
	(In thousands)	
Balance, December 29, 2012	$ 793	$ 280
Provision	3,643	371
Write-off, disposal, costs, and other	(3,412)	(307)
Balance, December 28, 2013	$ 1,024	$ 344
Provision	4,845	156
Write-off, disposal, costs, and other	(4,761)	(200)
Balance, January 03, 2015	$ 1,108	$ 300

EXHIBIT B

Management's Discussion and Analysis ("MD&A") of Financial Condition and Results of Operations

The following discussion provides information and analysis of the Company's results of operations and its liquidity and capital resources, and should be read in conjunction with the Company's Consolidated Financial Statements and the other financial information included in Exhibit A and elsewhere in this Annual Report. This discussion contains forward-looking statements that involve risks and uncertainties. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of any number of factors.

The Company's operating and reporting period is on a 52-53 week fiscal year ending on the Saturday nearest to December 31. The Company refers to the fiscal year ended December 29, 2012 as "fiscal 2012," the fiscal year ending December 28, 2013 as "fiscal 2013," and the fiscal year ending January 3, 2015 as "fiscal 2014." The 52-week fiscal years consist of four equal quarters of 13 weeks each, and the 53-week fiscal years consist of three 13-week fiscal quarters and one 14-week fiscal quarter. The financial results for the 53-week fiscal years and 14-week fiscal quarters will not be exactly comparable to the 52-week fiscal years and 13-week fiscal quarters. Fiscal 2012 and fiscal 2013 each include 52 weeks and fiscal 2014 includes 53 weeks.

General

Phoenix Footwear Group, Inc. specializes in quality comfort women's and men's footwear. The Company designs, develops, markets, and sells footwear in a wide range of sizes and widths under the brands Trotters®, SoftWalk®, and beginning in April of fiscal 2013, Grey's Anatomy by SoftWalk®. The Company has been engaged in the manufacture or importation and sale of quality footwear since 1882.

Trotters and SoftWalk products are sold by the Company's own dedicated employee sales force that covers the U.S. market. Beginning with fiscal 2011, the Company distributes its products in Canada under an exclusive distribution agreement with an independent third party, Canada Shoe Corp, the sole importer and distributor of the Company's Trotters and SoftWalk brands in Canada. Prior to fiscal 2011, the Company sold Trotters and SoftWalk products in Canada through its wholly-owned Canadian subsidiary, which utilized independent sales representatives.

On April 2, 2013, the Company entered into a three year licensing agreement with Touchstone Television Productions, LLC ("ABC Studios"), to design, market and distribute footwear for the medical community under the Grey's Anatomy brand. Concurrent with the ABC Studios licensing agreement, the Company entered into a three year joint marketing agreement with Barco Uniforms, Inc. ("Barco"), an industry leading designer, manufacturer and distributor of uniforms, including medical scrubs bearing the Grey's Anatomy label. Under the terms of the joint marketing agreement, the Company has agreed to pay a commission on all sales of its footwear trademarked under the licensing agreement with ABC Studios sold by Barco's sales representatives.

During fiscal 2014, the Company's products were carried by approximately 858 customers in over 1,417 retail locations throughout the United States. The Company's distribution channels include department stores, leading specialty and independent retail stores, mail order catalogues, internet retailers and independent uniform suppliers. The Company also operates its own direct to consumer internet retail business.

Fiscal 2014 Financial Overview

Continuing Operations. Net sales from continuing operations for fiscal 2014 were $22.0 million, an increase of $2.8 million or 14.5%, compared to net sales of $19.2 million for fiscal 2013. Net income from continuing operations was $341,000, an increase of $198,000, or greater than 100.0%, compared to net income from continuing operations of $143,000 during fiscal 2013.

The Company's working capital as of January 3, 2015 and December 28, 2013 was $3.3 million and $3.5 million, respectively.

