

ROCKY BRANDS, INC.

Form 10-Q

October 26, 2007

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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, 2007

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 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 NO

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

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ROCKY BRANDS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

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

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

See notes to the interim unaudited condensed consolidated financial statements.

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

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

See notes to the interim unaudited condensed consolidated financial statements.

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

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

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

See notes to the interim unaudited condensed consolidated financial statements.

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AND SUBSIDIARIES****NOTES TO THE INTERIM UNAUDITED CONDENSED CONSOLIDATED FINANCIAL
STATEMENTS FOR THE THREE-MONTH AND NINE-MONTH PERIODS ENDED
SEPTEMBER 30, 2007 AND 2006****1. INTERIM FINANCIAL REPORTING**

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

The components of total comprehensive income are shown below:

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

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

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Inventories are comprised of the following:

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

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

3. SUPPLEMENTAL CASH FLOW INFORMATION

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

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

Table of Contents**4. PER SHARE INFORMATION**

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

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

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

5. RECENT FINANCIAL ACCOUNTING STANDARDS

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

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

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

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

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6. INCOME TAXES

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

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

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

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

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A schedule of intangible assets is as follows:

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

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

	Gross Amount	Accumulated Amortization	Carrying Amount
September 30, 2006 (unaudited)			
Trademarks:			
Wholesale	\$ 28,933,009		\$ 28,933,009
Retail	6,900,000		6,900,000
Patents	2,268,828	\$ 781,302	1,487,526
Customer relationships	1,000,000	350,000	650,000
Total Identified Intangibles	\$ 39,101,837	\$ 1,131,302	\$ 37,970,535

Amortization expense for intangible assets was \$166,108 and \$143,600 for the three months ended September 30, 2007 and 2006, respectively and \$497,825 and \$430,385 for the nine months ended September 30, 2007 and 2006, respectively. The weighted average amortization period for patents is six years and for customer relationships is five years.

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

2008	\$664,540
2009	664,535
2010	124,452
2011	123,072
2012	123,072

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On May 11, 2004, our shareholders approved the 2004 Stock Incentive Plan. This Stock Incentive Plan includes 750,000 of our common shares that may be granted for stock options and restricted stock awards. As of September 30, 2007, we were authorized to issue approximately 484,000 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, 2007 through September 30, 2007:

	Shares	Weighted Average Exercise Price
Options outstanding at January 1, 2007	536,176	\$ 14.33
Issued	15,000	14.40
Exercised	(63,500)	5.86
Forfeited	(11,375)	21.41
Options outstanding at September 30, 2007	476,301	\$ 15.24
Options exercisable at:		
January 1, 2007	443,426	\$ 13.39
September 30, 2007	425,739	\$ 14.85
Unvested options at January 1, 2007	92,750	\$ 18.81
Granted	15,000	14.40
Vested	(45,792)	17.01
Forfeited	(11,375)	21.41
Unvested options at September 30, 2007	50,583	\$ 18.55

During the nine-month period ended September 30, 2007, we issued 7,595 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. We also issued 15,000 options with a grant date fair value of \$7.82 per share.

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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. As a result of freezing the plan, we recognized a \$0.4 million charge in the first quarter of 2006 for previously unrecognized service costs. Net pension cost of the Company's plan is as follows:

	(Unaudited) Three Months Ended September 30,		(Unaudited) Nine Months Ended September 30,	
	2007	2006	2007	2006
Service cost	\$ 26,298	\$ 18,925	\$ 78,895	\$ 254,245
Interest	139,507	97,768	418,520	324,468
Expected return on assets	(179,239)	(148,558)	(537,717)	(494,442)
Amortization of unrecognized transition obligation	2,691	2,018	8,073	8,113
Amortization of unrecognized prior service cost	22,882	16,755	68,646	67,358
Curtailment charge				393,787
Net pension cost	\$ 12,139	\$ (13,092)	\$ 36,417	\$ 553,529

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 plans were as follows:

	2007	2006
Discount rate	6.00%	5.75%
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 plans have 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.

