

ROCKY SHOES & BOOTS INC

Form 10-Q

November 01, 2005

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**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 September 30, 2005

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: 0-21026

ROCKY SHOES & BOOTS, 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 the filing requirements for at least the past 90 days. YES NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES NO

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 5,319,595 shares of Common Stock, no par value, were outstanding at October 24, 2005.

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CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 30, 2005 Unaudited	December 31, 2004	September 30, 2004 Unaudited
ASSETS:			
CURRENT ASSETS:			
Cash and cash equivalents	\$ 2,050,120	\$ 5,060,859	\$ 780,739
Trade receivables net	83,711,308	27,182,198	45,522,136
Other receivables	1,629,606	1,114,959	782,285
Inventories	77,322,005	32,959,124	38,738,153
Deferred income taxes	1,297,850	230,151	959,810
Income tax receivable		2,264,531	
Prepaid expenses	1,339,103	588,618	809,482
Total current assets	167,349,992	69,400,440	87,592,605
FIXED ASSETS net	23,690,488	20,179,486	20,091,910
DEFERRED PENSION ASSET	1,347,824	1,347,824	2,499,524
IDENTIFIED INTANGIBLES	47,116,646	2,561,427	2,708,179
GOODWILL	20,620,543	1,557,861	1,557,861
OTHER ASSETS	4,072,999	1,658,616	587,942
TOTAL ASSETS	\$ 264,198,492	\$ 96,705,654	\$ 115,038,021
LIABILITIES AND SHAREHOLDERS EQUITY:			
CURRENT LIABILITIES:			
Accounts payable	\$ 13,242,936	\$ 4,349,248	\$ 6,704,676
Current maturities long term debt	6,389,559	6,492,020	525,596
Accrued expenses:			
Income taxes	3,222,774		2,354,207
Taxes other	596,460	422,692	382,846
Salaries and wages	2,656,279	1,295,722	2,270,769
Other	2,717,026	1,228,708	1,328,492
Total current liabilities	28,825,034	13,788,390	13,566,586
LONG TERM DEBT less current maturities	121,111,944	10,044,544	32,388,913
DEFERRED INCOME TAXES	18,527,196	1,205,814	262,907
DEFERRED LIABILITIES	1,472,442	296,108	2,232,671
TOTAL LIABILITIES	169,936,616	25,334,856	48,451,077
SHAREHOLDERS EQUITY:			
Common stock, no par value; 10,000,000 shares authorized; issued and outstanding September 30, 2005 5,295,845; December 31, 2004 4,694,670; September 30, 2004 4,620,170	50,694,385	38,399,114	36,674,834
Accumulated other comprehensive loss	(889,564)	(1,077,586)	(1,950,400)

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Retained earnings	44,457,055	34,049,270	31,862,510
Total shareholders equity	94,261,876	71,370,798	66,586,944
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 264,198,492	\$ 96,705,654	\$ 115,038,021

See notes to the interim unaudited condensed consolidated financial statements.

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ROCKY SHOES & BOOTS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2005	2004	2005	2004
NET SALES	\$ 94,087,786	\$ 50,052,894	\$ 221,105,507	\$ 99,368,970
COST OF GOODS SOLD	60,014,309	34,056,404	137,100,919	69,977,667
GROSS MARGIN	34,073,477	15,996,490	84,004,588	29,391,303
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	21,820,251	8,323,464	61,966,723	19,047,531
INCOME FROM OPERATIONS	12,253,226	7,673,026	22,037,865	10,343,772
OTHER INCOME AND (EXPENSES):				
Interest expense	(2,523,143)	(422,120)	(6,517,313)	(955,561)
Other net	130,958	(54,404)	248,597	43,984
Total other net	(2,392,185)	(476,524)	(6,268,716)	(911,577)
INCOME BEFORE INCOME TAXES	9,861,041	7,196,502	15,769,149	9,432,195
INCOME TAX EXPENSE	3,352,605	2,309,143	5,361,364	3,024,563
NET INCOME	\$ 6,508,436	\$ 4,887,359	\$ 10,407,785	\$ 6,407,632
NET INCOME PER SHARE				
Basic	\$ 1.23	\$ 1.06	\$ 1.99	\$ 1.41
Diluted	\$ 1.15	\$ 0.98	\$ 1.86	\$ 1.30
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING				
Basic	5,289,736	4,605,800	5,232,964	4,530,867
Diluted	5,646,161	4,992,319	5,585,224	4,943,929

See notes to the interim unaudited condensed consolidated financial statements.