Discontinued Operations. The net loss from discontinued operations for fiscal 2014 was $14,000 as compared to a net loss of $73,000 during fiscal 2013. The net loss from discontinued operations during fiscal 2014 includes legal fees associated with the Company's suit filed against Tandy on February 14, 2011, that was settled on January 17, 2014. The net loss during 2013 also includes legal fees associated the suit against Tandy as well as the transfer and assumption of a severance payment obligation to a former executive of Altama assumed by the Company in connection with the sale of Altama on December 19, 2007. The Severance Agreement required the Company to pay an annual severance of $33,600 in twenty-six equal bi-weekly installments of $1,292 to the former Altama executive until his death at which time the severance obligation terminates. During fiscal 2013, the severance agreement terminated in accordance with its own terms.

As of January 3, 2015 and December 28, 2013, there were no current assets or liabilities from discontinued operations.

Net Earnings/Loss Per Share. Net income per share from continuing operations for the fiscal year ended January 3, 2015 was $0.04 compared to a net income per share of $0.02 from continuing operations for the fiscal year ended December 28, 2013.

Results of Operations

Fiscal 2014 Compared to Fiscal 2013

The following table sets forth selected consolidated operating results stated in dollars and as a percentage of net sales:

	12 Months Ended					
	January 3, 2015		December 28, 2013		Increase (Decrease)	
			(In thousands)			
Net sales	$ 21,995	100%	$ 19,218	100%	$ 2,777	15%
Cost of goods sold	13,914	63%	12,097	63%	1,817	15%
Gross profit	8,081	37%	7,121	37%	960	14%
Operating expenses:						
Selling, general and administrative	6,949	32%	6,299	33%	650	10%
Total operating expenses	6,949	32%	6,299	33%	650	10%
Operating earnings	1,132	5%	822	4%	310	38%
Other (income)/expense, net	—	—%	(121)	1%	121	100%
Interest expense, net	773	5%	772	4%	1	0%
Earnings before income taxes and discontinued operations	359	2%	171	1%	188	*%
Income tax expense (benefit)	18	— %	28	— %	(10)	(36)%
Earnings from continuing operations	341	2%	143	1%	198	*%
Loss from discontinued operations	(14)	— %	(73)	— %	(59)	(81)%
Net earnings	$ 327	2 %	$ 70	—%	$ 257	*%

* Greater than 100%

Net Sales

Net sales from continuing operations for fiscal 2014 increased $2.8 million, or 14.5%, to $22.0 million compared to $19.2 million in fiscal 2013. The increase in net sales for the period was primarily driven by the timely fulfillment of new product introductions designed to appeal to the broader customer demographic of the Company's internet based accounts, national retailers, and sales of licensed footwear.

Gross Profit

Gross profit from continuing operations for fiscal 2014 increased $960,000 or 13.5% to $8.1 million from $7.1 million when compared to fiscal 2013. Gross profit as a percentage of net sales was 36.7% during fiscal 2014 compared to 37.1% for fiscal 2013.

The 40 basis point decrease in the gross profit percentage for the period was primarily attributable to an increase, as a percentage of total net sales, in the sales of licensed footwear with a lower starting margin that was partly offset by an improvement in the selling margin of phased-out and discontinued styles sold during the period when compared to the twelve months ended December 28, 2013.

Cost of goods sold includes all direct costs of products (net of purchase discounts and vendor allowances), allocated overhead (primarily sourcing and indirect production costs), inbound freight and merchandise acquisition costs such as import fees, as well as outbound shipping and handling. The Company's cost of goods sold may not be comparable to those of other entities, since some entities include all of the costs associated with their distribution functions in cost of goods sold while the Company includes these costs in SG&A expenses.

Operating Expenses

Selling, general and administrative expenses, or SG&A, increased $650,000, to $6.9 million during fiscal 2014 compared to $6.3 million for fiscal 2013. SG&A as a percentage of net sales decreased to 31.6% for fiscal 2014, compared to 32.8% for fiscal 2013.

