ROCKY BRANDS, INC.
Form 10-Q
August 03, 2010
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2010
OR
"TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from $\qquad$ to

Commission file number: 1-34382
ROCKY BRANDS, INC.
(Exact name of registrant as specified in its charter)

Ohio
(State or Other Jurisdiction of Incorporation or Organization)

31-1364046
(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 x NO "

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes " No "

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

Large accelerated filer * Accelerated filer" Non-accelerated filer * Smaller reporting company x
(Do not check if a smaller reporting company)
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES" NO x

As of July 29, 2010, 7,406,787 shares of Rocky Brands, Inc. common stock, no par value, were outstanding.

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## SIGNATURE

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PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS

# ROCKY BRANDS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS 

June 30, 2010 December 31, 2009 June 30, 2009 (Unaudited) (Unaudited)


LIABILITIES AND SHAREHOLDERS' EQUITY:
CURRENT LIABILITIES:

| Accounts payable | $\$ 13,415,750$ | $\$$ | $6,781,534$ | $\$$ |
| :--- | ---: | ---: | ---: | ---: |
| Current maturities - long term debt | 528,434 | 511,870 | 495,976 |  |
| Accrued expenses: |  |  |  |  |
| Salaries and wages | $1,080,435$ | 343,345 | 830,733 |  |
| Co-op advertising | 259,779 | 460,190 | 522,670 |  |
| Interest | 181,502 | 471,091 | 459,483 |  |
| Income taxes payable | - | 26,242 | - |  |
| Taxes - other | 535,101 | 440,223 | 502,032 |  |
| Commissions | 493,086 | 487,340 | 339,379 |  |
| Current portion of pension funding | 700,000 | 700,000 | - |  |
| Other | $2,216,962$ | $2,764,783$ | $2,351,937$ |  |
| Total current liabilities | $19,411,049$ | $12,986,618$ | $14,006,309$ |  |
| LONG TERM DEBT - less current maturities | $36,370,863$ | $55,079,776$ | $87,023,125$ |  |
| DEFERRED INCOME TAXES | $9,071,639$ | $9,071,639$ | $9,438,921$ |  |
| DEFERRED PENSION LIABILITY | $3,687,075$ | $3,589,875$ | $3,860,920$ |  |
| DEFERRED LIABILITIES | 187,973 | 184,481 | 195,264 |  |
| TOTAL LIABILITIES | $68,728,599$ | $80,912,389$ | $114,524,539$ |  |

COMMITMENTS AND CONTINGENCIES
SHAREHOLDERS' EQUITY:
Common stock, no par value;
$25,000,000$ shares authorized; issued and outstanding June 30,
2010-7,406,787; December 31, 2009-5,576,465 and June 30,
2009-5,547,215 68,931,586 54,598,104 54,384,172
Accumulated other comprehensive loss (3,037,242) (3,217,144) (3,062,448)

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|  | $31,059,580$ |  | $31,096,714$ | $27,405,804$ |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Retained earnings | $96,953,924$ | $82,477,674$ | $78,727,528$ |  |
| Total shareholders' equity | $\$ 165,682,523$ | $\$$ | $163,390,063$ | $\$ 193,252,067$ |

See notes to the interim unaudited condensed consolidated financial statements.

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

|  | Three Months Ended June 30, |  | Six Months Ended June 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2010 | 2009 | 2010 | 2009 |
| NET SALES | \$ 55,223,054 | \$ 51,188,615 | \$ 111,302,040 | \$ 101,253,176 |
| COST OF GOODS SOLD | 36,123,970 | 33,470,943 | 73,446,107 | 63,443,016 |
| GROSS MARGIN | 19,099,084 | 17,717,672 | 37,855,933 | 37,810,160 |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES | 16,163,354 | 18,119,173 | 34,188,041 | 38,065,301 |
| INCOME (LOSS) FROM OPERATIONS | 2,935,730 | $(401,501)$ | 3,667,892 | $(255,141)$ |
| OTHER INCOME AND (EXPENSES): |  |  |  |  |
| Interest expense, net | $(2,121,552)$ | $(1,936,490)$ | $(3,766,143)$ | (3,710,420) |
| Other - net | 3,432 | 158,023 | 40,117 | 33,457 |
| Total other - net | $(2,118,120)$ | $(1,778,467)$ | $(3,726,026)$ | $(3,676,963)$ |
| INCOME (LOSS) BEFORE INCOME TAXES | 817,610 | $(2,179,968)$ | $(58,134)$ | $(3,932,104)$ |
| INCOME TAX EXPENSE (BENEFIT) | 294,000 | $(785,000)$ | $(21,000)$ | $(1,416,000)$ |
| NET INCOME (LOSS) | \$ 523,610 | \$ $(1,394,968)$ | $(37,134)$ | \$ $(2,516,104)$ |
| NET INCOME (LOSS) PER SHARE |  |  |  |  |
| Basic | \$ 0.08 | (0.25) | (0.01) | (0.45) |
| Diluted | \$ 0.08 | \$ (0.25) | (0.01) | (0.45) |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING |  |  |  |  |
| Basic | 6,535,812 | 5,547,215 | 6,072,045 | 5,546,880 |
| Diluted | 6,557,289 | 5,547,215 | 6,072,045 | 5,546,880 |

See notes to the interim unaudited condensed consolidated financial statements.

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



See notes to the interim unaudited condensed consolidated financial statements.

## ROCKY BRANDS, INC.

 AND SUBSIDIARIES
## NOTES TO THE INTERIM UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX-MONTH PERIOD ENDED JUNE 30, 2010 AND 2009

## 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 condensed consolidated financial statements are considered to be of a normal and recurring nature. The results of the operations for the three-month and six-month periods ended June 30, 2010 and 2009 are not necessarily indicative of the results to be expected for the whole year. Accordingly, these unaudited 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, 2009.