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ROCKY SHOES & BOOTS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 10,407,785	\$ 6,407,632
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	3,772,572	2,464,937
Deferred compensation and pension	773,226	(394,922)
Deferred income taxes	(16,118)	
Loss on disposal of fixed assets	16,790	
Stock issued as directors' compensation	60,000	66,885
Change in assets and liabilities, (net of effect of acquisition):		
Receivables	(27,611,537)	(25,942,003)
Inventories	(9,689,337)	(669,966)
Other current assets	2,239,986	235,756
Other assets	142,171	(402,958)
Accounts payable	3,337,976	3,940,097
Accrued and other liabilities	1,325,009	760,740
Net cash used in operating activities	(15,241,477)	(13,533,802)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of fixed assets	(4,268,847)	(4,467,840)
Acquisition of business	(92,916,237)	
Net cash used in investing activities	(97,185,084)	(4,467,840)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from revolving credit facility	263,128,948	91,920,037
Repayment of revolving credit facility	(194,567,038)	(76,772,448)
Proceeds from long-term debt	48,000,000	
Repayments of long-term debt	(5,596,971)	(252,008)
Debt financing costs	(2,310,550)	
Proceeds from exercise of stock options	761,433	1,727,750
Net cash provided by financing activities	109,415,822	16,623,331
DECREASE IN CASH AND CASH EQUIVALENTS	(3,010,739)	(1,378,311)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	5,060,859	2,159,050

CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 2,050,120	\$ 780,739
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See notes to the interim unaudited condensed consolidated financial statements.

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**ROCKY SHOES & BOOTS, INC.
AND SUBSIDIARIES**

NOTES TO THE INTERIM UNAUDITED CONDENSED CONSOLIDATED FINANCIAL
STATEMENTS FOR THE THREE MONTH AND NINE MONTH PERIODS ENDED
SEPTEMBER 30, 2005 AND 2004

1. INTERIM FINANCIAL REPORTING

In the opinion of management, the accompanying interim unaudited condensed consolidated financial statements reflect all adjustments which are necessary for a fair presentation of the financial results. All such adjustments reflected in the unaudited interim consolidated financial statements are considered to be of a normal and recurring nature. The results of the operations for the three-month periods and nine-month periods ended September 30, 2005 and 2004 are not necessarily indicative of the results to be expected for the whole year. Accordingly, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2004.

We account for our stock option plans in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees, under which no compensation cost has been recognized. Had compensation cost for all stock option plans been determined consistent with the fair value approach described in the SFAS No. 123, Accounting for Stock Based Compensation, our net income and earnings per share would have resulted in the pro forma amounts as reported below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income as reported	\$ 6,508,436	\$ 4,887,359	\$ 10,407,785	\$ 6,407,632
Deduct: Stock based employee compensation expense determined under fair value based method for all awards, net of tax	273,930	205,125	821,792	634,970
Pro forma net income	\$ 6,234,506	\$ 4,682,234	\$ 9,585,993	\$ 5,772,662
Earnings per share:				
Basic as reported	\$ 1.23	\$ 1.06	\$ 1.99	\$ 1.41
Basic pro forma	\$ 1.18	\$ 1.02	\$ 1.83	\$ 1.27
Diluted as reported	\$ 1.15	\$ 0.98	\$ 1.86	\$ 1.30
Diluted pro forma	\$ 1.10	\$ 0.94	\$ 1.72	\$ 1.17

The pro forma amounts may not be representative of the effects on reported net income for future years.

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Inventories are comprised of the following:

	September 30, 2005	December 31, 2004	September 30, 2004
Raw materials	\$ 9,766,712	\$ 4,711,014	\$ 6,110,035
Work-in-process	937,712	564,717	1,690,521
Finished goods	65,635,079	26,565,240	29,166,558
Factory outlet finished goods	1,697,725	1,268,153	1,996,039
Reserve for obsolescence or lower of cost or market	(715,223)	(150,000)	(225,000)
Total	\$ 77,322,005	\$ 32,959,124	\$ 38,738,153

3. SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest and federal, state and local income taxes was as follows:

	Nine Months Ended September 30,	
	2005	2004
Interest	\$ 6,034,000	\$ 877,000
Federal, state and local income taxes	\$ 2,136,000	\$ 2,580,000

We issued 484,261 common shares valued at \$11,473,838, as part of the purchase of the EJ Footwear LLC, Georgia Boot LLC, and HM Lehigh Safety Shoe Co. LLC (the EJ Footwear Group) from SILLC Holdings LLC.

4. PER SHARE INFORMATION

Basic earnings per share (EPS) is computed by dividing net income applicable to common shareholders by the basic 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.

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A reconciliation of the shares used in the basic and diluted income per common share computation for the three months and nine months ended September 30, 2005 and 2004 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Basic weighted average shares outstanding	5,289,736	4,605,800	5,232,964	4,530,867
Diluted stock options	356,425	386,519	352,260	413,062
Diluted weighted average shares outstanding	5,646,161	4,992,319	5,585,224	4,943,929
Anti-diluted weighted average shares outstanding	0	84,141	0	84,141

5. RECENT FINANCIAL ACCOUNTING STANDARDS

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)), which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation. The statement supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123. The statement requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. SFAS 123(R) establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair value based measurement method in accounting for share-based payment transactions with employees, except for equity instruments held by employee share ownership plans. SFAS 123(R) applies to all awards granted after the required effective date (the beginning of the first annual reporting period that begins after June 15, 2005 in accordance with the Securities and Exchange Commission's delay of the original effective date of SFAS 123(R)) and to awards modified, repurchased or canceled after that date. As a result, beginning January 1, 2006, we will adopt SFAS 123(R) and begin reflecting the stock option expense determined under fair value based methods in our consolidated statement of operations rather than as pro forma disclosure in the notes to the financial statements.