The increase in SG&A during fiscal 2014 was comprised of an increase in commission expense associated with the sale of licensed footwear and overall increase in net sales of 14.5% together with increases in sales related travel, and an increase in staffing costs and other employee related benefits.

SG&A consists primarily of the following: compensation, sales and marketing, design and development, professional fees, insurance, depreciation and other operating expenses.

Interest Expense

Interest expense from continuing operations during fiscal 2014 and fiscal 2013 was $773,000 and $772,000, respectively.

Loss from Discontinued Operations

The loss net of tax from discontinued operations during fiscal 2014 was $14,000 compared to a loss from discontinued operations of $73,000 during fiscal 2013. The net loss from discontinued operations during fiscal 2014 includes legal fees associated with the Company's suit filed against Tandy on February 14, 2011, that was settled on January 17, 2014. The net loss during 2013 also includes legal fees associated the suit against Tandy as well as the transfer and assumption of a severance payment obligation to a former executive of Altama assumed by the Company in connection with the sale of Altama on December 19, 2007. The Severance Agreement required the Company to pay an annual severance of $33,600 in twenty-six equal bi-weekly installments of $1,292 to the former Altama executive until his death at which time the severance obligation terminates. During fiscal 2013, the severance agreement terminated in accordance with its own terms.

Liquidity and Capital Resources

Historically, the Company's primary sources of liquidity have been generated from cash flows from operations, the working capital line of credit with its banks, the issuance of debt and other financing alternatives such as leasing. However, the Company has incurred losses over the last several years and as a result has sold several of its operating divisions to generate additional working capital to fund ongoing operations and reduce bank debt. The Company requires cash for inventory purchasing, distribution and selling activities, as well as for general working capital purposes. The Company's

need for working capital is seasonal with the greatest requirements existing from December to February, and again between June and August of each year. The Company typically builds up its inventory early during each of these periods to meet customer demand for the Spring/Summer and Fall/Winter selling seasons.

Working Capital

During fiscal 2014 and fiscal 2013, the Company funded its operations with cash generated by operating activities, borrowings from its revolving credit facility, the sale of warehouse and land and refinancing of its property and equipment located in Old Town, Maine. Cash is used to purchase inventory and fund operating activities. Historically, the Company has also funded its operations through vendor provided credit.

The Company's working capital varies from time to time due to the seasonal requirements of its brands (which have historically been heightened during the first and third quarters), the timing of factory shipments, the need to increase inventories and support an in-stock position in anticipation of customers' orders, and the timing of accounts receivable collections.

As of January 3, 2015 and December 28, 2013, working capital consisted of the following:

	January 3, 2015	December 28, 2013	Increase (Decrease)
		(In thousands)	
Current assets of continuing operations	$ 11,441	$ 11,241	$ 200
Current liabilities of continuing operations	8,103	7,768	335
Working capital of continuing operations	$ 3,338	$ 3,473	$ (135)

The primary changes in the components of working capital were to accounts receivable, inventory, accounts payable, accrued expenses, revolving line of credit, and current portion of long-term debt.

Accounts Receivable

As of January 3, 2015, gross accounts receivable were $3.6 million, a decrease of $138,000 million or 3.7% from $3.7 million as of December 28, 2013.

Inventory

As of January 3, 2015, gross inventory was $8.5 million compared to $8.0 million as of December 28, 2013, an increase of $460,000 or 5.8%. The Company believes inventory is in line with anticipated customer demand for its Spring 2015 product offering and other non-seasonal core and carry-over styles.

Accounts Payable and Accrued Expenses

As of January 3, 2015 accounts payable and accrued expense were $3.7 million, an increase of $338,000 from $3.4 million as of December 28, 2013. The increase in accounts payable and accrued expenses is primarily associated with an increase in the accrual inventory, samples, product development and salaries payable partly offset by a decrease of in-transit inventory as of January 3, 2015.