The components of total comprehensive income (loss) are shown below:

|  | (Unaudited) <br> Three Months Ended <br> June 30, |  |  |  |  |  |  |  | (Unaudited) <br> Six Months Ended <br> June 30, |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2010 |  | 2009 | 2010 |  | 2009 |  |  |  |  |

## 2.

TRADE RECEIVABLES
Trade receivables are presented net of the related allowance for uncollectible accounts of approximately $\$ 951,000$, $\$ 1,178,000$ and $\$ 1,793,000$ at June 30, 2010, December 31, 2009 and June 30, 2009, respectively. The allowance for uncollectible accounts is calculated based on the relative age and size of trade receivable balances.

## 3.

## INVENTORIES

Inventories are comprised of the following:

|  |  | $\begin{aligned} & \text { June } 30 \text {, } \\ & 2010 \\ & \text { Unaudited) } \end{aligned}$ | $\begin{gathered} \text { December 31, } \\ 2009 \end{gathered}$ |  | $\begin{gathered} \text { June } 30 \text {, } \\ 2009 \\ \text { (Unaudited) } \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Raw materials | \$ | 10,987,932 | \$ | 5,438,055 | \$ | 9,560,424 |
| Work-in-process |  | 581,874 |  | 497,914 |  | 673,914 |
| Finished goods |  | 50,288,419 |  | 49,522,542 |  | 69,104,239 |
| Reserve for obsolescence or lower of cost or market |  | $(46,558)$ |  | $(38,044)$ |  | $(52,100)$ |
| Total | \$ | 61,811,667 | \$ | 55,420,467 | \$ | 79,286,477 |

4. 

SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information is as follows:

|  | (Unaudited) <br> Six Months Ended <br> June 30, |  |  |  |
| :--- | :---: | :---: | :---: | :---: |
|  |  | 2010 | 2009 |  |
| Interest | $\$$ | $3,282,283$ | $\$$ | $3,345,363$ |
| Federal, state and local income taxes, net of refunds | $\$$ | 331,181 | $\$$ | 928,666 |
| Fixed asset purchases in accounts payable | $\$$ | 150,054 | $\$$ | 139,283 |

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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-month and six-month periods ended June 30, 2010 and 2009 is as follows:

|  | (Unaudited) <br> Three Months Ended June 30, |  | (Unaudited) <br> Six Months Ended June 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2010 | 2009 | 2010 | 2009 |
| Weighted average shares outstanding | 6,535,812 | 5,547,215 | 6,072,045 | 5,546,880 |
| Dilutive stock options | 21,477 |  | - |  |
| Dilutive weighted average shares outstanding | 6,557,289 | 5,547,215 | 6,072,045 | 5,546,880 |
| Anti-dilutive stock options/weighted average shares outstanding | 201,896 | 403,534 | 217,251 | 403,534 |

## 6.

RECENT FINANCIAL ACCOUNTING STANDARDS
Recently adopted accounting standards
In June 2009, the FASB modified the accounting standard related to transfers and servicing. This standard, as modified, intends to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. This standard, as modified, must be applied as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. This standard, as modified, must be applied to transfers occurring on or after the effective date. The adoption of the transfers and servicing standard, as modified, did not have a material effect on our consolidated financial statements.

In June 2009, the FASB modified the accounting standard related to consolidation. This standard, as modified, intends to improve financial reporting by enterprises involved with variable interest entities. This standard, as modified, addresses the effects on certain provisions relating to the Consolidation of Variable Interest Entities, as a result of the elimination of the qualifying special-purpose entity concept in the accounting standard related to transfers and servicing, and constituent concerns about the application of certain key provisions of this standard, including those in which the accounting and disclosures under the standard do not always provide timely and useful information about an enterprise's involvement in a variable interest entity. This standard, as modified, is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The adoption of the consolidation standard, as modified, did not have a material effect on our consolidated
financial statements.

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In January 2010, the FASB issued "Fair Value Measurements and Disclosures - Improving Disclosures about Fair Value Measurements." This statement requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in FASB Statement "Fair Value Measurement". The amendments are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this pronouncement did not have a material effect on our consolidated financial statements.

Accounting standards not yet adopted
In September 2009, the Emerging Issues Task Force ("EITF") issued "Revenue Arrangements with Multiple Deliverables." This issue addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how to allocate the consideration to each unit of accounting. This issue eliminates the use of the residual value method for determining allocation of arrangement consideration and allows the use of an entity's best estimate to determine the selling price if vendor specific objective evidence and third-party evidence cannot be determined. This issue also requires additional disclosure to provide both qualitative and quantitative information regarding the significant judgments made in applying this issue. In addition, for each reporting period in the initial year of adoption, this issue requires disclosure of the amount of revenue recognized subject to the measurement requirements of this issue and the amount of revenue that would have been recognized if the related transactions were subject to the measurement requirements of Issue $00-21$. This issue is effective for revenue arrangements entered into or materially modified in fiscal years beginning after June 15, 2010. Early adoption is permitted. We are currently assessing the potential impact of the adoption of these rules on our consolidated financial statement disclosures.
7.

INCOME TAXES
We file income tax returns in the U.S. Federal jurisdiction and various state and foreign jurisdictions. We are no longer subject to U.S. Federal tax examinations for years before 2005. State jurisdictions that remain subject to examination range from 2004 to 2008. Foreign jurisdiction tax returns that remain subject to examination range from 2002 to 2008 for Canada and from 2004 to 2008 for Puerto Rico. 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 June 30, 2010, 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 $36 \%$ for the three-month and six-month periods ended June 30, 2010 and 2009.

