ROCKY BRANDS, INC.
Form 10-Q
October 26, 2007

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2007

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number: 0-21026

ROCKY BRANDS, INC.

(Exact name of registrant as specified in its charter)

Ohio	**31-1364046**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

39 E. Canal Street, Nelsonville, Ohio 45764

(Address of Principal Executive Offices, Including Zip Code)

(740) 753-1951

(Registrant s Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

As of October 23, 2007, 5,488,413 shares of Rocky Brands, Inc. common stock, no par value, were outstanding.

FORM 10-Q
ROCKY BRANDS, INC.
TABLE OF CONTENTS

Table of Contents

PART 1 FINANCIAL INFORMATION
ITEM 1 FINANCIAL STATEMENTS

ROCKY BRANDS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2007 (Unaudited)	December 31, 2006	September 30, 2006 (Unaudited)
ASSETS:			
CURRENT ASSETS:			
Cash and cash equivalents	$ 2,707,273	$ 3,731,253	$ 2,327,977
Trade receivables net	81,279,819	65,259,580	81,054,978
Other receivables	1,064,827	1,159,444	987,939
Inventories	85,081,978	77,948,976	87,710,315
Deferred income taxes	3,902,775	3,902,775	133,783
Income tax receivable	2,743,633	3,632,808	10,873
Prepaid expenses	1,494,045	1,581,303	2,320,048
Total current assets	178,274,350	157,216,139	174,545,913
FIXED ASSETS net	25,233,363	24,349,674	24,245,710
DEFERRED PENSION ASSET	53,866	13,564	1,563,639
IDENTIFIED INTANGIBLES	36,673,954	37,105,291	37,970,535
GOODWILL	24,874,368	24,874,368	24,874,368
OTHER ASSETS	2,618,442	2,796,776	2,815,654
TOTAL ASSETS	$ 267,728,343	$ 246,355,812	$ 266,015,819
LIABILITIES AND SHAREHOLDERS EQUITY:			
CURRENT LIABILITIES:			
Accounts payable	$ 15,514,243	$ 10,162,291	$ 16,290,173
Current maturities long term debt	318,024	7,288,474	7,282,374
Accrued expenses:			
Salaries and wages	605,905	178,235	810,280
Co-op advertising	446,410	452,272	77,154
Interest	1,822,664	338,281	694,096
Taxes other	571,718	552,782	255,598
Commissions	771,062	649,636	633,742
Other	2,504,345	2,025,079	1,391,248
Total current liabilities	22,554,371	21,647,050	27,434,665
LONG TERM DEBT less current maturities	122,438,442	103,203,107	120,040,154
DEFERRED INCOME TAXES	17,009,025	17,009,025	13,477,939
DEFERRED LIABILITIES	335,534	368,580	379,144
TOTAL LIABILITIES	162,337,372	142,227,762	161,331,902
COMMITMENTS AND CONTINGENCIES			
SHAREHOLDERS EQUITY:			

Common stock, no par value; 25,000,000 shares authorized; issued and outstanding September 30, 2007 5,488,293; December 31, 2006 5,417,198; September 30, 2006 5,405,098		53,897,100		53,238,841		52,723,651
Accumulated other comprehensive loss		(916,463)		(993,182)		
Retained earnings		52,410,334		51,882,391		51,960,266
Total shareholders equity		105,390,971		104,128,050		104,683,917
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$	267,728,343	$	246,355,812	$	266,015,819

See notes to the interim unaudited condensed consolidated financial statements.

3

Table of Contents

ROCKY BRANDS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
NET SALES	$ 82,308,547	$ 78,114,725	$ 202,763,235	$ 192,937,394
COST OF GOODS SOLD	53,030,023	45,998,535	123,477,571	111,831,955
GROSS MARGIN	29,278,524	32,116,190	79,285,664	81,105,439
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	25,108,505	22,606,038	70,222,025	65,166,515
INCOME FROM OPERATIONS	4,170,019	9,510,152	9,063,639	15,938,924
OTHER INCOME AND (EXPENSES):				
Interest expense, net	(2,943,139)	(2,883,656)	(8,786,060)	(8,295,285)
Other net	131,365	73,056	95,364	131,518
Total other net	(2,811,774)	(2,810,600)	(8,690,696)	(8,163,767)
INCOME BEFORE INCOME TAXES	1,358,245	6,699,552	372,943	7,775,157
INCOME TAX (BENEFIT) EXPENSE	209,000	2,480,000	(155,000)	2,878,000
NET INCOME	$ 1,149,245	$ 4,219,552	$ 527,943	$ 4,897,157
NET INCOME PER SHARE				
Basic	$ 0.21	$ 0.78	$ 0.10	$ 0.91
Diluted	$ 0.21	$ 0.76	$ 0.09	$ 0.88
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING				
Basic	5,484,923	5,400,647	5,472,233	5,386,254
Diluted	5,594,707	5,553,028	5,590,879	5,588,616

See notes to the interim unaudited condensed consolidated financial statements.

