

ROCKY BRANDS, INC.  
Form 10-Q  
July 29, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: **001-34382**

**ROCKY BRANDS, INC.**

(Exact name of registrant as specified in its charter)

**Ohio** **31-1364046**  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) 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 x 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," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer " Accelerated filer x Non-accelerated filer " Smaller reporting company "  
(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 26, 2013, 7,516,448 shares of Rocky Brands, Inc. common stock, no par value, were outstanding.

**FORM 10-Q**

ROCKY BRANDS, INC.

**TABLE OF CONTENTS**

	<b>PAGE NUMBER</b>
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Financial Statements	
Condensed Consolidated Balance Sheets June 30, 2013 and 2012 (Unaudited), and December 31, 2012	3
Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2013 and 2012 (Unaudited)	4
Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2013 and 2012 (Unaudited)	5
Notes to the Interim Unaudited Condensed Consolidated Financial Statements for the Three and Six Months Ended June 30, 2013 and 2012	6 –13
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	14 – 19
Item 3. Quantitative and Qualitative Disclosures About Market Risk	20
Item 4. Controls and Procedures	20
<b>PART II. OTHER INFORMATION</b>	
Item 1. Legal Proceedings	21
Item 1A. Risk Factors	21
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	21
Item 3. Defaults Upon Senior Securities	21
Item 4. Mine Safety Disclosures	21

Item 5. Other Information	21
Item 6. Exhibits	21
<b>SIGNATURE</b>	22

**PART I - FINANCIAL INFORMATION****ITEM 1 - FINANCIAL STATEMENTS****ROCKY BRANDS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

	June 30, 2013 (Unaudited)	December 31, 2012	June 30, 2012 (Unaudited)
<b>ASSETS:</b>			
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents	\$2,855,524	\$ 4,022,579	\$ 1,850,905
Trade receivables – net	46,429,928	44,555,057	36,729,487
Other receivables	496,669	575,984	760,596
Inventories	81,159,941	67,196,245	74,048,921
Income tax receivable	270,878	-	933,293
Deferred income taxes	1,252,030	1,252,030	1,154,040
Prepaid expenses	2,862,360	2,127,726	2,240,461
Total current assets	135,327,330	119,729,621	117,717,703
FIXED ASSETS – net	24,418,143	24,252,465	24,822,919
IDENTIFIED INTANGIBLES	30,503,659	30,498,802	30,490,861
OTHER ASSETS	330,743	363,527	436,525
<b>TOTAL ASSETS</b>	<b>\$ 190,579,875</b>	<b>\$ 174,844,415</b>	<b>\$ 173,468,008</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>			
<b>CURRENT LIABILITIES:</b>			
Accounts payable	\$ 15,252,448	\$ 9,930,518	\$ 10,740,705
Accrued expenses:			
Salaries and wages	1,157,593	592,568	1,122,898
Taxes - other	793,439	704,064	595,214
Accrued freight	652,695	857,991	511,152
Commissions	584,890	711,459	457,214
Income taxes payable	-	335,210	-
Other	1,577,503	1,162,650	933,674
Total current liabilities	20,018,568	14,294,460	14,360,857
LONG TERM DEBT	31,438,173	23,461,340	29,909,957
DEFERRED INCOME TAXES	11,148,333	11,148,333	10,987,395
DEFERRED LIABILITIES	255,906	303,406	488,437
<b>TOTAL LIABILITIES</b>	<b>62,860,980</b>	<b>49,207,539</b>	<b>55,746,646</b>
COMMITMENTS AND CONTINGENCIES			
SHAREHOLDERS' EQUITY:			

Edgar Filing: ROCKY BRANDS, INC. - Form 10-Q

Common stock, no par value; 25,000,000 shares authorized; issued and outstanding June 30, 2013 - 7,516,448; December 31, 2012 - 7,503,568 and June 30, 2012 - 7,503,568	69,862,770	69,694,770	69,694,770
Retained earnings	57,856,125	55,942,106	48,026,592
Total shareholders' equity	127,718,895	125,636,876	117,721,362
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 190,579,875</b>	<b>\$ 174,844,415</b>	<b>\$ 173,468,008</b>

See notes to the interim unaudited condensed consolidated financial statements.