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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) Three Months Ended September 30,		(Unaudited) Nine Months Ended September 30,	
	2007	2006	2007	2006
NET SALES:				
Wholesale	\$ 64,106,769	\$ 63,363,200	\$ 150,574,407	\$ 147,063,730
Retail	18,201,778	14,563,625	51,751,898	44,787,799
Military		187,900	436,930	1,088,865
Total Net Sales	\$ 82,308,547	\$ 78,114,725	\$ 202,763,235	\$ 192,940,394
GROSS MARGIN:				
Wholesale	\$ 20,036,008	\$ 24,413,169	\$ 51,316,794	\$ 57,034,411
Retail	9,242,516	7,671,123	26,663,477	23,907,141
Military		31,898	1,305,393*	163,887
Total Gross Margin	\$ 29,278,524	\$ 32,116,190	\$ 79,285,664	\$ 81,105,439

* The gross margin for the nine-month period ended September 30, 2007 includes a reduction of cost of goods sold from the reimbursement of contract related expenses incurred in prior periods of \$1.2 million.

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

11. LONG-TERM DEBT

In May 2007, we entered into a Note Purchase Agreement, totaling \$40 million, with Laminar Direct Capital L.P., Whitebox Hedged High Yield Partners, L.P. and GPC LIX L.L.C., and issued notes to each for \$20 million,

\$17.5 million and \$2.5 million, respectively, at 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 proceeds from these notes were used to pay down the GMAC Commercial Finance (GMAC) term loans which totaled approximately \$17.5 million and the \$15 million American Capital Strategies, LTD (ACAS) term loan. The balance of the proceeds, net of debt acquisition costs of approximately \$1.4 million, was used to reduce the outstanding balance on the revolving credit facility. The Note Purchase Agreement is secured by a security interest in our assets and is subordinate to the security interest under the GMAC line of credit.

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Interest expense for the second quarters of 2007 and 2006 includes charges of approximately \$0.8 million and \$0.4 million, respectively, which represent the accelerated amortization of deferred financing costs related to the early refinancing of its loan agreements.

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 September 30, 2007, we were in compliance with these restrictive covenants.

Table of Contents**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		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost Of Goods Sold	64.4%	58.9%	60.9%	58.0%
Gross Margin	35.6%	41.1%	39.1%	42.0%
Selling, General and Administrative Expenses	30.5%	28.9%	34.6%	33.8%
Income From Operations	5.1%	12.2%	4.5%	8.2%

Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006

Net sales. Net sales for the three months ended September 30, 2007 were \$82.3 million compared to \$78.1 million for the same period in 2006. Wholesale sales for the three months ended September 30, 2007 were \$64.1 million compared to \$63.4 million for the same period in 2006. The \$0.7 million increase in wholesale sales is the result of an increase in sales in our work footwear category partially offset by decreases in our hunting and western footwear and apparel categories. Retail sales for the three months ended September 30, 2007 were \$18.2 million compared to \$14.6 million for the same period in 2006. The \$3.6 million increase in retail sales results from the growth in market share experienced as a result of the bankruptcy of a leading competitor. Military segment sales, which occur from time to time, for the three months ended September 30, 2007, were zero compared to \$0.2 million in the same period in 2006.

Gross margin. Gross margin for the three months ended September 30, 2007 was \$29.3 million, or 35.6% of net sales, compared to \$32.1 million, or 41.1% of net sales, in the same period last year. Wholesale gross margin for the three months ended September 30, 2007 was \$20.0 million, or 31.3% of net sales, compared to \$24.4 million, or 38.5% of net sales, in the same period last year. The 720 basis point decrease reflects a decrease in sales price per unit for competitive reasons, as well as an increase in manufacturing costs from both our company operated facilities and third party manufacturers. Retail gross margin for the three months ended September 30, 2007 was \$9.2 million, or 50.8% of net sales, compared to \$7.7 million, or 52.7% of net sales, for the same period in 2006. The 190 basis point decrease reflects an increase in manufacturing costs at third party manufacturers. Military gross margin for the three months ended September 30, 2007 was zero compared to less than \$0.1 million or 17.0% of net sales, for the same period in 2006.

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SG&A expenses. SG&A expenses were \$25.1 million, or 30.5% of net sales, for the three months ended September 30, 2007, compared to \$22.6 million, or 28.9% of net sales for the same period in 2006. The net change primarily reflects increases in salaries and commissions of \$0.7 million, benefits of \$0.3 million, show expenses of \$0.3 million, vehicle expenses of \$0.5 million and freight and handling charges of \$0.5 million.