A schedule of intangible assets is as follows:

|  |  | Gross <br> Amount | Accumulated <br> Amortization | Carrying <br> Amount |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| June 30, 2010 (unaudited) |  |  |  |  |  |
| Trademarks: | $\$$ | $27,243,578$ | $\$$ | - | $27,243,578$ |
| Wholesale | $2,900,000$ | - | $2,900,000$ |  |  |
| Retail | $2,408,326$ | $2,039,083$ | 369,243 |  |  |
| Patents |  | $1,000,000$ | $1,000,000$ | - |  |
| Customer relationships | $\$$ | $33,551,904$ | $\$$ | $3,039,083$ | $\$$ |
| Total Identified Intangibles |  | $30,512,821$ |  |  |  |


| December 31, 2009 |  | Gross <br> Amount |  | Accumulated Amortization |  | Carrying <br> Amount |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Trademarks: |  |  |  |  |  |  |
| Wholesale | \$ | 27,243,578 | \$ | - | \$ | 27,243,578 |
| Retail |  | 2,900,000 |  | - |  | 2,900,000 |
| Patents |  | 2,388,999 |  | 2,015,667 |  | 373,332 |
| Customer relationships |  | 1,000,000 |  | 1,000,000 |  |  |
| Total Identified Intangibles | \$ | 33,532,577 |  | 3,015,667 | \$ | 30,516,910 |
| June 30, 2009 (unaudited) |  | Gross <br> Amount |  | Accumulated Amortization |  | Carrying Amount |
| Trademarks: |  |  |  |  |  |  |
| Wholesale | \$ | 27,243,578 | \$ |  | \$ | 27,243,578 |
| Retail |  | 2,900,000 |  |  |  | 2,900,000 |
| Patents |  | 2,349,152 |  | 1,823,482 |  | 525,670 |
| Customer relationships |  | 1,000,000 |  | 900,000 |  | 100,000 |
| Total Identified Intangibles | \$ | 33,492,730 | \$ | 2,723,482 | \$ | 30,769,248 |

Amortization expense for intangible assets was $\$ 11,764$ and $\$ 145,570$ for the three months ended June 30, 2010 and 2009 , respectively and $\$ 23,416$ and $\$ 290,841$ for the six months ended June 30, 2010 and 2009, respectively. The weighted average amortization period for patents is 15 years.

Estimate of Aggregate Amortization Expense for the years ending December 31, :

| 2011 | $\$ 45,755$ |
| :--- | ---: |
| 2012 | 45,755 |
| 2013 | 45,755 |
| 2014 | 45,755 |
| 2015 | 45,755 |

On May 11, 2004, our shareholders approved the 2004 Stock Incentive Plan. The Plan includes 750,000 of our common shares that may be granted for stock options and restricted stock awards. As of June 30, 2010, we were authorized to issue approximately 360,031 shares under our existing plans.

The Plan generally provides for grants with the exercise price equal to fair value on the date of grant, graduated vesting periods of up to five years, and lives not exceeding ten years. The following summarizes stock option transactions from January 1, 2010 through June 30, 2010:

|  |  | Weighted <br> Average <br> Exercise <br> Price |  |
| :--- | ---: | ---: | ---: |
|  | Shares |  |  |
| Options outstanding at January 1, 2010 | 335,250 | $\$$ | 18.25 |
| Issued | - | - |  |
| Exercised | $(14,250)$ | $\$$ | 5.61 |
| Forfeited | 252,000 | $\$$ | 18.81 |
| Options outstanding at June 30, 2010 |  | 18.81 |  |
|  |  |  |  |
| Options exercisable at: | 335,250 | $\$$ | 18.25 |
| January 1, 2010 | 252,000 | $\$$ | 18.81 |
| June 30, 2010 |  |  |  |
| Unvested options at January 1, 2010 | - |  |  |
| Granted | - |  |  |
| Vested | - |  |  |
| Forfeited |  | - |  |
| Unvested options at June 30, 2010 |  | - |  |

During the six-month period ended June 30, 2010, we issued 16,072 shares of common stock to members of our Board of Directors. We recorded compensation expense of $\$ 122,500$, which was the fair market value of the shares on the grant date. The shares are fully vested but cannot be sold for one year.

In June 2009, our Board of Directors adopted a Rights Agreement, which provides for one preferred share purchase right to be associated with each share of our outstanding common stock. Shareholders exercising these rights would become entitled to purchase shares of Series B Junior Participating Cumulative Preferred Stock. The rights are exercisable after the time when a person or group of persons without the approval of the Board of Directors acquire beneficial ownership of 20 percent or more of our common stock or announce the initiation of a tender or exchange offer which if successful would cause such person or group to beneficially own 20 percent or more of our common stock. Such exercise would ultimately entitle the holders of the rights to purchase at the exercise price, shares of common stock of the surviving corporation or purchaser, respectively, with an aggregate market value equal to two times the exercise price. The person or groups effecting such 20 percent acquisition or undertaking such tender offer would not be entitled to exercise any rights. These rights expire during July 2012.

In May 2010, the Company completed a public offering of 1.8 million shares of common stock at a price of $\$ 8.40$ per share. We received net proceeds from the offering of $\$ 14.1$ million after deducting $\$ 0.9$ million in underwriting discounts and $\$ 0.1$ million in expenses. The proceeds were used to prepay amounts due under term loans with Laminar Direct Capital L.P. and Whitebox Hedged High Yield Partners, L.P. After the prepayment, principal under the term loans total $\$ 26$ million in the aggregate. The term loans have an interest rate of $11.5 \%$ payable semi-annually over the five year term of the notes. Principal repayment is due at maturity in May 2012. The transaction is expected to generate approximately $\$ 1.6$ million in interest savings annually. In connection with this transaction, $\$ 0.2$ million of prepayment fees and $\$ 0.2$ million of non-cash charges related to deferred interest expense were incurred and have been reflected as a component of interest expense.