Revolving Credit Facility

The outstanding balance on the revolving credit facility as of January 3, 2015 was $3.8 million, a decrease of $338,000 when compared to $4.2 million as of December 28, 2013. The decrease in the outstanding balance of the revolving credit facility is primarily associated timing difference of inventory receiving when compared to the prior year.

Current Portion of Long-term Debt

As of January 3, 2015, the term note with Gibraltar Business Capital of $460,000 with a maturity date of less than one year (October 30, 2015) was reclassified as a current liability.

On February 2, 2015, the Company entered into a Loan and Security Agreement with NewStar Business Credit, LLC. The proceeds were used to pay in full the obligations outstanding under that Loan and Security Agreement dated July 30, 2012 between the Company and AloStar Bank of Commerce, and that Loan and Security Agreement dated July 30, 2012 between the Company and Gibraltar Business Capital, while also extending the maturity date of the subordinated secured 1% convertible notes to July 2020.

Economic Outlook

The current economic recovery has been hampered by a historically lower than normal labor participation rate and persistently higher than normal unemployment that has contributed to the lowering of the consumer's confidence. While steadily improving over the last several years, any uncertainty about the current or future economic conditions may cause consumers and retailers to defer purchases or cancel purchase orders for the Company's products in response to tighter credit, decreased cash availability and weakened consumer confidence.

On July 1, 2013, the Company completed the sale and contemporaneous leaseback of its warehouse facility and land in Old Town, Maine, under a purchase and sale agreement between its subsidiary Penobscot Shoe Company and Old Town Partners, LLC. Penobscot sold the property to Old Town Partners for $620,000. Concurrently with the sale, the Company and Penobscot entered into a 10 year commercial lease of the same property with the Old Town Partners.

On November 8, 2013 the Company entered into a 5 year term loan agreement with the Financial Authority of Maine in the amount of $200,000.

On February 2, 2015, the Company and Penobscot entered into a Loan and Security Agreement with NewStar Business Credit, LLC, a Delaware limited liability company as administrative agent ("NewStar"), and the lenders party thereto from time to time (the "NewStar Loan Agreement"). The NewStar Loan Agreement provides for up to $9.0 million in borrowing capacity consisting up to $8.0 million (subject to a borrowing base as defined in the NewStar Loan Agreement) that accrues interest on the principal amount at a rate equal to the greater of (i) the rate per annum published on each Business Day in the "Money Rates" table of *The Wall Street Journal* as the one-month LIBOR rate, adjusted daily, and (ii) 1.0% (such greater amount, the "LIBOR Rate") plus 3.75% with a five-year maturity (the "RLOC") and a term loan of $1,000,000 (the "Term Loan") accruing interest at the rate equal to the LIBOR Rate plus 5% on the principal amount outstanding under the Term Loan. The principal amount of the Term Loan is payable in 36 equal monthly installments of $27,778, together with accrued interest, on the first day of each calendar month beginning March 1, 2015. The obligations of the Company as the borrower under the NewStar Loan Agreement have been guaranteed by Penobscot. As security for the obligations of the Company and Penobscot under the NewStar Loan Agreement, the Company and Penobscot have each granted NewStar (for the benefit of the lenders party to the NewStar Loan Agreement) a security interest in all of their personal property.

Proceeds from the NewStar Loan Agreement were used to pay in full the obligations outstanding under that Loan and Security Agreement dated July 30, 2012 between the Company and AloStar Bank of Commerce, which carried an annual interest rate equal to the LIBOR Rate plus 5.5% and that Loan and Security Agreement dated July 30, 2012 between the Company and Gibraltar Business Capital which carried an annual interest rate of 18.0%.

As a condition to the closing under the NewStar Loan Agreement, the Company also extended from October 30, 2015 until July 2020 the maturity date of the $1,350,000 in aggregate principal amount of its subordinated secured 1% convertible notes held by Greenwood Capital Limited Partnership and MGPLA LP.

