

ROCKY BRANDS, INC.  
Form 10-Q  
October 30, 2018  
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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, 2018

OR

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

Commission File Number: 001-34382

ROCKY BRANDS, INC.

(Exact name of Registrant as specified in its charter)

Ohio  
(State or other jurisdiction of incorporation or organization)

No. 31 1364046  
(I.R.S. Employer Identification No.)

39 East Canal Street, Nelsonville, Ohio 45764  
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (740) 753 9100

Indicate by checkmark 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

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Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

There were 7,421,317 shares of the Registrant's Common Stock outstanding on October 29, 2018.

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## PART 1 – FINANCIAL INFORMATION

## ITEM 1 – FINANCIAL STATEMENTS

## Rocky Brands, Inc. and Subsidiaries

## Condensed Consolidated Balance Sheets

(Unaudited)

|                                              | September 30,<br>2018 | December<br>31,<br>2017 | September 30,<br>2017 |
|----------------------------------------------|-----------------------|-------------------------|-----------------------|
| <b>ASSETS:</b>                               |                       |                         |                       |
| <b>CURRENT ASSETS:</b>                       |                       |                         |                       |
| Cash and cash equivalents                    | \$ 4,210,391          | \$ 3,680,776            | \$ 2,238,862          |
| Trade receivables, net                       | 50,691,234            | 45,027,002              | 45,106,205            |
| Contract receivables                         | 4,849,176             | -                       | -                     |
| Other receivables                            | 281,798               | 806,468                 | 800,322               |
| Inventories                                  | 78,408,480            | 65,622,432              | 76,885,153            |
| Income tax receivable                        | -                     | 1,849,237               | -                     |
| Prepaid expenses                             | 2,121,908             | 2,199,648               | 2,431,996             |
| Total current assets                         | 140,562,987           | 119,185,563             | 127,462,538           |
| PROPERTY, PLANT & EQUIPMENT – net            | 23,208,663            | 23,781,001              | 24,742,833            |
| IDENTIFIED INTANGIBLES – net                 | 30,282,805            | 30,314,749              | 33,319,334            |
| OTHER ASSETS                                 | 163,821               | 197,977                 | 225,310               |
| <b>TOTAL ASSETS</b>                          | <b>\$ 194,218,276</b> | <b>\$ 173,479,290</b>   | <b>\$ 185,750,015</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b> |                       |                         |                       |
| <b>CURRENT LIABILITIES:</b>                  |                       |                         |                       |
| Accounts payable                             | \$ 20,621,758         | \$ 12,982,535           | \$ 16,861,274         |
| Contract liabilities                         | 4,849,176             | -                       | -                     |
| Accrued expenses:                            |                       |                         |                       |
| Salaries and wages                           | 3,660,745             | 1,754,681               | 2,298,042             |
| Taxes - other                                | 158,251               | 599,793                 | 502,252               |
| Accrued freight                              | 465,293               | 770,219                 | 483,859               |
| Commissions                                  | 431,532               | 455,845                 | 401,261               |
| Accrued duty                                 | 2,726,833             | 2,160,847               | 2,534,286             |
| Income tax payable                           | 1,888,060             | -                       | 1,275,893             |

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|                                                                                                                                                                                            |                |                |                |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|----------------|----------------|
| Other                                                                                                                                                                                      | 1,308,627      | 1,301,931      | 1,601,591      |
| Total current liabilities                                                                                                                                                                  | 36,110,275     | 20,025,851     | 25,958,458     |
| LONG TERM DEBT                                                                                                                                                                             | -              | 2,199,423      | 11,630,000     |
| LONG TERM TAXES PAYABLE                                                                                                                                                                    | 169,366        | 2,286,512      | -              |
| DEFERRED INCOME TAXES                                                                                                                                                                      | 7,726,234      | 7,726,234      | 10,464,435     |
| DEFERRED LIABILITIES                                                                                                                                                                       | 152,271        | 148,408        | 181,737        |
| TOTAL LIABILITIES                                                                                                                                                                          | 44,158,146     | 32,386,428     | 48,234,630     |
| SHAREHOLDERS' EQUITY:                                                                                                                                                                      |                |                |                |
| Common stock, no par value;<br>25,000,000 shares authorized; issued and outstanding September<br>30, 2018 - 7,421,317; December 31, 2017 - 7,398,654 and<br>September 30, 2017 - 7,403,195 | 69,589,049     | 68,973,927     | 68,979,376     |
| Retained earnings                                                                                                                                                                          | 80,471,081     | 72,118,935     | 68,536,009     |
| Total shareholders' equity                                                                                                                                                                 | 150,060,130    | 141,092,862    | 137,515,385    |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY                                                                                                                                                 | \$ 194,218,276 | \$ 173,479,290 | \$ 185,750,015 |