## 10.

## RETIREMENT PLANS

We sponsor a noncontributory defined benefit pension plan covering non-union workers in our Ohio and Puerto Rico operations. Benefits under the non-union plan are based upon years of service and highest compensation levels as defined. On December 31, 2005, we froze the noncontributory defined benefit pension plan for all non-U.S. territorial employees.

Net pension cost of the Company's plan is as follows:

|  | (Unaudited) Three Months Ended June 30, |  |  |  | (Unaudited) Six Months Ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 2010 |  | 2009 |  | 2010 |  | 2009 |
| Service cost | \$ | 19,977 | \$ | 28,843 | \$ | 39,954 | \$ | 57,686 |
| Interest |  | 161,677 |  | 151,454 |  | 323,354 |  | 302,908 |
| Expected return on assets |  | $(133,054)$ |  | $(121,613)$ |  | $(266,108)$ |  | $(243,227)$ |
| Amortization of unrecognized net gain or loss |  | 71,853 |  | 61,786 |  | 143,706 |  | 123,572 |
| Amortization of unrecognized transition obligation |  | - |  | - |  | - |  | - |
| Amortization of unrecognized prior service cost |  | 18,098 |  | 18,098 |  | 36,196 |  | 36,196 |
| Net pension cost | \$ | 138,551 | \$ | 138,568 | \$ | 277,102 | \$ | 277,135 |

Our unrecognized benefit obligations existing at the date of transition for the non-union plan are being amortized over 21 years. Actuarial assumptions used in the accounting for the plan were as follows:

$$
2010 \quad 2009
$$

| Discount rate | $5.91 \%$ | $6.00 \%$ |
| :--- | :---: | :---: |
| Average rate of increase in compensation levels | $3.0 \%$ | $3.0 \%$ |
| Expected long-term rate of return on plan assets | $8.0 \%$ | $8.0 \%$ |

Our desired investment result is a long-term rate of return on assets that is at least $8 \%$. The target rate of return for the plan has been based upon the assumption that returns will approximate the long-term rates of return experienced for each asset class in our investment policy. Our investment guidelines are based upon an investment horizon of greater than five years, so that interim fluctuations should be viewed with appropriate perspective. Similarly, the plan's strategic asset allocation is based on this long-term perspective.

## 11.

SEGMENT INFORMATION
We have identified three reportable segments: Wholesale, Retail and Military. Wholesale includes sales of footwear and accessories to several classifications of retailers, including sporting goods stores, outdoor specialty stores, mail order catalogs, independent retailers, mass merchants, retail uniform stores, and specialty safety shoe stores. Retail includes all sales from our stores and all sales in our Lehigh division, which includes sales via shoemobiles to individual customers. Military includes sales to the U.S. Military. The following is a summary of segment results for the Wholesale, Retail, and Military segments.

|  | (Unaudited) <br> Three Months Ended June 30, |  |  |  | (Unaudited) <br> Six Months Ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 2010 |  | 2009 |  | 2010 |  | 2009 |
| NET SALES: |  |  |  |  |  |  |  |  |
| Wholesale | \$ | 38,504,796 | \$ | 37,903,590 | \$ | 76,409,660 | \$ | 73,933,498 |
| Retail |  | 11,006,622 |  | 12,347,196 |  | 23,932,562 |  | 26,059,490 |
| Military |  | 5,711,636 |  | 937,829 |  | 10,959,818 |  | 1,260,188 |
| Total Net Sales | \$ | 55,223,054 | \$ | 51,188,615 | \$ | 111,302,040 | \$ | 101,253,176 |
| GROSS MARGIN: |  |  |  |  |  |  |  |  |
| Wholesale | \$ | 13,479,972 | \$ | 11,853,483 | \$ | 25,657,968 | \$ | 25,157,771 |
| Retail |  | 4,869,379 |  | 5,829,704 |  | 10,772,638 |  | 12,596,190 |
| Military |  | 749,733 |  | 34,485 |  | 1,425,327 |  | 56,199 |
| Total Gross Margin | \$ | 19,099,084 | \$ | 17,717,672 | \$ | 37,855,933 | \$ | 37,810,160 |

Segment asset information is not prepared or used to assess segment performance.

In March 2009, we amended the terms of our revolving credit facility with GMAC Commercial Finance ("GMAC") which was set to expire on January 5, 2010. The size of the facility was reduced to $\$ 85$ million from $\$ 100$ million and the maturity date was extended to April 30, 2012. The interest rates for the term of this amendment are LIBOR plus $3.75 \%$ or prime plus $2.25 \%$, at our option. The financing costs associated with this amendment totaled approximately $\$ 1.5$ million.

In May 2010, we amended the terms of our revolving credit facility with GMAC Commercial Finance ("GMAC") to advance $\$ 15$ million to the Company under the existing revolving portion of its credit facility to prepay amounts due under term loans with Laminar Direct Capital L.P. and Whitebox Hedged High Yield Partners, L.P. After the prepayment, principal under the term loans total $\$ 11$ million in the aggregate. The term loans have an interest rate of $11.5 \%$ payable semi-annually over the five year term of the notes. Principal repayment is due at maturity in May 2012. The interest rate for the revolving portion of the Company's credit facility is currently LIBOR plus $3.75 \%$. The transaction is expected to generate approximately $\$ 1.1$ million in interest savings annually based on the current LIBOR rate. In connection with this transaction, $\$ 0.2$ million of prepayment fees and $\$ 0.2$ million of non-cash charges related to deferred interest expense were incurred and have been reflected as a component of interest expense.