The Company's financial success is sensitive to changes in the general economic conditions, both globally and nationally, that may adversely affect the demand for its products including recessionary economic cycles, higher interest borrowing rates, higher fuel and other energy costs, inflation, increases in commodity prices, higher levels of unemployment, higher consumer debt levels, higher tax rates and other economic factors. If economic and financial market conditions in the United States deteriorate or remain weak for an extended period of time, this could result in a slowing of consumer spending,

the effect of which may inhibit the Company's ability to maintain or increase its sales to new and existing customers, reduce orders or increase order cancellations from wholesale accounts that are directly impacted by fluctuations in the broader economy, leading to higher discounting and lower gross margins, thus making it increasingly more difficult to generate the level of availability under the Company's revolving credit facility needed to manage inventory.

In the absence of a decline in sales levels, the Company believes that cash flows from operations, the borrowing capacity of its revolving credit facility, and its access to capital will be sufficient to meet the ongoing needs of its business, anticipated growth, flow of inventory, investment requirements and working capital needs for the next twelve months. Additional future financing may be necessary and there can be no assurance that, if needed, the Company will be able to secure additional debt or equity financing with terms acceptable to it or even at all.

Cash Flows Provided by (Used in) Operations

Continuing Operations

Net cash provided by operating activities from continuing operations during fiscal 2014 was $774,000 compared to $812,000 of net cash used in operating activities from continuing operations in during fiscal 2013.

Cash provided by operating activities during fiscal 2014 were produced by net earnings of $341,000 from continuing operations, net increase in accounts payables and accrued expense of $338,000 and $138,000 decrease in accounts receivables that were partly offset by an increase in inventories of $504,000 and net decrease in other long-term liabilities.

Cash used in operating activities during fiscal 2013 were largely associated with an increase in accounts receivables and inventory of $1.1 million and $672,000, respectively, resulting from an increase in net sales of 14.8%, partly offset by an increases in accounts payable, associated with inventory purchases and other long-term liabilities including a deferred gain from the sale and leaseback of land and warehouse located in Old Town, Maine and gain on the settlement of the Company's lawsuit filed against Tandy of $121,000, decrease in prepaid amounts to factories included in other current assets, non-cash adjustments for depreciation, the amortization of deferred debt issuances, stock-based compensation and $143,000 in earnings from continuing operations.

Discontinued Operations

Net cash of $14,000 was used in operating activities from discontinued operations during fiscal 2014 compared to $73,000 used in operating activities from discontinued operations during fiscal 2013. Net cash used in operating activities from discontinued operations during fiscal 2014 and fiscal 2013 included legal fees and settlement of the Company's suit filed against Tandy and severance payments to a former executive of Altama.

Cash Flows Provided by Investing Activities

Net Cash used in investing activities during fiscal 2014 was $20,000, compared to net cash provided by investing activities of $487,000 during fiscal 2013. Net cash of $20,000 used in investing activities during fiscal 2014 was associated with improvements made to the warehouse facility located in Old Town.

Net cash of $487,000 provided by investing activities during fiscal 2013 included the net proceeds received from the sale of land and the warehouse facility located in Old Town, Maine during the third quarter that was partly offset by $41,000 in leasehold improvements to the Old Town, Maine warehouse.

Cash Flows Provided by Financing Activities

Net cash used in financing activities during fiscal 2014 of $553,000 is primarily the result of increased payments on the Company's revolving credit facility.

Net cash provided by financing activities during fiscal 2013 of $496,000 is primarily the result of increased borrowings on the revolving credit facility and refinancing costs incurred with the closing of the new credit facilities on July 30, 2012.

Inflation

The Company believes that the relatively moderate rates of inflation in recent years have not had a significant impact on its net sales or profitability.