**ROCKY BRANDS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(UNAUDITED)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
NET SALES	\$59,419,751	\$44,408,358	\$113,135,227	\$97,734,276
COST OF GOODS SOLD	39,109,264	29,056,731	74,153,970	64,360,568
GROSS MARGIN	20,310,487	15,351,627	38,981,257	33,373,708
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	17,441,736	14,893,727	34,605,918	31,635,785
INCOME FROM OPERATIONS	2,868,751	457,900	4,375,339	1,737,923
OTHER INCOME AND (EXPENSES):				
Interest expense, net	(147,194 )	(130,606 )	(276,752 )	(274,953 )
Other – net	4,723	13,270	(211 )	4,281
Total other - net	(142,471 )	(117,336 )	(276,963 )	(270,672 )
INCOME BEFORE INCOME TAXES	2,726,280	340,564	4,098,376	1,467,251
INCOME TAX EXPENSE	954,000	122,000	1,434,000	528,000
COMPREHENSIVE INCOME	\$1,772,280	\$218,564	\$2,664,376	\$939,251
NET INCOME PER SHARE				
Basic	\$0.24	\$0.03	\$0.35	\$0.13
Diluted	\$0.24	\$0.03	\$0.35	\$0.13
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING				
Basic	7,516,448	7,503,568	7,516,306	7,503,419
Diluted	7,516,448	7,503,568	7,516,306	7,503,419

See notes to the interim unaudited condensed consolidated financial statements.

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

	Six Months Ended	
	June 30,	2012
	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$2,664,376	\$939,251
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	3,129,940	2,822,201
Loss (gain) on disposal of fixed assets	10,714	(57,503 )
Stock compensation expense	168,000	122,500
Change in assets and liabilities		
Receivables	(1,795,556 )	8,465,396
Inventories	(13,963,696)	(9,029,873 )
Other current assets	(1,005,512 )	552,851
Other assets	32,784	73,768
Accounts payable	5,658,892	4,990,781
Accrued and other liabilities	354,678	(1,614,007 )
Net cash (used in) provided by operating activities	(4,745,380 )	7,265,365
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of fixed assets	(3,654,890 )	(4,051,981 )
Investment in trademarks and patents	(31,062 )	(22,547 )
Proceeds from sale of fixed assets	37,801	99,820
Net cash used in investing activities	(3,648,151 )	(3,974,708 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from revolving credit facility	36,896,833	30,019,432
Repayments of revolving credit facility	(28,920,000)	(35,109,475)
Dividends paid on common stock	(750,357 )	-
Net cash provided by (used in) financing activities	7,226,476	(5,090,043 )
DECREASE IN CASH AND CASH EQUIVALENTS	(1,167,055 )	(1,799,386 )
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	4,022,579	3,650,291
CASH AND CASH EQUIVALENTS,		



END OF PERIOD	\$2,855,524	\$1,850,905
---------------	-------------	-------------

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 THREE AND SIX MONTHS ENDED JUNE 30, 2013 AND 2012****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 and six months ended June 30, 2013 and 2012 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, 2012.

**2. TRADE RECEIVABLES**

Trade receivables are presented net of the related allowance for uncollectible accounts of approximately \$820,000, \$650,000 and \$519,000 at June 30, 2013, December 31, 2012 and June 30, 2012, respectively. The allowance for uncollectible accounts is calculated based on the relative age and size of trade receivable balances. Our credit policy generally provides that trade receivables will be deemed uncollectible and written-off once we have pursued all reasonable efforts to collect on the account.

**3. INVENTORIES**

Inventories are comprised of the following:

	June 30, 2013 (Unaudited)	December 31, 2012	June 30, 2012 (Unaudited)
Raw materials	\$ 15,478,537	\$ 10,611,641	\$ 12,792,812
Work-in-process	1,010,923	407,262	993,791

Edgar Filing: ROCKY BRANDS, INC. - Form 10-Q

Finished goods	64,787,021	56,359,742	60,371,168
Reserve for obsolescence or lower of cost or market	(116,540 )	(182,400 )	(108,850 )
Total	\$81,159,941	\$67,196,245	\$74,048,921

6

**4.SUPPLEMENTAL CASH FLOW INFORMATION**

Supplemental cash flow information is as follows:

	(Unaudited) Six Months Ended June 30,	
	2013	2012
Interest	\$269,953	\$319,432
Federal, state and local income taxes, net of refunds	\$2,020,008	\$273,766
Fixed asset purchases in accounts payable	\$281,812	\$207,731

**5.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 and six months ended June 30, 2013 and 2012 is as follows:

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2013	2012	2013	2012
Weighted average shares outstanding	7,516,448	7,503,568	7,516,306	7,503,419
Dilutive stock options	-	-	-	-
Dilutive weighted average shares outstanding	7,516,448	7,503,568	7,516,306	7,503,419
Anti-dilutive stock options/weighted average shares outstanding	9,000	10,000	9,160	11,813

## 6. RECENT FINANCIAL ACCOUNTING STANDARDS

### Recently adopted accounting standards

In February 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The update does not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the update requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. The amendments are effective prospectively for reporting periods beginning after December 15, 2012. The adoption of this standard did not have a material effect on our consolidated financial statements.

### Accounting standards not yet adopted

In July 2013, the FASB issued ASU No. 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The update provides that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this update do not require new recurring disclosures. The amendments are effective prospectively for reporting periods beginning after December 15, 2013. We are currently assessing the potential impact of the adoption of this update on our consolidated financial statements.

## 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 2009. State jurisdictions that remain subject to examination range from 2008 to 2011. Foreign jurisdiction tax returns that remain subject to examination range from 2006 to 2011 for Canada and from 2006 to 2011 for Puerto Rico. We do not believe there will be any material changes in our uncertain tax positions over the next 12 months.

Our policy is to accrue interest and penalties on any uncertain tax positions as a component of income tax expense. As of June 30, 2013, no such expenses were recognized during the quarter.

We provided for income taxes at an estimated effective tax rate of 35% and 36% for the three and six months ended June 30, 2013 and 2012, respectively.

**8. INTANGIBLE ASSETS**

A schedule of intangible assets is as follows:

June 30, 2013 (unaudited)	Gross Amount	Accumulated Amortization	Carrying Amount
Trademarks:			
Wholesale	\$27,243,578	\$ -	\$27,243,578
Retail	2,900,000	-	2,900,000
Patents	2,547,465	2,187,384	360,081
Customer relationships	1,000,000	1,000,000	-
Total Identified Intangibles	\$33,691,043	\$ 3,187,384	\$30,503,659

December 31, 2012	Gross Amount	Accumulated Amortization	Carrying Amount
Trademarks:			
Wholesale	\$27,243,578	\$ -	\$27,243,578
Retail	2,900,000	-	2,900,000
Patents	2,516,402	2,161,178	355,224
Customer relationships	1,000,000	1,000,000	-
Total Identified Intangibles	\$33,659,980	\$ 3,161,178	\$30,498,802

June 30, 2012 (unaudited)	Gross Amount	Accumulated Amortization	Carrying Amount
Trademarks:			
Wholesale	\$27,243,578	\$ -	\$27,243,578
Retail	2,900,000	-	2,900,000
Patents	2,483,337	2,136,054	347,283
Customer relationships	1,000,000	1,000,000	-
Total Identified Intangibles	\$33,626,915	\$ 3,136,054	\$30,490,861

Amortization expense for intangible assets was \$13,302 and \$12,450 for the three months ended June 30, 2013 and 2012, respectively and \$26,205 and \$24,793 for the six months ended June 30, 2013 and 2012, respectively. The weighted average amortization period for patents is 15 years.

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

2014 \$52,328

2015	51,753
2016	48,979
2017	44,411
2018	38,267

10



## 9. CAPITAL STOCK

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, 2013, we were authorized to issue approximately 321,370 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, 2013 through June 30, 2013:

	Shares	Weighted Average Exercise Price
Options outstanding at January 1, 2013	10,000	\$ 24.36
Issued	-	-
Exercised	-	-
Forfeited	(1,000 )	\$ 24.36
Options outstanding at June 30, 2013	9,000	\$ 24.36
Options exercisable at:		
January 1, 2013	10,000	\$ 24.36
June 30, 2013	9,000	\$ 24.36
Unvested options at June 30, 2013	-	

During the six month period ended June 30, 2013, we issued 12,880 shares of common stock to members of our Board of Directors. We recorded compensation expense of \$168,000, 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. The Rights Agreement was renewed in June 2012 and expires in June

2017.