Our credit facilities contain certain restrictive covenants, which require us to maintain a minimum fixed charge coverage ratio and limit the annual amount of capital expenditures. As of June 30, 2010, we were in compliance with these restrictive covenants.

## 13.

## FINANCIAL INSTRUMENTS

The fair values of cash, accounts receivable, other receivables and accounts payable approximated their carrying values because of the short-term nature of these instruments. Accounts receivable consists primarily of amounts due from our customers, net of allowances. Other receivables consist primarily of amounts due from employees (sales persons' advances in excess of commissions earned and employee travel advances); other customer receivables, net of allowances; and expected insurance recoveries. The carrying amount of the mortgages and other short-term financing obligations also approximates fair value, as they are comparable to the available financing in the marketplace during the year.

The carrying amount and fair value of our long-term debt not measured on a recurring basis subject to fair value reporting is as follows:

June 30, 2010

|  | Carrying <br> Amount | Fair <br> Value |
| :--- | :---: | :---: | :---: |
| Debt | \$ $36,899,297$ | $\$ 36,385,099$ |

We estimated the fair value of debt using market quotations and calculations based on market rates.

## RESTRUCTURING

During the fourth quarter of 2009, we initiated a comprehensive series of actions to reduce the operating cost structure and increase the operating efficiency of both our wholesale and retail divisions. These actions involved the relocation of our wholesale division's customer care function from Franklin, TN to Nelsonville, OH; and the closing of underperforming mini-stores and trucks in our retail division. These charges were composed of severance and employee benefits related costs, transition costs, and facility exit costs, which includes facility shut down and lease contract termination costs.

The schedule below summarizes the charges included in the accompanying consolidated financial statements for the first half of 2010 for our wholesale and retail divisions:

|  | Liability Beginning Balance 12/31/2009 |  | (Unaudited) Expense |  | (Unaudited) Payments |  | (Unaudited) Liability Ending Balance 6/30/2010 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Wholesale |  |  |  |  |  |  |  |  |
| Severance and employee benefits | \$ | 148,080 | \$ | - | \$ | 148,080 | \$ |  |
| Transition costs |  | - |  | - |  | - |  |  |
| Facility exit costs |  | 31,475 |  | - |  | 31,475 |  |  |
| Total Wholesale | \$ | 179,555 | \$ | - | \$ | 179,555 | \$ |  |
| Retail |  |  |  |  |  |  |  |  |
| Severance and employee benefits | \$ | - | \$ | - | \$ | - | \$ | - |
| Transition costs |  | 36,091 |  | - |  | 36,091 |  | - |
| Facility exit costs |  | 160,717 |  | - |  | 147,367 |  | 13,350 |
| Total Retail | \$ | 196,808 | \$ | - | \$ | 183,458 | \$ | 13,350 |
| Total | \$ | 376,363 | \$ | - | \$ | 363,013 | \$ | 13,350 |

The liability ending balance at December 31, 2009 and June 30, 2010 is included in our Consolidated Balance Sheet under Accrued Expenses.

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

## RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, information derived from our Interim Unaudited Condensed Consolidated Financial Statements, expressed as a percentage of net sales. The discussion that follows the table should be read in conjunction with our Interim Unaudited Condensed Consolidated Financial Statements.

|  | Three Months Ended |  | Six Months Ended |  |
| :--- | :---: | ---: | :---: | ---: | ---: |
|  | June 30, |  | June 30, |  |

Three Months Ended June 30, 2010 Compared to Three Months Ended June 30, 2009
Net sales. Net sales for the three months ended June 30, 2010 were $\$ 55.2$ million compared to $\$ 51.2$ million for the same period in 2009. Wholesale sales for the three months ended June 30, 2010 were $\$ 38.5$ million compared to $\$ 37.9$ million for the same period in 2009. The $\$ 0.6$ million increase in wholesale sales was the result of increased sales in our work footwear category. Retail sales for the three months ended June 30, 2010 were $\$ 11.0$ million compared to $\$ 12.3$ million for the same period in 2009. The $\$ 1.3$ million decrease in retail sales resulted from plant closings and layoffs in the manufacturing sector as the current economic conditions have impacted a significant portion of our retail customer base. In addition, retail sales were negatively impacted by our ongoing transition to more internet driven transactions and the decision to remove a portion of our Lehigh mobile stores from operations which resulted in reductions in SG\&A expenses. Military segment sales for the three months ended June 30, 2010, were $\$ 5.7$ million, compared to $\$ 0.9$ million in the same period in 2009. Shipments in 2010 were under the $\$ 29.0$ million contract, issued in July 2009.

Gross margin. Gross margin for the three months ended June 30 , 2010 was $\$ 19.1$ million, or $34.6 \%$ of net sales, compared to $\$ 17.7$ million, or $34.6 \%$ of net sales, in the same period last year. Wholesale gross margin for the three months ended June 30, 2010 was $\$ 13.5$ million, or $35.0 \%$ of net sales, compared to $\$ 11.9$ million, or $31.3 \%$ of net sales, in the same period last year. The 370 basis point increase is primarily the result of a decrease in manufacturing costs. Retail gross margin for the three months ended June 30, 2010 was $\$ 4.9$ million, or $44.2 \%$ of net sales, compared to $\$ 5.8$ million, or $47.2 \%$ of net sales, for the same period in 2009. The 300 basis point decrease reflects reduced sales via our mobile stores, which carry the highest gross margin in our retail business. Military gross margin for the three months ended June 30, 2010 was $\$ 0.7$ million, or $13.1 \%$ of net sales, compared to less than $\$ 0.1$ million, or $3.7 \%$ of net sales, for the same period in 2009.