See Notes to Unaudited Condensed Consolidated Financial Statements

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Rocky Brands, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(Unaudited)

|                                                         | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |                |
|---------------------------------------------------------|-------------------------------------|---------------|------------------------------------|----------------|
|                                                         | 2018                                | 2017          | 2018                               | 2017           |
| NET SALES                                               | \$ 65,915,564                       | \$ 64,675,082 | \$ 185,508,077                     | \$ 186,202,989 |
| COST OF GOODS SOLD                                      | 43,515,323                          | 45,163,538    | 122,610,241                        | 128,779,845    |
| GROSS MARGIN                                            | 22,400,241                          | 19,511,544    | 62,897,836                         | 57,423,144     |
| OPERATING EXPENSES                                      | 16,790,903                          | 16,026,654    | 49,687,739                         | 49,313,498     |
| INCOME FROM OPERATIONS                                  | 5,609,338                           | 3,484,890     | 13,210,097                         | 8,109,646      |
| OTHER INCOME (EXPENSES)                                 | 30,502                              | (98,126)      | (147,995)                          | (245,760)      |
| INCOME BEFORE INCOME TAXES                              | 5,639,840                           | 3,386,764     | 13,062,102                         | 7,863,886      |
| INCOME TAX EXPENSE                                      | 594,830                             | 1,152,000     | 2,116,830                          | 2,674,000      |
| NET INCOME                                              | \$ 5,045,010                        | \$ 2,234,764  | \$ 10,945,272                      | \$ 5,189,886   |
| INCOME PER SHARE                                        |                                     |               |                                    |                |
| Basic                                                   | \$ 0.68                             | \$ 0.30       | \$ 1.48                            | \$ 0.70        |
| Diluted                                                 | \$ 0.67                             | \$ 0.30       | \$ 1.47                            | \$ 0.70        |
| WEIGHTED AVERAGE NUMBER OF<br>COMMON SHARES OUTSTANDING |                                     |               |                                    |                |
| Basic                                                   | 7,418,028                           | 7,437,913     | 7,411,670                          | 7,438,061      |
| Diluted                                                 | 7,480,340                           | 7,443,001     | 7,453,764                          | 7,441,378      |

See Notes to Unaudited Condensed Consolidated Financial Statements

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Rocky Brands, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

|                                                                                   | Nine Months Ended<br>September 30, |                    |
|-----------------------------------------------------------------------------------|------------------------------------|--------------------|
|                                                                                   | 2018                               | 2017               |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                                    |                    |
| Net income                                                                        | \$ 10,945,272                      | \$ 5,189,886       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |                    |
| Depreciation and amortization                                                     | 4,073,636                          | 5,024,500          |
| (Gain) loss on disposal of fixed assets                                           | (8,071)                            | 32,975             |
| Stock compensation expense                                                        | 491,444                            | 245,083            |
| Change in assets and liabilities:                                                 |                                    |                    |
| Receivables                                                                       | (3,290,325)                        | (4,373,693)        |
| Inventories                                                                       | (12,786,048)                       | (7,716,711)        |
| Other current assets                                                              | 77,740                             | 264,424            |
| Other assets                                                                      | 34,156                             | 7,199              |
| Accounts payable                                                                  | 7,702,442                          | 5,204,387          |
| Accrued and other liabilities                                                     | 1,711,828                          | 1,275,893          |
| Income taxes payable                                                              | 1,888,060                          | 1,695,938          |
| Long term taxes payable                                                           | (2,117,146)                        | -                  |
| Net cash provided by operating activities                                         | 8,722,988                          | 6,849,881          |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                                    |                    |
| Purchase of fixed assets                                                          | (3,541,733)                        | (3,453,886)        |
| Proceeds from sales of fixed assets                                               | 17,231                             | 329,278            |
| Net cash used in investing activities                                             | (3,524,502)                        | (3,124,608)        |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                                    |                    |
| Proceeds from revolving credit facility                                           | 4,247,897                          | 49,996,460         |
| Repayments on revolving credit facility                                           | (6,447,320)                        | (52,950,468)       |
| Proceeds from stock options                                                       | 123,678                            | 14,236             |
| Repurchase of common stock                                                        | -                                  | (571,580)          |
| Dividends paid on common stock                                                    | (2,593,126)                        | (2,455,564)        |
| Net cash used in financing activities                                             | (4,668,871)                        | (5,966,916)        |
| <b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                           | <b>529,615</b>                     | <b>(2,241,643)</b> |

CASH AND CASH EQUIVALENTS:

|                     |              |              |
|---------------------|--------------|--------------|
| BEGINNING OF PERIOD | 3,680,776    | 4,480,505    |
| END OF PERIOD       | \$ 4,210,391 | \$ 2,238,862 |

See Notes to Unaudited Condensed Consolidated Financial Statements



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Rocky Brands, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

We are a leading designer, manufacturer and marketer of premium quality footwear and apparel marketed under a portfolio of well recognized brand names including Rocky, Georgia Boot, Durango and Lehigh. Our brands have a long history of representing high quality, comfortable, functional and durable footwear and our products are organized around six target markets: outdoor, work, duty, commercial military, western and lifestyle. In addition, as part of our strategy of outfitting consumers from head-to-toe, we market complementary branded apparel and accessories that we believe leverage the strength and positioning of each of our brands.

In the opinion of management, the accompanying 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 condensed consolidated financial statements are considered to be of a normal and recurring nature. The results of operations for the three and nine months ended September 30, 2018 and 2017 are not necessarily indicative of the results to be expected for the whole year. The December 31, 2017 condensed consolidated balance sheet data was derived from the audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP"). This Quarterly Report on Form 10-Q should be read in connection with our Annual Report on Form 10-K for the year ended December 31, 2017, which includes all disclosures required by GAAP.