Interest expense. Interest expense was \$2.9 million in the three months ended September 30, 2007, compared to \$2.9 million for the same period in the prior year.

Income taxes. Income tax expense for the three months ended September 30, 2007 was \$0.2 million, compared to \$2.5 million for the same period a year ago. We provided for income taxes at an estimated effective tax rate of 37% for the three months ended September 30, 2007 and 2006. During the three months ended September 30, 2007, we recognized a prior year state income tax refund of \$0.3 million which reduced the effective tax rate to 15.4%.

Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006

Net sales. Net sales for the nine months ended September 30, 2007 were \$202.8 million compared to \$192.9 million for the same period in 2006. Wholesale sales for the nine months ended September 30, 2007 were \$150.6 million compared to \$147.1 million for the same period in 2006. The \$3.5 million increase in sales is the result of increases in sales in our work, duty and, outdoor footwear categories, offset by decreases in our western footwear and apparel categories. Retail sales for the nine months ended September 30, 2007 were \$51.8 million compared to \$44.8 million for the same period in 2006. The \$7.0 million increase in retail sales results from the growth in market share experienced as a result of the bankruptcy of a leading competitor. Military segment sales, which occur from time to time, for the nine months ended September 30, 2007, were \$0.4 million, compared to \$1.1 million in the same period in 2006.

Gross margin. Gross margin in the nine months ended September 30, 2007 was \$79.3 million, or 39.1% of net sales, compared to \$81.1 million, or 42.0% of net sales, in the same period last year. Wholesale gross margin for the nine months ended September 30, 2007 was \$51.3 million, or 34.1% of net sales, compared to \$57.0 million, or 38.8% of net sales, in the same period last year. The 470 basis point decrease reflects a decrease in sales price per unit for competitive reasons, as well as an increase in sales of discontinued products at lower margins and an increase in manufacturing costs from both our company operated facilities and third party manufacturers. Retail gross margin for the nine months ended September 30, 2007 was \$26.7 million, or 51.5% of net sales, compared to \$23.9 million, or 53.4% of net sales, for the same period in 2006. The 190 basis point decrease reflects an increase in manufacturing costs at third party manufacturers. Military gross margin for the nine months ended September 30, 2007 was \$1.3 million compared to \$0.2 million for the same period in 2006. The gross margin for 2007 results includes a \$1.2 million reduction of cost of goods sold from the reimbursement of contract related expenses incurred in prior periods.

SG&A expenses. SG&A expenses were \$70.2 million, or 34.6% of net sales, for the nine months ended September 30, 2007, compared to \$65.2 million, or 33.8% of net sales for the same period in 2006. The net change primarily reflects increases in salaries and commissions of \$1.6 million, professional fees of \$1.0 million, bad debt expense of \$0.7 million, co-op advertising of \$0.4 million, depreciation and amortization of \$0.4 million, utilities of \$0.5 million, freight and handling of \$0.7, and vehicle expenses of \$0.8 million, partially offset by a decrease in benefits of \$0.2 million and advertising expense of \$1.0 million. SG&A expenses for 2006 include a gain on the sale of a company-owned property of \$0.7 million and pension expense of \$0.4 million relating to the pension curtailment relating to the freezing of the non-union pension plan in 2006.

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Interest expense. Interest expense was \$8.8 million in the nine months ended September 30, 2007, compared to \$8.3 million for the same period in the prior year. The increase reflects the accelerated amortization of \$0.8 million of deferred financing costs under the Note Purchase Agreements with GMAC and ACAS, partially offset by a reduction in interest expense resulting from a decrease in average borrowings.

Income taxes. Income tax benefit for the nine months ended September 30, 2007 was \$0.2 million, compared to an expense of \$2.9 million for the same period a year ago. Our estimated effective tax rate was 37% for the nine months ended September 30, 2007 and 2006. During the nine months ended September 30, 2007, we recognized a prior year state income tax refund of \$0.3 million which when combined with the income tax provision of 37% resulted in the recognition of the aforementioned tax benefit.