Critical Accounting Policies

The Company's accounting policies are more fully described in Note 1 of the Consolidated Financial Statements included in this Annual Report for the fiscal period ended January 3, 2015. As disclosed in Note 1, the Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of the Company's consolidated financial statements requires the Company to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities in the consolidated financial statements and accompanying notes. Although these estimates are based on the Company's knowledge of current events and actions it may undertake in the future, actual results may ultimately differ from these estimates and assumptions. Furthermore, when testing assets for impairment in future periods, if the Company's management uses different assumptions or if different conditions occur, impairment charges may result.

The Company believes that the following discussion addresses its most critical accounting policies, which are those that are most important to the portrayal of its financial condition and results of operations and require the Company's most difficult, subjective and complex judgments.

Revenue Recognition

The Company recognizes revenue from product sales when persuasive evidence of an arrangement exists, products are shipped and the customer takes title and assumes risk of loss, the sales price charged is fixed or determinable and collectability is reasonably assured. Product sales and shipping revenues, net of sales allowances, discounts and return allowances, are recorded when the products are shipped or, in certain situations, upon acceptance by the customer. Allowances for estimated returns are accounted for as reductions to sales, cost of goods sold, accounts receivable and an increase in inventory to the extent such product is resalable. The Company bases its estimates on historical rates of customer returns and allowances, as well as the specific identification of outstanding returns and allowances, which are known to the Company but which have not yet been received or paid. Sales taxes collected from e-commerce customers are excluded from reported sales.

Allowance for Doubtful Accounts

The Company provides a reserve against its accounts receivable for estimated losses that may result from non-collection due to the financial position of its customers. To minimize the likelihood of uncollectibility, customers' credit-worthiness is reviewed periodically based on external credit reporting services and the Company's experience with the account, and it is adjusted accordingly. When a customer's account becomes significantly past due, the Company generally places a hold on the account and discontinues further shipments to that customer, minimizing further risk of loss. The Company determines the amount of the reserve by analyzing known uncollectible accounts, aged receivables, economic conditions in the customers' industries, historical losses and its customers' credit-worthiness. Amounts later determined and specifically identified to be uncollectible are charged or written off against this reserve. In addition to these individual assessments, in general, outstanding trade accounts receivable amounts that are greater than 365 days are fully reserved for and amounts greater than 120 days are 75% reserved for. The Company's level of reserves may fluctuate depending upon all of the factors mentioned above. The Company also reserves for potential trade discounts and deductions for co-op advertising

normally taken by its customers, allowances the Company provides to its retail customers to effectively flow goods through the retail channels and an allowance for estimated sales returns.

Historically, actual results in these areas have not been materially different than management's estimates, and the Company does not anticipate that its estimates and assumptions are likely to materially change in the future. However, if the Company incorrectly anticipates trends or unexpected events occur, the Company's results of operations could be materially affected.

Reserve for Obsolete or Slow Moving Inventory

The Company reduces the carrying cost of inventories for obsolete or slow moving items as necessary to properly reflect inventory value. Reserves are estimated based upon inventory on hand, historical sales activity and the expected net realizable value. The Company's analysis includes a review of inventory quantities on hand at period end in relation to year-to-date sales, existing orders from customers and projections for sales in the near future. The net realizable value, or market value, is determined using the Company's estimate of sales prices of such inventory based upon historical sales experience on a style by style basis or, if necessary, through off-price or discount store channels.

Historically, actual results in these areas have not been materially different than the estimates of management and the Company does not anticipate that its estimates and assumptions are likely to materially change in the future. However, the likelihood of any material change is dependent primarily on the Company's expectations of future consumer demand for its footwear. A misinterpretation or misunderstanding of future consumer demand for the Company's footwear or of the economy, or other failure to estimate correctly, could result in inventory valuation changes, either favorably or unfavorably, compared to the requirement determined to be appropriate as of the balance sheet date.