SG\&A expenses. SG\&A expenses were $\$ 16.2$ million, or $29.3 \%$ of net sales, for the three months ended June 30, 2010 , compared to $\$ 18.1$ million, or $35.4 \%$ of net sales for the same period in 2009 . The net change primarily reflects decreases in compensation and benefits of $\$ 0.6$ million, advertising of $\$ 0.4$ million, bad debt expense of $\$ 0.3$ million and Lehigh store expenses of $\$ 0.2$ million.

Interest expense. Interest expense was $\$ 2.1$ million in the three months ended June 30, 2010, compared to $\$ 1.9$ million for the same period in the prior year. The increase of $\$ 0.2$ million resulted from fees of $\$ 0.9$ million associated with the early repayment of a portion of the company's term loans, partially offset by a reduction in average borrowings compared to the same period last year.

Income taxes. Income tax expense for the three months ended June 30,2010 was $\$ 0.3$ million, compared to a benefit of $\$ 0.8$ million for the same period a year ago. We provided for income taxes at effective tax rates of $36 \%$.

Six Months Ended June 30, 2010 Compared to Six Months Ended June 30, 2009
Net sales. Net sales for the six months ended June 30, 2010 were $\$ 111.3$ million compared to $\$ 101.3$ million for the same period in 2009. Wholesale sales for the six months ended June 30 , 2010 were $\$ 76.4$ million compared to $\$ 73.9$ million for the same period in 2009. The $\$ 2.5$ million increase in wholesale sales was the result of increased sales in our work footwear category. Retail sales for the six months ended June 30, 2010 were $\$ 23.9$ million compared to $\$ 26.1$ million for the same period in 2009. The $\$ 2.2$ million decrease in retail sales resulted from plant closings and layoffs in the manufacturing sector as the current economic conditions have impacted a significant portion of our retail customer base. In addition, retail sales were negatively impacted by our ongoing transition to more internet driven transactions and the decision to remove a portion of our Lehigh mobile stores from operations which resulted in reductions in SG\&A expenses. Military segment sales for the six months ended June 30, 2010, were $\$ 11.0$ million, compared to $\$ 1.3$ million in the same period in 2009. Shipments in 2010 were under the $\$ 29.0$ million contract, issued in July 2009.

Gross margin. Gross margin for the six months ended June 30, 2010 was $\$ 37.9$ million, or $34.0 \%$ of net sales, compared to $\$ 37.8$ million, or $37.3 \%$ of net sales, in the same period last year. Wholesale gross margin for the six months ended June 30, 2010 was $\$ 25.7$ million, or $33.6 \%$ of net sales, compared to $\$ 25.2$ million, or $34.0 \%$ of net sales, in the same period last year. Retail gross margin for the six months ended June 30, 2010 was $\$ 10.8$ million, or $45.0 \%$ of net sales, compared to $\$ 12.6$ million, or $48.3 \%$ of net sales, for the same period in 2009. The 330 basis point decrease reflects reduced sales via our mobile stores, which carry the highest gross margin in our retail business. Military gross margin for the six months ended June 30, 2010 was $\$ 1.4$ million, or $13.0 \%$ of net sales, compared to $\$ 0.1$ million or $4.5 \%$ of net sales for the same period in 2009.

SG\&A expenses. SG\&A expenses were $\$ 34.2$ million, or $30.7 \%$ of net sales, for the six months ended June 30, 2010, compared to $\$ 38.1$ million, or $37.6 \%$ of net sales for the same period in 2009. The net change primarily reflects decreases in compensation and benefits of $\$ 1.8$ million, bad debt expense of $\$ 0.6$ million, advertising of $\$ 0.5$ million and Lehigh store expenses of $\$ 0.3$ million.

Interest expense. Interest expense was $\$ 3.8$ million in the six months ended June 30, 2010, compared to $\$ 3.7$ million for the same period in the prior year. The increase of $\$ 0.1$ million resulted from fees of $\$ 0.9$ million associated with the early repayment of a portion of the company's term loans, partially offset by a reduction in average borrowings compared to the same period last year.

Income taxes. Income tax benefit for the six months ended June 30, 2010 was less than $\$ 0.1$ million, compared to a benefit of $\$ 1.4$ million for the same period a year ago. We provided for income taxes at effective tax rates of $36 \%$.

## Liquidity and Capital Resources

Our principal sources of liquidity have been our income from operations, borrowings under our credit facility and other indebtedness.

Over the last several years our principal uses of cash have been for working capital and capital expenditures to support our growth. Our working capital consists primarily of trade receivables and inventory, offset by accounts payable and accrued expenses. Our working capital fluctuates throughout the year as a result of our seasonal business cycle and business expansion and is generally lowest in the months of January through March of each year and highest during the months of May through October of each year. We typically utilize our revolving credit facility to fund our seasonal working capital requirements. As a result, balances on our revolving credit facility will fluctuate significantly throughout the year. Our capital expenditures relate primarily to projects relating to our property, merchandising fixtures, molds and equipment associated with our manufacturing operations, retail sales fleet and for information technology. Capital expenditures were $\$ 2.6$ million for the first six months of 2010, compared to $\$ 3.1$ million for the same period in 2009. Capital expenditures for all of 2010 are anticipated to be approximately $\$ 4.5$ million.

In March 2009, we amended the terms of our revolving credit facility with GMAC Commercial Finance ("GMAC") which was set to expire on January 5, 2010. The size of the facility was reduced to $\$ 85$ million from $\$ 100$ million and the maturity date was extended to April 30, 2012. The financing costs associated with this amendment totaled approximately $\$ 1.5$ million. The interest rates for the term of this amendment are LIBOR plus $3.75 \%$ or prime plus $2.25 \%$, at our option.