In the second quarter of 2013, we declared a dividend on our common stock of \$0.10 per share with a record date of May 28, 2013 and payable on June 11, 2013. The \$750,356 dividend paid is reflected as a reduction to retained earnings in the Condensed Consolidated Balance Sheet.

11

**10. 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 consumer websites, 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) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2013	2012	2013	2012
<b>NET SALES:</b>				
Wholesale	\$45,839,745	\$34,697,580	\$87,838,162	\$77,065,992
Retail	9,776,433	9,139,712	20,614,078	19,635,883
Military	3,803,573	571,066	4,682,987	1,032,401
Total Net Sales	\$59,419,751	\$44,408,358	\$113,135,227	\$97,734,276
<b>GROSS MARGIN:</b>				
Wholesale	\$15,198,460	\$11,058,323	\$28,768,321	\$23,991,162
Retail	4,581,459	4,267,641	9,560,859	9,339,243
Military	530,568	25,663	652,077	43,303
Total Gross Margin	\$20,310,487	\$15,351,627	\$38,981,257	\$33,373,708

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

**11. LONG-TERM DEBT**

In October 2010, we entered into a financing agreement with PNC Bank (“PNC”) to provide a \$70 million credit facility. The term of the facility is five years and the current interest rate is generally LIBOR plus 1.50%.

Our credit facility contains a restrictive covenant which requires us to maintain a fixed charge coverage ratio. This restrictive covenant is only in effect upon a triggering event taking place (as defined in the credit facility agreement). At June 30, 2013, no triggering event had occurred and the covenant was not in effect.

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, 2013, we had total capacity under this facility of \$70.0 million of which we had borrowings of \$31.4 million.

## 12. FINANCIAL INSTRUMENTS

Generally accepted accounting standards establish a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under generally accepted accounting standards are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2: Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The only asset or liability measured at fair value on a recurring basis by the Company at June 30, 2013, December 31, 2012 and June 30, 2012 was cash and cash equivalents of \$2,855,524, \$4,022,579 and \$1,850,905, respectively. Cash and cash equivalents are considered to be Level 1.

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 amounts of our revolving line of credit, our mortgages and other short-term financing obligations also approximate fair value, as they are comparable to the available financing in the marketplace during the year.



## 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,	
	2013	2012	2013	2012
Net Sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost Of Goods Sold	65.8 %	65.4 %	65.5 %	65.9 %
Gross Margin	34.2 %	34.6 %	34.5 %	34.1 %
Selling, General and Administrative Expenses	29.4 %	33.5 %	30.6 %	32.4 %
Income From Operations	4.8 %	1.1 %	3.9 %	1.7 %

### Three Months Ended June 30, 2013 Compared to Three Months Ended June 30, 2012

*Net sales.* Net sales for the three months ended June 30, 2013 were \$59.4 million compared to \$44.4 million for the same period in 2012. Wholesale sales for the three months ended June 30, 2013 were \$45.8 million compared to \$34.7 million for the same period in 2012. The \$11.1 million increase in wholesale sales was the result of an increase from all footwear and apparel categories, primarily led by a \$5.4 million increase in our work footwear category, a \$2.7 million increase in our western footwear category and a \$1.0 million increase in our lifestyle footwear category. During first quarter of 2013, we began shipping to Tractor Supply under an agreement to produce boots under their trade name C.E. Schmidt. During the second quarter of 2013, we had sales of \$3.5 million under this agreement that is included in the work footwear category. In addition, in the second quarter of 2012, severe storms knocked out power to our distribution center in Logan, OH. As a result, approximately \$2.5 million of sales shifted from the second quarter of 2012 into the third quarter of 2012. Retail sales for the three months ended June 30, 2013 were \$9.8 million compared to \$9.1 million for the same period in 2012. The \$0.7 million increase is primarily driven by a significant gain in our business-to-consumer e-commerce sales. Military segment sales for the three months ended June 30, 2013, were \$3.8 million, compared to \$0.6 million in the same period in 2012. We recently received an order to fulfill a contract to the U.S. Military to produce "Hot Weather" combat boots. Shipment of the boots under this contract began in March 2013.