2. ACCOUNTING STANDARDS UPDATES

Recently Issued Accounting Pronouncements

Rocky Brands, Inc. is currently evaluating the impact of certain Accounting Standards Updates ("ASU") on its Unaudited Condensed Consolidated Financial Statements or Notes to the Unaudited Condensed Consolidated Financial Statements:

| Standard                                                                                                                                                                                                | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | Anticipated Adoption Period | Effect on the financial statements or other significant matters                                                                                                                                                                                                                          |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ASU 2018-15 Internal-use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract (A Consensus of the FASB EITF) | This pronouncement aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). It also provides criteria for determining which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The capitalized implementation costs are required to be expensed over the term of the hosting arrangement. The guidance also clarifies the presentation requirements for reporting such costs in the entity's financial statements. | Q4 2018                     | The Company is planning to adopt this standard early and will adopt prospectively. Costs that previously would have been expensed in the fourth quarter of 2018 will be capitalized and amortized over the life of the cloud computing arrangement in accordance with this new standard. |
| ASU 2018-13 Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement                                                                  | This pronouncement changes the fair value measurement disclosure requirements of ASC 820. The amendments in this ASU are the result of a broader disclosure project called FASB Concepts Statement, Conceptual Framework for Financial Reporting — Chapter 8: Notes to Financial Statements.                                                                                                                                                                                                                                                                                                                                                                                                                                           | Q1 2020                     | The Company is evaluating the impact of the new standard on its Unaudited Condensed Consolidated Financial Statements, but does not anticipate the standard will have a significant impact.                                                                                              |

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|                                                                                                                      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |         |                                                                                                                                                                                                                                                                                                                                                                                                                   |
|----------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ASU 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-based Payment Accounting | The pronouncement simplifies the accounting for share-based payments granted to nonemployees for goods and services. Under the ASU, most of the guidance on such payments to nonemployees would be aligned with the requirements for share-based payments granted to employees.                                                                                                                                                                                                                                                                                                   | Q1 2019 | The Company is evaluating the impact of the new standard on its Unaudited Condensed Consolidated Financial Statements, but does not anticipate the standard will have a significant impact.                                                                                                                                                                                                                       |
| ASU 2016-13, Measurement of Credit Losses on Financial Instruments                                                   | The pronouncement seeks to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date by replacing the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates.                                                                 | Q1 2020 | The Company is evaluating the impacts of the new standard on its existing financial instruments, including trade receivables.                                                                                                                                                                                                                                                                                     |
| ASU 2016-02, Leases (Topic 842)                                                                                      | The pronouncement introduces a lessee model that brings most leases on the balance sheet. The standard requires that lessees recognize the following for all leases (with the exception of short-term leases, as that term is defined in the standard) at the lease commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. | Q1 2019 | The Company has formed an internal project team to begin gathering data relating to leasing activity at the Company. This includes compiling a list of all contracts that could meet the definition of a lease under the new standard and evaluating the accounting for these contracts under the new standard to determine the ultimate impact the new standard will have on the Company's financial statements. |

## Accounting Standards Adopted in the Current Year

| Standard | Description | Effect on the financial statements or other significant matters |
|----------|-------------|-----------------------------------------------------------------|
|----------|-------------|-----------------------------------------------------------------|

ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force).

The pronouncement provides specific guidance on eight cash flow classification issues to reduce the diversity in practice.

The Company adopted this ASU in the first quarter of 2018, which did not have a material effect on the Unaudited Condensed Consolidated Financial Statements.

ASU 2014-09, Revenue from Contracts with Customers (Topic 606).

The pronouncement outlines a single, comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The core principle of the new standard is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The Company adopted this ASU in the first quarter of 2018, which did not have a material effect on the Unaudited Condensed Consolidated Financial Statements. The Company elected to adopt this standard using the modified retrospective method. For additional information please see Note 4.

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3. FAIR VALUE

Generally accepted accounting standards establish a framework for measuring fair value. The fair value accounting standard defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This standard clarifies how to measure fair value as permitted under other accounting pronouncements.

The fair value accounting standard defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. This standard also establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.
- Level 2 – Observable inputs other than quoted market prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The fair values of cash and cash equivalents, receivables, and payables approximated their carrying values because of the short-term nature of these instruments. Receivables consist primarily of amounts due from our customers, net of allowances, 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 long-term credit facility and other short-term financing obligations also approximate fair value, as they are comparable to the available financing in the marketplace during the year. The fair value of our revolving line of credit is categorized as Level 2.

4. REVENUE

On January 1, 2018, we adopted the new accounting standard ASC 606, Revenue from Contracts with Customers and all the related amendments (“New Revenue Standard”) for all contracts not yet completed as of January 1, 2018 using the modified retrospective method. This method requires a cumulative effect adjustment to reflect the impact of initially applying the New Revenue Standard as an adjustment to the opening balance of retained earnings. The New Revenue Standard did not result in a material impact to the opening balance of retained earnings, and therefore no adjustment was made. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. We expect the impact of the adoption of the New Revenue Standard to be immaterial to our net income on an ongoing basis.

#### Nature of Performance Obligations

Our products are distributed through three distinct channels, which represent our business segments: Wholesale, Retail, and Military. In our Wholesale business, we distribute our products through a wide range of distribution channels representing over ten thousand retail store locations in the U.S., Canada, and internationally. Our Wholesale channels vary by product line and include sporting goods stores, outdoor specialty stores, online retailers, independent retailers, mass merchants, retail uniform stores, and specialty safety shoe stores. Our Retail business includes direct sales of our products to consumers through our e-commerce websites, our Rocky outlet store, and Lehigh business. We also sell footwear under the Rocky label to the U.S. Military.

#### Significant Accounting Policies and Judgements

Revenue is recognized when obligations under the terms of a contract with our customer are satisfied; this generally occurs upon shipment of our product to our customer, which is when the transfer of control of our products passes to the customer. The duration of our arrangements with our customers are typically one year or less. Revenue is measured as the amount of consideration we expect to receive in exchange for the transfer of our products at a point in time and consists of either fixed or variable consideration or a combination of both.