In May 2010, we amended the terms of our revolving credit facility with GMAC Commercial Finance ("GMAC") to advance $\$ 15$ million to the Company under the existing revolving portion of its credit facility to prepay amounts due under term loans with Laminar Direct Capital L.P. and Whitebox Hedged High Yield Partners, L.P. The term loans have an interest rate of $11.5 \%$ payable semi-annually over the five year term of the notes. Principal repayment is due at maturity in May 2012. The interest rate for the revolving portion of the Company's credit facility is currently LIBOR plus $3.75 \%$. The transaction is expected to generate approximately $\$ 1.1$ million in interest savings annually based on the current LIBOR rate. In connection with this transaction, $\$ 0.2$ million of prepayment fees and $\$ 0.2$ million of non-cash charges related to deferred interest expense were incurred and have been reflected as a component of interest expense.

The total amount available under our revolving credit facility is subject to a borrowing base calculation based on various percentages of accounts receivable and inventory. As of June 30, 2010, we had $\$ 23.6$ million in borrowings under this facility and total capacity of $\$ 51.4$ million. Our credit facilities contain certain restrictive covenants, which require us to maintain a minimum fixed charge coverage ratio and limit the annual amount of capital expenditures. As of June 30, 2010, we were in compliance with these restrictive covenants.

We believe that our existing credit facilities coupled with cash generated from operations will provide sufficient liquidity to fund our operations for at least the next twelve months. Our continued liquidity, however, is contingent upon future operating performance, cash flows and our ability to meet financial covenants under our credit facilities.

In May 2010, the Company completed a public offering of 1.8 million shares of common stock at a price of $\$ 8.40$ per share. We received net proceeds from the offering of $\$ 14.1$ million after deducting $\$ 0.9$ million in underwriting discounts and $\$ 0.1$ million in expenses. The proceeds were used to prepay amounts due under term loans with Laminar Direct Capital L.P. and Whitebox Hedged High Yield Partners, L.P. The term loans have an interest rate of $11.5 \%$ payable semi-annually over the five year term of the notes. Principal repayment is due at maturity in May 2012. The transaction is expected to generate approximately $\$ 1.6$ million in interest savings annually. In connection with this transaction, $\$ 0.2$ million of prepayment fees and $\$ 0.2$ million of non-cash charges related to deferred interest expense were incurred and have been reflected as a component of interest expense.

Operating Activities. Cash provided by operating activities totaled $\$ 8.6$ million for the six months ended June 30, 2010, compared to $\$ 3.4$ million in the same period of 2009. Cash provided by operating activities for the six months ended June 30, 2010 was primarily impacted by a reduction in accounts receivable and an increase in accounts payable partially offset by an increase in inventory. Cash provided by operating activities for the six months ended June 30 , 2009 was primarily impacted by a reduction in accounts receivable, partially offset by an increase in inventory.

Investing Activities. Cash used in investing activities was $\$ 2.6$ million for the six months ended June 30, 2010, compared to $\$ 3.1$ million in the same period of 2009. Cash used in investing activities reflects an investment in property, plant and equipment of $\$ 2.6$ million in 2010 and $\$ 3.1$ million in 2009. Our 2010 and 2009 expenditures primarily relate to investments in molds and equipment associated with our manufacturing operations and for information technology.

Financing Activities. Cash used in financing activities for the six months ended June 30, 2010 was $\$ 4.6$ million and reflects $\$ 14.1$ million of proceeds from the aforementioned issuance of common stock, an increase in net borrowings under the revolving credit facility of $\$ 10.5$ million and repayments on long-term debt of $\$ 29.3$ million. Cash used in financing activities for the six months ended June 30, 2009 was $\$ 1.7$ million and reflects debt financing costs associated with the amendment of our credit facility with GMAC of $\$ 1.5$ million and repayments on long-term debt of $\$ 0.2$ million.

## Inflation

We cannot determine the precise effects of inflation; however, inflation continues to have an influence on the cost of materials, salaries, and employee benefits. We attempt to offset the effects of inflation through increased selling prices, productivity improvements, and reduction of costs.

## Critical Accounting Policies and Estimates

"Management's Discussion and Analysis of Financial Condition and Results of Operations" discusses our interim condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these interim condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the interim condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. A summary of our significant accounting policies is included in the Notes to Consolidated Financial Statements included in the Annual Report on Form 10-K for the year ended December 31, 2009.

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Our management regularly reviews our accounting policies to make certain they are current and also to provide readers of the interim condensed consolidated financial statements with useful and reliable information about our operating results and financial condition. These include, but are not limited to, matters related to accounts receivable, inventories, pension benefits and income taxes. Implementation of these accounting policies includes estimates and judgments by management based on historical experience and other factors believed to be reasonable. This may include judgments about the carrying value of assets and liabilities based on considerations that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Our management believes the following critical accounting policies are most important to the portrayal of our financial condition and results of operations and require more significant judgments and estimates in the preparation of our interim condensed consolidated financial statements.

Revenue recognition

Revenue principally consists of sales to customers, and, to a lesser extent, license fees. Revenue is recognized when the risk and title passes to the customer, while license fees are recognized when earned. Customer sales are recorded net of allowances for estimated returns, trade promotions and other discounts, which are recognized as a deduction from sales at the time of sale.

Accounts receivable allowances
Management maintains allowances for uncollectible accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The allowance for uncollectible accounts is calculated based on the relative age and size of trade receivable balances.

Sales returns and allowances

We record a reduction to gross sales based on estimated customer returns and allowances. These reductions are influenced by historical experience, based on customer returns and allowances. The actual amount of sales returns and allowances realized may differ from our estimates. If we determine that sales returns or allowances should be either increased or decreased, then the adjustment would be made to net sales in the period in which such a determination is made.