*Gross margin.* Gross margin for the three months ended June 30, 2013 was \$20.3 million, or 34.2% of net sales, compared to \$15.4 million, or 34.6% of net sales, in the same period last year. Wholesale gross margin for the three months ended June 30, 2013 was \$15.2 million, or 33.2% of net sales, compared to \$11.1 million, or 31.9% of net sales, in the same period last year. The 130 basis point increase was primarily the result of improved manufacturing efficiencies. The Retail gross margin for the three months ended June 30, 2013 was \$4.6 million, or 46.9% of net sales, compared to \$4.3 million, or 46.7% of net sales, for the same period in 2012. Military gross margin for the three months ended June 30, 2013 was \$0.5 million, or 13.9% of net sales, compared to less than \$0.1 million, or 4.5% of net sales, for the same period in 2012.

*SG&A expenses.* SG&A expenses were \$17.4 million, or 29.4% of net sales, for the three months ended June 30, 2013, compared to \$14.9 million, or 33.5% of net sales for the same period in 2012. The \$2.5 million increase primarily reflected increased advertising expenses of \$1.0 million as well as increased selling costs of \$0.7 million, higher distribution costs of \$0.1 million and increased freight expenses of \$0.3 million associated with the additional sales during the quarter.

*Interest expense.* Interest expense was \$0.1 million in the three months ended June 30, 2013, compared to \$0.1 million for the same period in the prior year.

*Income taxes.* Income tax expense for the three months ended June 30, 2013 was \$1.0 million, compared to \$0.1 million for the same period a year ago. We provided for income taxes at effective tax rates of 35% in 2013 and 36% in 2012. The estimated effective tax rate for 2013 is lower than the estimated rate for 2012 as we are anticipating making additional permanent capital investment in our operations in the Dominican Republic, which will reduce the amount of dividends that we need to provide for U.S. income taxes.

### **Six Months Ended June 30, 2013 Compared to Six Months Ended June 30, 2012**

*Net sales.* Net sales for the six months ended June 30, 2013 were \$113.1 million compared to \$97.7 million for the same period in 2012. Wholesale sales for the six months ended June 30, 2013 were \$87.8 million compared to \$77.1 million for the same period in 2012. The \$10.7 million increase in wholesale sales was the result of an increase from most of our footwear and apparel categories, primarily led by a \$4.5 million increase in our western footwear category, a \$4.0 million increase in our work footwear category, a \$1.6 million increase in our lifestyle footwear category and a \$1.5 million increase in our apparel sales, which was partially offset by a \$1.3 million decline in our commercial military footwear category. During first quarter of 2013, we began shipping to Tractor Supply under an agreement to produce boots under their trade name C.E. Schmidt. During the first six months of 2013, we had sales of \$5.8 million under this agreement that is included in the work footwear category. In addition, in the second quarter of 2012, severe storms knocked out power to our distribution center in Logan, OH. As a result, approximately \$2.5 million of sales shifted from the second quarter of 2012 into the third quarter of 2012. Retail sales for the six months ended June 30, 2013 were \$20.6 million compared to \$19.6 million for the same period in 2012. The \$1.0 million

increase in retail sales was primarily driven by a significant gain in our business-to-consumer e-commerce sales. Military segment sales for the six months ended June 30, 2013, were \$4.7 million, compared to \$1.0 million in the same period in 2012. We recently received an order to fulfill a contract to the U.S. Military to produce “Hot Weather” combat boots. Shipment of the boots under this contract began in March 2013.

*Gross margin.* Gross margin for the six months ended June 30, 2013 was \$39.0 million, or 34.5% of net sales, compared to \$33.4 million, or 34.1% of net sales, in the same period last year. Wholesale gross margin for the six months ended June 30, 2013 was \$28.8 million, or 32.8% of net sales, compared to \$24.0 million, or 31.1% of net sales, in the same period last year. The 170 basis point increase was primarily the result of improved manufacturing efficiencies. The Retail gross margin for the six months ended June 30, 2013 was \$9.6 million, or 46.4% of net sales, compared to \$9.3 million, or 47.6% of net sales, for the same period in 2012. The 120 basis point decrease was largely due to lower average selling prices on our internet driven transactions than our mobile store transactions. Military gross margin for the six months ended June 30, 2013 was \$0.7 million, or 13.9% of net sales, compared to less than \$0.1 million, or 4.2% of net sales, for the same period in 2012.