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Revenues from sales are recorded at the net sales price, which includes estimates of variable consideration for which reserves are established. Components of variable consideration include prompt payment discounts, volume rebates, and product returns. These reserves, as detailed below, are based on the amounts earned, or to be claimed on the related sales, and are classified as reductions of accounts receivable (if the amount is payable to the customer) or a current liability (if the amount is payable to a party other than a customer).

The amount of variable consideration which is included in the transaction price may be constrained, and is included in the net sales price only to the extent that it is probable that a significant reversal in the amount of the cumulative revenue recognized under the contract will not occur in a future period. Our analyses also contemplated application of the constraint in accordance with the guidance, under which it determined a material reversal of revenue would not occur in a future period for the estimates detailed below as of September 30, 2018. Actual amounts of consideration ultimately received may differ from our estimates. If actual results in the future vary from our estimates, we will adjust these estimates, which would affect net revenue and earnings in the period such variances become known.

When a customer has a right to a prompt payment discount, we estimate the likelihood that the customer will earn the discount using historical data and adjust our estimate when the estimate of the likelihood that a customer will earn the discount changes or the consideration becomes fixed, whichever occurs earlier. The estimated amount of variable consideration is recognized as a credit to trade receivables and a reduction in revenue until the uncertainty of the variable consideration is alleviated. Because most of our customers have payment terms less than six months there is not a significant financing component in our contracts with customers.

When a customer is offered a rebate on purchases retroactively this is accounted for as variable consideration because the consideration for the current and past purchases is not fixed until it is known if the discount is earned. We estimate the expected discount the customer will earn at contract inception using historical data and projections and update our estimates when projections materially change or consideration becomes fixed. The estimated rebate is recognized as a credit to trade receivables and offset against revenue until the rebate is earned or the earning period has lapsed.

When a right of return is part of the arrangement with the customer, we estimate the expected returns based on an analysis using historical data. We adjust our estimate either when the most likely amount of consideration we expect to receive changes or when the consideration becomes fixed, whichever occurs earlier. Previously, we recorded the return reserve liability as a contra balance within accounts receivable, and we will continue to do so under ASC 606. Previously, the related return reserve asset for the right to recover cost of goods sold was recognized within the inventory balance, and we will continue to do so under ASC 606. Please see Notes 5 and 6 for additional information.

Trade receivables represent our right to unconditional payment that only relies on the passage of time.

Contract receivables represent contractual minimum payments required under non-cancellable contracts with the U.S. Military with a duration of one year or less.

Contract liabilities are performance obligations that we expect to satisfy or relieve within the next twelve months, advance consideration obtained prior to satisfying a performance obligation, or unconditional obligations to provide goods or services under non-cancellable contracts before the transfer of goods or services to the customer has occurred. Our contract liability represents unconditional obligations to provide goods under non-cancellable contracts with the U.S. Military.

Items considered immaterial within the context of the contract are recognized as an expense.

Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue producing transaction, that are collected from customers, are excluded from revenue.

Costs associated with our manufacturer's warranty continue to be recognized as expense when the products are sold in accordance with guidance surrounding product warranties.

Shipping and handling costs associated with outbound freight after control over a product has transferred to a customer are accounted for as a fulfillment cost and are included in operating expenses. This treatment is consistent with how we accounted for these costs in prior periods.

Costs associated with obtaining a contract are expensed as incurred in accordance with the practical expedient in ASC 340-40 in instances where the amortization period is one year or less. We anticipate substantially all of our costs incurred to obtain a contract would be subject to this practical expedient.



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## Contract Balances

The following table provides information about contract liabilities from contracts with our customers.

|                      | September 30,<br>2018 | December 31,<br>2017 | September 30,<br>2017 |
|----------------------|-----------------------|----------------------|-----------------------|
| Contract liabilities | \$ 4,849,176          | \$ -                 | \$ -                  |

Significant changes in the contract liabilities balance during the period are as follows:

|                                                                                         | Contract liabilities |
|-----------------------------------------------------------------------------------------|----------------------|
| Balance, December 31, 2017                                                              | -                    |
| Non-cancelable contracts with customers recognized as a result of ASC 606 adoption      | \$ 9,394,130         |
| Non-cancelable contracts with customers entered into during the period                  | 10,176,280           |
| Revenue recognized related to non-cancelable contracts with customers during the period | (14,721,234)         |
| Balance, September 30, 2018                                                             | \$ 4,849,176         |

## Disaggregation of Revenue

All revenues are recognized at a point in time when control of our products pass to the customer at point of shipment. Because all revenues are recognized at a point in time and are disaggregated by channel, our segment disclosures are consistent with ASC 606 disaggregation requirements. See Note 12 for segment disclosures.

## 5. TRADE RECEIVABLES

Trade receivables are presented net of the related allowance for uncollectible accounts of approximately \$1,357,000, \$177,000 and \$556,000 at September 30, 2018, December 31, 2017 and September 30, 2017, respectively. We record the allowance based on historical experience, the age of the receivables, and identification of customer accounts that are likely to prove difficult to collect due to various criteria including pending bankruptcy. However, estimates of the allowance in any future period are inherently uncertain and actual allowances may differ from these estimates. If actual or expected future allowances were significantly greater or less than established reserves, a reduction or increase to bad debt expense would be recorded in the period this determination was made. 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.

In accordance with ASC 606, the return reserve liability netted against trade receivables is \$908,000 at September 30, 2018.