## Inventories

Management identifies slow moving or obsolete inventories and estimates appropriate loss provisions related to these inventories. Historically, these loss provisions have not been significant as the vast majority of our inventories are considered saleable, and we have been able to liquidate slow moving or obsolete inventories through our factory outlet stores or through various discounts to customers. Should management encounter difficulties liquidating slow moving or obsolete inventories, additional provisions may be necessary. Management regularly reviews the adequacy of our inventory reserves and makes adjustments to them as required.

Intangible assets
Intangible assets, including goodwill, trademarks and patents are reviewed for impairment annually, and more frequently, if necessary. We perform such testing of goodwill and indefinite-lived intangible assets in the fourth quarter of each year or as events occur or circumstances change that would more likely than not reduce the fair value of the asset below its carrying amount.

In assessing whether indefinite-lived intangible assets are impaired, we must make certain estimates and assumptions regarding future cash flows, long-term growth rates of our business, operating margins, weighted average cost of capital and other factors such as discount rates, royalty rates, cost of capital, and market multiples to determine the fair value of our assets. These estimates and assumptions require management's judgment, and changes to these estimates and assumptions could materially affect the determination of fair value and/or impairment for each of our other indefinite-lived intangible assets. Future events could cause us to conclude that indications of intangible asset impairment exist. Impairment may result from, among other things, deterioration in the performance of our business, adverse market conditions, adverse changes in applicable laws and regulations, competition, or the sale or disposition of a reporting segment. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

Pension benefits
Accounting for pensions involves estimating the cost of benefits to be provided well into the future and attributing that cost over the time period each employee works. To accomplish this, extensive use is made of assumptions about inflation, investment returns, mortality, turnover, medical costs and discount rates. These assumptions are reviewed annually.

Pension expenses are determined by actuaries using assumptions concerning the discount rate, expected return on plan assets and rate of compensation increase. An actuarial analysis of benefit obligations and plan assets is determined as of December 31 each year.

The funded status of our plans and reconciliation of accrued pension cost is determined annually as of December 31 . Further discussion of our pension plan and related assumptions is included in Note 10, "Retirement Plans," to the unaudited condensed consolidated financial statements for the quarterly period ended June 30, 2010. Actual results would be different using other assumptions. Management records an accrual for pension costs associated with our sponsored non-contributory defined benefit pension plan covering our non-union workers. Future adverse changes in market conditions or poor operating results of underlying plan assets could result in losses or a higher accrual. At December 31, 2005, we froze the non-contributory defined benefit pension plan for all non-U.S. territorial employees.

Income taxes
Management has recorded a valuation allowance to reduce its deferred tax assets for a portion of state and local income tax net operating losses that it believes may not be realized. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance; however, in the event we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to income in the period such determination was made.

## SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995.

Except for the historical information contained herein, the matters discussed in this Quarterly Report on Form 10-Q include certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are intended to be covered by the safe harbors created thereby. Those statements include, but may not be limited to, all statements regarding our and management's intent, belief, and expectations, such as statements concerning our future profitability and our operating and growth strategy. Words such as "believe," "anticipate," "expect," "will," "may," "should," "intend," "plan," "estimate," "p "potential," "continue," "likely" and similar expressions are intended to identify forward-looking statements. Investors are cautioned that all forward-looking statements contained in this Quarterly Report on Form 10-Q and in other statements we make involve risks and uncertainties including, without limitation, the factors set forth under the caption "Risk Factors" included in our Annual Report on Form 10-K for the year ended December 31, 2009, and other factors detailed from time to time in our other filings with the Securities and Exchange Commission. One or more of these factors have affected, and in the future could affect our businesses and financial results and could cause actual results to differ materially from plans and projections. Although we believe that the assumptions underlying the forward-looking statements contained herein are reasonable, there can be no assurance that any of the forward-looking statements included in this Quarterly Report on Form 10-Q will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. All forward-looking statements made in this Quarterly Report on Form 10-Q are based on information presently available to our management. We assume no obligation to update any forward-looking statements.

## ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes since December 31, 2009.

## ITEM 4 - CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, our management, with the participation of our chief executive officer and chief financial officer, carried out an evaluation of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 promulgated under the Exchange Act. Based upon this evaluation, our chief executive officer and our chief financial officer concluded that our disclosure controls and procedures were (1) designed to ensure that material information relating to our Company is accumulated and made known to our management, including our chief executive officer and chief financial officer, in a timely manner, particularly during the period in which this report was being prepared, and (2) effective, in that they provide reasonable assurance that information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Management believes, however, that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a Company have been detected.

Internal Controls. There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act) during our fiscal quarter ended June 30, 2010, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II — OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

None

## ITEM 1A - RISK FACTORS

There have been no material changes to our risk factors as disclosed in Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2009.

## ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 - RESERVED

ITEM 5 - OTHER INFORMATION

None

ITEM 6 - EXHIBITS

| EXHIBIT | EXHIBIT |
| :--- | :--- |
| NUMBER | DESCRIPTION |
| $31(\mathrm{a})^{*}$ | Certification pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a) of the Chief <br> Executive Officer. <br> Certification pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a) of the Chief |
| $31(\mathrm{~b})^{*}$ | Financial Officer. <br> Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of <br> the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer. <br> Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of <br> $32(b)+$ |


| $*$ | Filed with this report. |
| :--- | :--- |
| + | Furnished with this report. |

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## SIGNATURE

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

Rocky Brands, Inc.
Date: August 3, 2010
/s/ James E. McDonald
James E. McDonald, Executive Vice President and Chief Financial Officer*

* In his capacity as Executive Vice President and Chief Financial Officer, Mr. McDonald is duly authorized to sign this report on behalf of the Registrant.

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