Table of Contents

ROCKY BRANDS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30, 2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 527,943	$ 4,897,157
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,226,093	3,894,797
Deferred compensation and other	3,371	329,510
Deferred debt financing costs	811,582	382,144
Loss (gain) on disposal of fixed assets	29,070	(592,027)
Stock compensation expense	285,984	352,061
Change in assets and liabilities		
Receivables	(15,925,622)	(17,840,167)
Inventories	(7,133,002)	(12,323,583)
Other current assets	976,434	513,310
Other assets	795,282	626,333
Accounts payable	5,591,785	3,568,959
Accrued and other liabilities	2,525,818	(1,914,759)
Net cash used in operating activities	(7,285,262)	(18,106,265)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of fixed assets	(4,957,897)	(4,631,428)
Investment in trademarks and patents	(66,488)	(80,092)
Proceeds from sale of fixed assets	77,037	1,855,583
Net cash used in investing activities	(4,947,348)	(2,855,937)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from revolving credit facility	206,281,446	203,591,775
Repayments of revolving credit facility	(201,297,047)	(173,426,868)
Proceeds from long-term debt	40,000,000	15,000,000
Repayments of long-term debt	(32,719,514)	(23,214,985)
Debt financing costs	(1,428,530)	(610,000)
Proceeds from exercise of stock options	372,275	341,577
Net cash provided by financing activities	11,208,630	21,681,499
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,023,980)	719,297

CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		3,731,253		1,608,680
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	2,707,273	$	2,327,977

See notes to the interim unaudited condensed consolidated financial statements.

Table of Contents

ROCKY BRANDS, INC.
AND SUBSIDIARIES
NOTES TO THE INTERIM UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE-MONTH AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2007 AND 2006

1. INTERIM FINANCIAL REPORTING

In the opinion of management, the accompanying interim unaudited condensed consolidated financial statements reflect all adjustments that are necessary for a fair presentation of the financial results. All such adjustments reflected in the unaudited interim consolidated financial statements are considered to be of a normal and recurring nature. The results of the operations for the three-month and nine-month periods ended September 30, 2007 and 2006 are not necessarily indicative of the results to be expected for the whole year. Accordingly, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2006.

The components of total comprehensive income are shown below:

	(Unaudited) Three Months Ended September 30, 2007	(Unaudited) Nine Months Ended September 30, 2007
Net income	$ 1,149,245	$ 527,943
Other comprehensive income:		
Amortization of unrecognized transition obligation and service cost	25,573	76,719
Total comprehensive income	$ 1,174,818	$ 604,662

For the three-month and nine-month periods ended September 30, 2006, net income was equal to comprehensive income.

Table of Contents

2. INVENTORIES

Inventories are comprised of the following:

	September 30, 2007 (Unaudited)	December 31, 2006	September 30, 2006 (Unaudited)
Raw materials	$ 8,222,483	$ 6,564,731	$ 7,448,509
Work-in-process	261,295	249,644	286,903
Finished goods	76,798,200	71,518,898	80,589,267
Reserve for obsolescence or lower of cost or market	(200,000)	(384,297)	(614,364)
Total	$ 85,081,978	$ 77,948,976	$ 87,710,315

Included in raw materials, at December 31, 2006 and September 30, 2006, is $1.6 million of purchases associated with the U.S. military. These raw material purchases were made exclusively for production under a subcontract for the U.S. military. Subsequent to the purchase of raw materials, the subcontract was cancelled for convenience by the U.S. military. In March 2007, we received a partial settlement and finalized the ultimate settlement of the contract in June 2007. As a result of this settlement and other third-party sales, the value of the raw material inventory was realized. In addition, the settlement provided for a reimbursement of expenses incurred in prior periods. This reimbursement is recognized as a reduction of cost of goods sold of approximately $0.7 million and $0.5 million in the first and second quarters of 2007, respectively.

3. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash information including, cash paid for interest and Federal, state and local income taxes, net of refunds, was as follows:

	Nine Months Ended September 30, 2007	2006
Interest	$ 5,970,000	$ 7,375,000
Federal, state and local income taxes	$ (991,000)	$ 1,711,000
Fixed asset purchases in accounts payable	$ 132,350	$

Table of Contents

4. PER SHARE INFORMATION

Basic earnings per share (EPS) is computed by dividing net income applicable to common shareholders by the weighted average number of common shares outstanding during each period. The diluted earnings per share computation includes common share equivalents, when dilutive. There are no adjustments to net income necessary in the calculation of basic and diluted earnings per share.