## 6. INVENTORIES

Inventories are comprised of the following:

|                 | September 30,<br>2018 | December 31,<br>2017 | September 30,<br>2017 |
|-----------------|-----------------------|----------------------|-----------------------|
| Raw materials   | \$ 14,310,672         | \$ 11,394,657        | \$ 15,287,467         |
| Work-in-process | 876,298               | 709,406              | 1,286,966             |
| Finished goods  | 63,221,510            | 53,518,369           | 60,310,720            |
| Total           | \$ 78,408,480         | \$ 65,622,432        | \$ 76,885,153         |

In accordance with ASC 606, the return reserve asset netted against inventories is \$555,000 at September 30, 2018.

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## 7. IDENTIFIED INTANGIBLE ASSETS

A schedule of identified intangible assets is as follows:

|                        | Gross<br>Amount | Accumulated<br>Amortization | Carrying<br>Amount |
|------------------------|-----------------|-----------------------------|--------------------|
| September 30, 2018     |                 |                             |                    |
| Trademarks             |                 |                             |                    |
| Wholesale              | \$ 27,192,281   | -                           | \$ 27,192,281      |
| Retail                 | 2,900,000       | -                           | 2,900,000          |
| Patents                | 895,477         | \$ 704,953                  | 190,524            |
| Customer Relationships | -               | -                           | -                  |
| Total Intangibles      | \$ 30,987,758   | \$ 704,953                  | \$ 30,282,805      |

|                        | Gross<br>Amount | Accumulated<br>Amortization | Carrying<br>Amount |
|------------------------|-----------------|-----------------------------|--------------------|
| December 31, 2017      |                 |                             |                    |
| Trademarks             |                 |                             |                    |
| Wholesale              | \$ 27,192,281   | -                           | \$ 27,192,281      |
| Retail                 | 2,900,000       | -                           | 2,900,000          |
| Patents                | 895,477         | \$ 673,009                  | 222,468            |
| Customer Relationships | -               | -                           | -                  |
| Total Intangibles      | \$ 30,987,758   | \$ 673,009                  | \$ 30,314,749      |

|                        | Gross<br>Amount | Accumulated<br>Amortization | Carrying<br>Amount |
|------------------------|-----------------|-----------------------------|--------------------|
| September 30, 2017     |                 |                             |                    |
| Trademarks             |                 |                             |                    |
| Wholesale              | \$ 29,343,578   | -                           | \$ 29,343,578      |
| Retail                 | 2,900,000       | -                           | 2,900,000          |
| Patents                | 2,595,477       | \$ 2,413,054                | 182,423            |
| Customer Relationships | 2,200,000       | 1,306,667                   | 893,333            |
| Total Intangibles      | \$ 37,039,055   | \$ 3,719,721                | \$ 33,319,334      |

The weighted average life for our patents is 4.3 years.

A schedule of approximate amortization expense related to finite-lived intangible assets for the three and nine months ended September 30, 2018 and 2017 is as follows:

|                      | Three Months<br>Ended<br>September 30, |           | Nine Months<br>Ended<br>September 30, |           |
|----------------------|----------------------------------------|-----------|---------------------------------------|-----------|
|                      | 2018                                   | 2017      | 2018                                  | 2017      |
| Amortization expense | \$ 10,000                              | \$ 32,000 | 32,000                                | \$ 96,000 |

A schedule of approximate expected amortization expense related to finite-lived intangible assets for the years ending December 31, is as follows:

|       | Amortization<br>Expense |
|-------|-------------------------|
| 2018  | \$ 41,000               |
| 2019  | 33,000                  |
| 2020  | 31,000                  |
| 2021  | 26,000                  |
| 2022  | 22,000                  |
| 2023+ | 69,000                  |

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## 8. LONG-TERM DEBT

In December 2014, we amended and restated our financing agreement with PNC Bank (“PNC”) to increase the credit facility to \$75.0 million and extend the term of the facility an additional five years to November 2019. The credit facility’s base interest rate is the current prime rate less 0.25%, however the credit facility provides us the option to borrow on up to eight fixed loans at LIBOR plus 1.25% in accordance with the 2014 amended and restated credit agreement. The LIBOR rate is determined based on the fixed loan maturities, which vary from 30, 60, 90, or 180 days.

Our credit facility borrowings consist of the following:

|                                  | September 30,<br>2018 | December 31,<br>2017 | September 30,<br>2017 |
|----------------------------------|-----------------------|----------------------|-----------------------|
| LIBOR borrowings                 | -                     | -                    | \$ 10,000,000         |
| Prime borrowings                 | -                     | \$ 2,199,423         | 1,630,000             |
| Total credit facility borrowings | -                     | \$ 2,199,423         | \$ 11,630,000         |

The total amount available under our amended and restated revolving credit facility is subject to a borrowing base calculation based on various percentages of accounts receivable and inventory. As of September 30, 2018, we had total capacity of \$68.3 million.

## Credit Facility Covenants

Our amended and restated 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 amended and restated credit facility agreement). Our amended and restated credit facility places a restriction on the amount of dividends that may be paid. At September 30, 2018, there was no triggering event and the covenant was not in effect.

## 9. TAXES

We are subject to tax examinations in various taxing jurisdictions. The earliest exam years open for examination are as follows:

| Taxing Authority Jurisdiction: | Earliest Exam Year |
|--------------------------------|--------------------|
| U.S. Federal                   | 2014               |
| Various U.S. States            | 2013               |
| Puerto Rico (U.S. Territory)   | 2012               |
| Canada                         | 2012               |

Our policy is to accrue interest and penalties on any uncertain tax position as a component of income tax expense. No such expenses were recognized during the three and nine months ended September 30, 2018. We do not believe there will be any material changes in our uncertain tax positions over the next 12 months.