*SG&A expenses.* SG&A expenses were \$34.6 million, or 30.6% of net sales, for the six months ended June 30, 2013, compared to \$31.6 million, or 32.4% of net sales for the same period in 2012. The net change primarily reflected increased advertising expenses of \$1.1 million and higher freight costs of \$0.8 million, partially offset by lower compensation and benefits costs of \$0.4 million.

*Interest expense.* Interest expense was \$0.3 million in the six months ended June 30, 2013, compared to \$0.3 million for the same period in the prior year.

*Income taxes.* Income tax expense for the six months ended June 30, 2013 was \$1.4 million, compared to \$0.5 million for the same period a year ago. We provided for income taxes at effective tax rates of 35% in 2013 and 36% in 2012. The estimated effective tax rate for 2013 is lower than the estimated rate for 2012 as we are anticipating making additional permanent capital investment in our operations in the Dominican Republic, which will reduce the amount of dividends that we need to provide for U.S. income taxes.

## **Liquidity and Capital Resources**

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

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 and for information technology. Capital expenditures were \$3.7 million for the first six months of 2013, compared to \$4.1 million for the same period in 2012. Total capital expenditures for 2013 are anticipated to be approximately \$7.6 million.

In October 2010, we entered into a financing agreement with PNC Bank (“PNC”) to provide a \$70 million credit facility. The term of the facility is five years and the current interest rate is generally LIBOR plus 1.50%.

Our credit facility contains a restrictive covenant which requires us to maintain a fixed charge coverage ratio. This restrictive covenant is only in effect upon a triggering event taking place (as defined in the credit facility agreement).

At June 30, 2013, no triggering event had occurred and the covenant was not in effect.

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, 2013, we had total capacity under this facility of \$70.0 million of which we had borrowings of \$31.4 million.

We believe that our existing credit facility 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 facility.

*Operating Activities.* Cash used in operating activities totaled \$4.7 million for the six months ended June 30, 2013, compared to cash provided by operating activities of \$7.3 million in the same period of 2012. Cash used in operating activities for the six months ended June 30, 2013 was primarily impacted by increases in inventory and accounts receivable, partially offset by increases in accounts payable. Cash provided by operating activities for the six months ended June 30, 2012 was primarily impacted by decreases in accounts receivable and increases in accounts payable, partially offset by increases in inventory.

*Investing Activities.* Cash used in investing activities was \$3.6 million for the six months ended June 30, 2013, compared to \$4.0 million in the same period of 2012. Cash used in investing activities reflects an investment in property, plant and equipment of \$3.7 million in 2013 and \$4.1 million in 2012. Our 2013 and 2012 expenditures primarily relate to investments in molds and equipment associated with our manufacturing operations and for information technology.

*Financing Activities.* Cash provided by financing activities for the six months ended June 30, 2013 was \$7.2 million and was primarily related to a net increase under the revolving credit facility of \$8.0 million, partially offset by the payment \$0.8 million of dividends on common stock. Cash used in financing activities for the six months ended June 30, 2012 was \$5.1 million and entirely reflected a net reduction under the revolving credit facility.

## **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, 2012.

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, intangibles 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 actual 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.

#### *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," "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, 2012, 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, 2012.

### 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, 2013, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II — OTHER INFORMATION**

**ITEM 1 - LEGAL PROCEEDINGS**

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, 2012.

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

None

**ITEM 3 - DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4 – MINE SAFETY DISCLOSRES**

None

**ITEM 5 - OTHER INFORMATION**

None

**ITEM 6 - EXHIBITS**

**EXHIBIT EXHIBIT  
NUMBER DESCRIPTION**

31 (a)\* Certification pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a) of the Chief Executive Officer.

31 (b)\* Certification pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a) of the Chief Financial Officer.

32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley  
(a)+ Act of 2002, of the Chief Executive Officer.

32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley  
(b)+ Act of 2002, of the Chief Financial Officer.

21

Attached as Exhibits 101 to this report are the following financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013 formatted in XBRL ("eXtensible Business Reporting Language"): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Comprehensive Income, (iii) the Consolidated Statements of Cash Flows, and (vi) related notes to these financial statements.

\*Filed with this report.

+Furnished with this report.

## **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: July 29, 2013 /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.