A reconciliation of the shares used in the basic and diluted income per common share computation for the three months and nine months ended September 30, 2007 and 2006 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Weighted average shares outstanding	5,484,923	5,400,647	5,472,233	5,386,254
Diluted stock options	109,784	152,381	118,646	202,362
Diluted weighted average shares outstanding	5,594,707	5,553,028	5,590,879	5,588,616
Anti-diluted weighted average shares outstanding	270,707	257,375	270,707	186,267

5. RECENT FINANCIAL ACCOUNTING STANDARDS

In June 2006, the FASB ratified the Emerging Issues Task Force (EITF) position EITF 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (that is Gross versus Net Presentation*) (EITF 06-3), which addresses disclosure requirements for taxes assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, and may include, but is not limited to, sales, use, value-added, and some excise taxes. EITF 06-3 requires disclosure of the method of accounting for the applicable assessed taxes, and the amount of assessed taxes that are included in revenues if they are accounted for under the gross method. The provisions of EITF 06-3 are effective for interim and annual reporting periods beginning after December 15, 2006, with earlier application permitted. We report sales, net of sales tax remittance. The adoption of EITF 06-3 on January 1, 2007 did not have a material effect on our financial statements.

In September 2006, the FASB issued a Statement of Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, rather it applies under existing accounting pronouncements that require or permit fair value measurements. The provisions of SFAS 157 are effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS 157 on our financial statements.

Table of Contents

Also in September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefits Pension and Other Postretirement Plans, an Amendment of FASB Statements 87, 88, 106, and 132(R) (SFAS 158). SFAS 158, requires an employer to recognize in its statement of financial position the funded status of its defined benefit plans and to recognize as a component of other comprehensive income, net of tax, any unrecognized transition obligations and assets, the actuarial gains and losses and prior service costs and credits that arise during the period. The recognition provisions of Statement No. 158 were effective for fiscal years ending after December 15, 2006. In addition, Statement No. 158 requires a fiscal year end measurement of plan assets and benefit obligations, eliminating the use of earlier measurement dates currently permissible. However, the new measurement date requirement will not be effective until fiscal years ending after December 15, 2008. We utilize a measurement date of September 30th and will be required to change that measurement date to December 31st. The adoption of Statement No. 158 as of December 31, 2006 resulted in a write-down of our pension asset by $1.6 million, increased accumulated other comprehensive loss by $1.0 million, and decreased deferred income tax liabilities by $0.6 million.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of statement No. 115 (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The standard also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for annual periods in fiscal years beginning after November 15, 2007. If the fair value option is elected, the effect of the first remeasurement to fair value is reported as a cumulative effect adjustment to the opening balance of retained earnings. In the event we elect the fair value option promulgated by this standard, the valuations of certain assets and liabilities may be impacted. The statement is applied prospectively upon adoption. We are currently evaluating the impact of adopting SFAS 159 on our financial statements.

Table of Contents

6. INCOME TAXES

We adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48), on January 1, 2007. We did not have any unrecognized tax benefits and there was no effect on our financial condition or results of operations as a result of implementing FIN 48.

We file income tax returns in the U.S. Federal jurisdiction and various state and foreign jurisdictions. An examination of our 2004 Federal income tax return resulted in an immaterial adjustment. The examination of the 2003 Federal income tax return resulted in no changes. We are no longer subject to U.S. Federal tax examinations for years before 2003. State jurisdictions that remain subject to examination range from 2003 to 2006. Foreign jurisdiction (Canada and Puerto Rico) tax returns that remain subject to examination range from 2001 to 2006. We do not believe there will be any material changes in our unrecognized tax positions over the next 12 months.

Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, accrued interest or penalties were not material, and no such expenses were recognized during the quarter.

We provided for income taxes at an estimated effective tax rate of 37% for the three-month and nine-month periods ended September 30, 2007 and 2006. During the three months ended September 30, 2007, we recognized a prior year state income tax refund of $0.3 million which reduced the effective tax rate for the three-month period ended September 30 2007 to 15.4%. The tax benefit for the nine-month period ended September 30, 2007 results from the recognition of the aforementioned tax refund when combined with our provision for income taxes at the effective tax rate of 37%.

Table of Contents

7. INTANGIBLE ASSETS

A schedule of intangible assets is as follows:

September 30, 2007 (unaudited)	Gross Amount	Accumulated Amortization	Carrying Amount
Trademarks:			
Wholesale	$ 28,272,514	$ 64,689	$ 28,207,825
Retail	6,900,000		6,900,000
Patents	2,274,325	1,158,196	1,116,129
Customer relationships	1,000,000	550,000	450,000
Total Identified Intangibles	$ 38,446,839	$ 1,772,885	$ 36,673,954

December 31, 2006	Gross Amount	Accumulated Amortization	Carrying Amount
Trademarks:			
Wholesale	$ 28,241,370		$ 28,241,370
Retail	6,900,000		6,900,000
Patents	2,238,981	$ 875,060	1,363,921
Customer relationships	1,000,000	400,000	600,000
Total Identified Intangibles	$ 38,380,351	$ 1,275,060	$ 37,105,291

September 30, 2006 (unaudited)	Gross Amount	Accumulated Amortization	Carrying Amount