Accounting for uncertainty in income taxes requires financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements. Under this guidance, income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of the standard. We did not have any unrecognized tax benefits and there was no effect on its financial condition or results of operations.

In the third quarter of this year, we recognized a tax benefit of approximately \$561,000 as we adjusted the amount of transition tax we need to pay on earnings from our Dominican Republic subsidiary that were brought back to the U.S. following last year's tax reform. Our original estimate, which was based on initial guidelines, proved to be too high once more specific rules were published midway through 2018. Due to this one-time adjustment, our effective tax rate was 10.5% and 16.2% for the three and nine months ended September 30, 2018, respectively. Excluding this adjustment, we estimate our 2018 effective tax rate to be 20.5%. Our effective tax rate was 34.0% for the three and nine months ended September 30, 2017.

## 10. EARNINGS PER SHARE

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.



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A reconciliation of the shares used in the basic and diluted income per common share computation for the three and nine months ended September 30, 2018 and 2017 is as follows:

|                                               | Three Months Ended    |                       | Nine Months Ended     |                       |
|-----------------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                               | September 30,<br>2018 | September 30,<br>2017 | September 30,<br>2018 | September 30,<br>2017 |
| Basic - weighted average shares outstanding   | 7,418,028             | 7,437,913             | 7,411,670             | 7,438,061             |
| Dilutive restricted share units               | 2,267                 | 4,339                 | 966                   | 3,123                 |
| Dilutive stock options                        | 60,045                | 749                   | 41,128                | 194                   |
| Diluted - weighted average shares outstanding | 7,480,340             | 7,443,001             | 7,453,764             | 7,441,378             |
| Anti-dilutive securities                      | -                     | 37,361                | 39,500                | 87,180                |

## 11. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information is as follows:

|                                                           | Nine Months Ended     |                       |
|-----------------------------------------------------------|-----------------------|-----------------------|
|                                                           | September 30,<br>2018 | September 30,<br>2017 |
| Interest paid                                             | \$ 140,427            | \$ 292,961            |
| Federal, state, and local income taxes (refund) paid, net | \$ 496,678            | \$ 646,129            |



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|                                                              |                |            |
|--------------------------------------------------------------|----------------|------------|
| Change in contract receivables, net                          | \$ (4,849,176) | \$ -       |
| Change in contract liabilities, net                          | \$ 4,849,176   | \$ -       |
| Property, plant, and equipment purchases in accounts payable | \$ 119,604     | \$ 284,370 |

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## 12. 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, online retailers, independent retailers, mass merchants, retail uniform stores, and specialty safety shoe stores. Our Retail business includes direct sales of our products to consumers through our e-commerce websites, our Rocky outlet store, and Lehigh business. Military includes sales to the U.S. Military. The following is a summary of segment results for the Wholesale, Retail, and Military segments.

|                      | Three Months Ended    |               | Nine Months Ended     |                |
|----------------------|-----------------------|---------------|-----------------------|----------------|
|                      | September 30,<br>2018 | 2017          | September 30,<br>2018 | 2017           |
| <b>NET SALES:</b>    |                       |               |                       |                |
| Wholesale            | \$ 47,000,718         | \$ 46,049,837 | \$ 127,235,693        | \$ 122,323,991 |
| Retail               | 11,915,337            | 11,069,669    | 36,712,440            | 33,944,718     |
| Military             | 6,999,509             | 7,555,576     | 21,559,944            | 29,934,280     |
| Total Net Sales      | \$ 65,915,564         | \$ 64,675,082 | \$ 185,508,077        | \$ 186,202,989 |
| <b>GROSS MARGIN:</b> |                       |               |                       |                |
| Wholesale            | \$ 15,448,657         | \$ 14,087,674 | \$ 42,492,453         | \$ 38,623,219  |
| Retail               | 5,344,274             | 4,877,916     | 16,145,274            | 14,889,559     |
| Military             | 1,607,310             | 545,954       | 4,260,109             | 3,910,366      |
| Total Gross Margin   | \$ 22,400,241         | \$ 19,511,544 | \$ 62,897,836         | \$ 57,423,144  |



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

## RESULTS OF OPERATIONS

The following tables set forth, for the periods indicated, information derived from our Unaudited Condensed Consolidated Financial Statements, expressed as a percentage of net sales. The discussion that follows each table should be read in conjunction with our Unaudited Condensed Consolidated Financial Statements as well as our annual report on 10-K for the year ended December 31, 2017.

|                        | Three Months Ended |                    | Nine Months Ended  |                    |
|------------------------|--------------------|--------------------|--------------------|--------------------|
|                        | September 30, 2018 | September 30, 2017 | September 30, 2018 | September 30, 2017 |
| Net sales              | 100.0 %            | 100.0 %            | 100.0 %            | 100.0 %            |
| Cost of goods sold     | 66.0               | 69.8               | 66.1               | 69.2               |
| Gross margin           | 34.0               | 30.2               | 33.9               | 30.8               |
| Operating expense      | 25.5               | 24.8               | 26.8               | 26.5               |
| Income from operations | 8.5 %              | 5.4 %              | 7.1 %              | 4.4 %              |

## Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

|                   | Three Months Ended |                    | Inc./ (Dec.) | Inc./ (Dec.) |
|-------------------|--------------------|--------------------|--------------|--------------|
|                   | September 30, 2018 | September 30, 2017 |              |              |
| <b>NET SALES:</b> |                    |                    |              |              |
| Wholesale         | \$ 47,000,718      | \$ 46,049,837      | \$ 950,881   | 2.1 %        |
| Retail            | 11,915,337         | 11,069,669         | 845,668      | 7.6          |
| Military          | 6,999,509          | 7,555,576          | (556,067)    | (7.4)        |
| Total Net Sales   | \$ 65,915,564      | \$ 64,675,082      | \$ 1,240,482 | 1.9 %        |

Wholesale sales increased as consumers continued to respond favorably to several recent product introductions across our brand portfolio, which we believe is being fueled by new innovations and enhanced marketing programs that are generating increased awareness and demand in our work, outdoor and commercial military categories. This was partially offset by the loss of the Creative Recreation brand which was sold in the fourth quarter of 2017.