Valuation of Deferred Income Taxes

The Company records a valuation allowance when necessary to reduce its deferred tax assets to the amount that is more likely than not to be realized. The Company evaluates its projections of taxable income to determine the recoverability of its deferred tax assets and the need for a valuation allowance. The Company considers all evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations. As of January 3, 2015 and December 28, 2013, the Company had a full valuation allowance on its deferred tax assets. The likelihood of a material change in the Company's expected realization of its deferred tax assets depends on future taxable income and the effectiveness of the Company's tax planning strategies amongst the various domestic and international tax jurisdictions in which the Company operates.

Recently Issued Accounting Standards

Going Concern

On August 27, 2014, the FASB issued ASU 2014-15, which provides guidance on determining when and how reporting entities must disclose going concern uncertainties in their financial statements. The new standard requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date of issuance of the entity's financial statements (or within one year after the date on which the financial statements are available to be issued, when applicable). Further, an entity must provide certain disclosures if there is "substantial doubt about the entity's ability to continue as a going concern.

The FASB believes that requiring management to perform the assessment will enhance the timeliness, clarity and consistency of related disclosures and improve convergence with IFRSs (which emphasize management's responsibility for performing the going concern assessment). However, the time horizon for the assessment (look-forward period) and the disclosure thresholds under U.S. GAAP and IFRSs will continue to differ. This ASU is effective for annual periods ending after December 16, 2016, and interim periods thereafter; early adoption is permitted. The Company does not believe that this pronouncement will have a material impact to the Company's consolidated financial statements.

Share-Based Payment

On June 19, 2014, the FASB issued ASU 2014-12 in response to the EITF consensus on Issue 13-D. The ASU clarifies that entities should treat performance targets that can be met after the requisite service period of a share-based payment award as performance conditions that affect vesting. Therefore, an entity would not record compensation expense related to an award for which transfer to the employee is contingent on the entity's satisfaction of a performance target until it becomes probable that the performance target will be met. The ASU does not contain any new disclosure requirements. This ASU is effective for all entities for reporting periods (including interim periods) beginning after December 15, 2015. The Company does not believe that this pronouncement will have a material impact to the Company's consolidated financial statements.

Revenue Recognition

In May 2014, the FASB issued their final standard on revenue from contracts with customers. The standard, issued as ASU No. 2014-09: *Revenue from Contracts with Customers (Topic 606)* by the FASB, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that "an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services." In applying the revenue model to contracts within its scope, an entity:

- Identifies the contract(s) with a customer (Step 1)
- Identifies the performance obligations in the contract (Step 2)
- Determines the transaction price (Step 3)
- Allocates the transaction price to the performance obligations in the contract (Step 4)
- Recognizes revenue when (or as) the entity satisfies a performance obligation (Step 5)

The ASU applies to all contracts with customers except those that are within the scope of other topics in the FASB Accounting Standards Codification. Certain of the ASU's provisions also apply to transfers of nonfinancial assets, including in-substance nonfinancial assets that are not an output of an entity's ordinary activities (e.g., sales of property, plant, and equipment, real estate or intangible assets). Existing accounting guidance applicable to these transfers has been amended or superseded. Compared with current U.S. GAAP, the ASU also requires significantly expanded disclosures about revenue recognition.

The ASU is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017. Early application is not permitted. The Company is currently evaluating the impact that this pronouncement will have on the Company's consolidated financial statements.

Off-Balance Sheet Arrangements

As described in Note 4 "Commitments and Contingencies" of the notes to the consolidated financial statements, on April 2, 2013, the Company entered into a licensing agreement with ABC Studios guaranteeing a minimum royalty payment of $150,000 to be paid over the three year term of the agreement. Other than operating leases, entered into from time to time in the normal course of business, and as discussed here and described in Note 4 of the notes to the consolidated financial statements, the Company does not have any other off-balance sheet arrangements. The Company does not believe that these operating leases or the licensing agreement are material to its current or future financial condition, results of operations, liquidity, capital resources or capital expenditures.