In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin Number 107 (SAB 107) that provided additional guidance to public companies relating to share-based payment transactions and the implementation of SFAS 123(R), including guidance regarding valuation methods and related assumptions, classification of compensation expense and income tax effects of share-based payment arrangements.

We have not completed our assessment of the impact or method of adoption of SFAS 123(R) and SAB 107.

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In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements, which changes the requirements for the accounting and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in accounting principle as well as to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS No. 154 will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company is currently evaluating the impact of adopting this standard in its financial statements.

6. ACQUISITION

On January 6, 2005, we completed the purchase of 100% of the issued and outstanding voting limited interests of the EJ Footwear Group from SILLC Holdings LLC.

The EJ Footwear Group was acquired to expand the Company's branded product lines, principally occupational products, and provide new channels for our existing product lines. The aggregate purchase price for the interests of EJ Footwear Group, including closing date working capital adjustments, was \$91.3 million in cash plus 484,261 shares of our common stock valued at \$11,473,838. Common stock value was based on the average closing share price during the three days preceding and three days subsequent to the date of the acquisition agreement.

On January 6, 2005, to fund the acquisition of EJ Footwear Group, we entered into a loan and security agreement with GMAC Commercial Finance LLC, refinancing our former \$45,000,000 revolving line of credit, for certain extensions of credit (the Credit Facility). The Credit Facility is comprised of (i) a five-year revolving credit facility up to a principal amount of \$100,000,000 with an interest rate of LIBOR plus two and a half percent (2.5%) or prime plus one percent (1.0%) and (ii) a three-year term loan in the principal amount of \$18,000,000 with an interest rate of LIBOR plus three and a quarter percent (3.25%) or prime plus one and three quarters percent (1.75%). The Credit Facility is secured by a first priority perfected security interest in all presently owned and hereafter acquired domestic personal property, subject to specified exceptions. Also, on January 6, 2005, we entered into a note agreement (the Note Purchase Agreement) with American Capital Financial Services, Inc., as agent, and American Capital Strategies, Ltd., as lender (collectively, ACAS), regarding \$30,000,000 in six-year Senior Secured Term B Notes with an interest rate of LIBOR plus eight percent (8.0%). The Note Purchase Agreement provides, among other terms, that (i) the ACAS Senior Secured Term B Notes will be senior indebtedness, secured by essentially the same collateral as the Credit Facility, (ii) such note facility will be last out in the event of liquidation of us and our subsidiaries, and (iii) principal payments on such note facility will begin in the fourth year of such note facility.

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We have allocated the purchase price to the tangible and intangible assets and liabilities acquired based upon the fair values and income tax basis determined with the assistance of independent appraisals. Goodwill resulting from the transaction can not practicably be allocated between business segments and will not be tax deductible. The purchase price has been allocated as follows:

Purchase price allocation:

Cash	\$ 91,298,435
Common shares 484,261 shares	11,473,838
Transaction costs	1,617,802
	\$ 104,390,075
Allocated to:	
Current assets	\$ 65,899,403
Fixed assets and other assets	3,032,740
Identified intangibles	44,800,000
Goodwill	19,062,682
Liabilities	(11,067,250)
Deferred taxes long term	(17,337,500)
	\$ 104,390,075

Estimated amounts of identified intangibles and goodwill and the related allocation by segment are subject to final allocation based on independent appraisals of fair value of assets acquired and final determination of income tax basis of assets and liabilities. During the second quarter of 2005, the Company paid the final adjustment of purchase price of \$1,795,435.

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A schedule of intangible assets is as follows:

	Gross Amount	Accumulated Amortization	Carrying Amount
September 30, 2005 (Unaudited)			
Trademarks:			
Wholesale	\$ 28,702,080		\$ 28,702,080
Retail	15,100,000		15,100,000
Patents	2,962,460	\$ 497,894	2,464,566
Customer Relationships	1,000,000	150,000	850,000
Goodwill	20,712,414	91,871	20,620,543
Total Intangibles	\$ 68,476,954	\$ 739,765	\$ 67,737,189
	Gross Amount	Accumulated Amortization	Carrying Amount
December 31, 2004			
Trademarks (Wholesale)	\$ 2,225,887		\$ 2,225,887
Patents	467,336	\$ 131,796	335,540
Goodwill	1,649,732	91,871	1,557,861
Total Intangibles	\$ 4,342,955	\$ 223,667	\$ 4,119,288