Retail sales increased primarily due to both a strong growth in our Lehigh business, which was primarily attributed to an expansion in our CustomFit model, and a mid-single digit increase in our direct to consumer ecommerce business which we believe is attributable to recent investments aimed at increasing traffic and conversion on our websites.

Military sales decreased, as expected, due to some contracts expiring in late 2017.

|                       | Three Months Ended |               |              |   |
|-----------------------|--------------------|---------------|--------------|---|
|                       | September 30,      |               |              |   |
|                       | 2018               | 2017          | Inc./ (Dec.) |   |
| <b>GROSS MARGIN:</b>  |                    |               |              |   |
| Wholesale Margin \$'s | \$ 15,448,657      | \$ 14,087,674 | \$ 1,360,983 |   |
| Margin %              | 32.9               | % 30.6        | % 2.3        | % |
| Retail Margin \$'s    | \$ 5,344,274       | \$ 4,877,916  | \$ 466,358   |   |
| Margin %              | 44.9               | % 44.1        | % 0.8        | % |
| Military Margin \$'s  | \$ 1,607,310       | \$ 545,954    | \$ 1,061,356 |   |
| Margin %              | 23.0               | % 7.2         | % 15.8       | % |
| Total Margin \$'s     | \$ 22,400,241      | \$ 19,511,544 | \$ 2,888,697 |   |
| Margin %              | 34.0               | % 30.2        | % 3.8        | % |

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Wholesale gross margin increased primarily due to our dedicated focus to increasing full price selling by offering less discounts while maintaining stronger initial margins on some of our newer products. In 2017, we also had sales from the Creative Recreation brand which carried lower margins as we were selling through some discontinued products.

Retail gross margin increased primarily due to an increase in direct to consumer sales that carry a higher margin and a decrease in certain Lehigh sales that carry lower margins.

Military gross margin increased significantly due to a number of lower margin contracts expiring in 2017 as well as \$1 million of additional expenses related to payroll and overhead costs that could not be capitalized in inventory due to lower than usual production volumes in our Puerto Rico facility as a result of the disruption from Hurricane Maria in the third quarter of 2017.

|                            | Three Months Ended<br>September 30, |               |              |              |   |
|----------------------------|-------------------------------------|---------------|--------------|--------------|---|
|                            | 2018                                | 2017          | Inc./ (Dec.) | Inc./ (Dec.) |   |
| <b>OPERATING EXPENSES:</b> |                                     |               |              |              |   |
| Operating Expenses         | \$ 16,790,903                       | \$ 16,026,654 | \$ 764,249   | 4.8          | % |
| % of Net Sales             | 25.5                                | % 24.8        | % 0.7        | %            |   |

The increase in operating expenses was primarily related to the increased investments in our core brands to help initiate growth and expand within our respective markets, variable expenses tied to sales increases, and bad debt expense. The increase was partially offset by the reduction of expenses for the Creative Recreation brand, which was sold in the fourth quarter of 2017.

|                      | Three Months Ended<br>September 30, |              |              |              |   |
|----------------------|-------------------------------------|--------------|--------------|--------------|---|
|                      | 2018                                | 2017         | Inc./ (Dec.) | Inc./ (Dec.) |   |
| <b>INCOME TAXES:</b> |                                     |              |              |              |   |
| Income Tax Expense   | \$ 594,830                          | \$ 1,152,000 | \$ (557,170) | (48.4)       | % |
| Effective Tax Rate   | 10.5                                | % 34.0       | % (23.5)     | %            |   |

The reduction in the effective tax rate was a result of the Tax Cuts and Jobs Act (TCJA) passed in December 2017, as well as an adjustment related to the one-time transition tax on the deemed repatriation of undistributed foreign earnings which resulted from additional interpretative guidance of the TCJA from the IRS.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

|                 | Nine Months Ended<br>September 30, |                |              |              |   |
|-----------------|------------------------------------|----------------|--------------|--------------|---|
|                 | 2018                               | 2017           | Inc./ (Dec.) | Inc./ (Dec.) |   |
| NET SALES:      |                                    |                |              |              |   |
| Wholesale       | \$ 127,235,693                     | \$ 122,323,991 | \$ 4,911,702 | 4.0          | % |
| Retail          | 36,712,440                         | 33,944,718     | 2,767,722    | 8.2          |   |
| Military        | 21,559,944                         | 29,934,280     | (8,374,336)  | (28.0)       |   |
| Total Net Sales | \$ 185,508,077                     | \$ 186,202,989 | \$ (694,912) | (0.4)        | % |

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Wholesale sales increased as consumers continued to respond favorably to several recent product introductions across our brand portfolio, which we believe is being fueled by new innovations and enhanced marketing programs that are generating increased awareness and demand in our work, outdoor and commercial military categories. This was partially offset by the loss of the Creative Recreation brand which was sold in the fourth quarter of 2017.