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 our acquisitions of EJ Footwear and certain assets of Gates-Mills, as well as 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 \$4.7 million for the first nine months of 2007, compared to \$4.6 million for the same period in 2006. Capital expenditures for all of 2007 are anticipated to be approximately \$6.0 million.

In May 2007, we entered into a Note Purchase Agreement, totaling \$40 million, with Laminar Direct Capital L.P., Whitebox Hedged High Yield Partners, L.P. and GPC LIX L.L.C., and issued notes to each for \$20 million, \$17.5 million and \$2.5 million, respectively, at 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 proceeds from these notes were used to pay down the GMAC Commercial Finance term loans which totaled approximately \$17.5 million and the \$15 million ACAS term loan. The balance of the proceeds, net of debt acquisition costs of approximately \$1.4 million, was used to reduce the outstanding balance on the revolving credit facility. The Note Purchase Agreement is secured by a security interest in our assets and is subordinate to the security interest under the GMAC line of credit.

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 September 30, 2007, we had \$79.7 million in borrowings under this facility and total capacity of \$93.1 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 September 30, 2007, we were in compliance with these restrictive covenants.

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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. *Operating Activities.* Cash used in operating activities totaled \$7.3 million in the first nine months of 2007, compared to \$18.1 million in the same period of 2006. Cash used in operating activities was primarily impacted by the seasonal buildup of both inventories and accounts receivable.

Investing Activities. Cash used in investing activities was \$4.9 million for the first nine months of 2007, compared to \$2.9 million in 2006. Cash used in investing activities in 2007 reflects an investment in property plant and equipment of \$4.7 million. Our 2007 expenditures primarily relate to investments in molds and equipment associated with our manufacturing operations and for information technology. Cash used in investing activities in 2006 primarily relates to investment in property, plant and equipment of \$4.6 million, offset by the sale of the Harper Street warehouse facility for \$1.9 million.

Financing Activities. Cash provided by financing activities for the nine months ended September 30, 2007 was \$11.2 million, reflecting an increase in net borrowings under the revolving credit facility of \$4.9 million, repayments on long-term debt of \$32.7 million, offset by proceeds from the exercise of stock options of \$0.4 million and the issuance of long term debt of \$40 million, less debt financing costs of \$1.4 million. Cash provided by financing activities for the nine months ended September 30, 2006 was \$21.7 million and reflects an increase in net borrowings under the revolving credit facility of 30.2 million, a new \$15.0 million term loan, and proceeds from the exercise of stock options of \$0.3 million partially offset by repayments on long-term debt of \$23.2 million and debt financing cost of \$0.6 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, 2006.

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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 doubtful 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. Management also records estimates for customer returns and discounts offered to customers. Should a greater proportion of customers return goods and take advantage of discounts than estimated by us, additional allowances may be required.

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.

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Intangible assets

Intangible assets, including goodwill, trademarks and patents are reviewed for impairment annually, and more frequently, if necessary. In performing the review of recoverability, we estimate future cash flows expected to result from the use of the asset and our eventual disposition. The estimates of future cash flows, based on reasonable and supportable assumptions and projections, require management's subjective judgments. The time periods for estimating future cash flows is often lengthy, which increases the sensitivity to assumptions made. Depending on the assumptions and estimates used, the estimated future cash flows projected in the evaluation of long-lived assets can vary within a wide range of outcomes. We consider the likelihood of possible outcomes in determining the best estimate of future cash flows. A significant assumption of estimated cash flows from trademarks is future sales of branded products. Other assumptions include discount rates, royalty rates, cost of capital, and market multiples. An impairment charge may be recorded if the expected future cash flows decline. Based upon our review, none of our intangibles were impaired as of September 30, 2007.

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 September 30 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 9,

Retirement Plans, to the unaudited condensed consolidated financial statements for the quarterly period ended September 30, 2007. Actual results would be different using other assumptions. Management records an accrual for pension costs associated with our sponsored noncontributory 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. As a result of freezing the plan, we have recognized a charge for previously unrecognized service costs of approximately \$0.4 million during the three-month period ended March 31, 2006.

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.

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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, 2006, 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 in the future 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.

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ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes since December 31, 2006.

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 September 30, 2007, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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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, 2006.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None

ITEM 5. OTHER INFORMATION.

None

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

* 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: October 26, 2007

/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.