Retail sales primarily increased due to both a strong growth in our Lehigh business, which was primarily attributed to an expansion in our CustomFit model, and a double digit increase in our direct to consumer ecommerce business which we believe is attributable to recent investments aimed at increasing traffic and conversion on our websites.

Military sales decreased, as expected, due to some contracts expiring in late 2017.

|                       | Nine Months Ended |               |              |   |
|-----------------------|-------------------|---------------|--------------|---|
|                       | September 30,     |               |              |   |
|                       | 2018              | 2017          | Inc./ (Dec.) |   |
| <b>GROSS MARGIN:</b>  |                   |               |              |   |
| Wholesale Margin \$'s | \$ 42,492,453     | \$ 38,623,219 | \$ 3,869,234 |   |
| Margin %              | 33.4              | % 31.6        | % 1.8        | % |
| Retail Margin \$'s    | \$ 16,145,274     | \$ 14,889,559 | \$ 1,255,715 |   |
| Margin %              | 44.0              | % 43.9        | % 0.1        | % |
| Military Margin \$'s  | \$ 4,260,109      | \$ 3,910,366  | \$ 349,743   |   |
| Margin %              | 19.8              | % 13.1        | % 6.7        | % |
| Total Margin \$'s     | \$ 62,897,836     | \$ 57,423,144 | \$ 5,474,692 |   |
| Margin %              | 33.9              | % 30.8        | % 3.1        | % |

Wholesale gross margin increased primarily due to our dedicated focus to increasing full price selling by offering less discounts while maintaining stronger initial margins on some of our newer products. In 2017, we also had sales from the Creative Recreation brand which carried lower margins as we were selling through some discontinued products.

Retail gross margin increased slightly due to an increase in direct to consumer sales that carry a higher margin and a decrease in certain Lehigh sales that carry lower margins.

Military gross margin increased significantly due to a number of lower margin contracts expiring in 2017 as well as \$1 million of additional expenses related to payroll and overhead costs that could not be capitalized in inventory due to



lower than usual production volumes in our Puerto Rico facility as a result of the disruption from Hurricane Maria in the third quarter of 2017.

|                            | Nine Months Ended     |               | Inc./ (Dec.) | Inc./ (Dec.) |   |
|----------------------------|-----------------------|---------------|--------------|--------------|---|
|                            | September 30,<br>2018 | 2017          |              |              |   |
| <b>OPERATING EXPENSES:</b> |                       |               |              |              |   |
| Operating Expenses         | \$ 49,687,739         | \$ 49,313,498 | \$ 374,241   | 0.8          | % |
| % of Net Sales             | 26.8                  | % 26.5        | % 0.3        | %            |   |

The increase in operating expenses was primarily related to the increased investments in our core brands to help initiate growth and expand within our respective markets, variable expenses tied to sales increases, and bad debt expense. The increase was partially offset by the reduction of expenses for the Creative Recreation brand, which was sold in the fourth quarter of 2017.

|                      | Nine Months Ended     |              | Inc./ (Dec.) | Inc./ (Dec.) |   |
|----------------------|-----------------------|--------------|--------------|--------------|---|
|                      | September 30,<br>2018 | 2017         |              |              |   |
| <b>INCOME TAXES:</b> |                       |              |              |              |   |
| Income Tax Expense   | \$ 2,116,830          | \$ 2,674,000 | \$ (557,170) | (20.8)       | % |
| Effective Tax Rate   | 16.2                  | % 34.0       | % (17.8)     | %            |   |

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The reduction in the effective tax rate was as a result of the TCJA passed in December 2017, as well as an adjustment related to the one-time transition tax on the deemed repatriation of undistributed foreign earnings which resulted from additional interpretative guidance of the TCJA from the IRS.

LIQUIDITY AND CAPITAL RESOURCES

Overview

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

Over the last several years our principal uses of cash have been for working capital and capital expenditures to support our growth. Our working capital consists primarily of trade receivables and inventory, offset by accounts payable and accrued expenses. Our working capital fluctuates throughout the year as a result of our seasonal business cycle and business expansion and is generally lowest in the months of January through March of each year and highest during the months of May through October of each year. We typically utilize our revolving credit facility to fund our seasonal working capital requirements. As a result, balances on our revolving credit facility can fluctuate significantly throughout the year.

Our capital expenditures relate primarily to projects relating to our corporate offices, property, merchandising fixtures, molds and equipment associated with our manufacturing and distribution operations and for information technology. Capital expenditures were \$3.5 million for the nine months ended September 30, 2018 and 2017, respectively.

We lease certain machinery, shoe centers, and manufacturing facilities under operating leases that generally provide for renewal options.

We believe that our 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. For more information regarding our credit facility please see Note 8.

As a result of the TCJA, we recorded a liability of \$2.5 million in the fourth quarter of 2017 related to the taxation of unremitted earnings of non-U.S. subsidiaries (toll charge), which was to be paid over eight years. The first installment of \$510,000 was paid in April 2018. Additional interpretive guidance was released by the IRS in August 2018 that indicated that any 2017 tax year overpayments made must first be applied against the toll charge liability. Based on the new IRS guidance, we expect to make approximately \$2.0 million in estimated tax payments in the fourth quarter of 2018 related to the 2018 tax year.

## Cash Flows

| (\$ in millions)                        | Nine Months<br>Ended<br>September 30, |          |
|-----------------------------------------|---------------------------------------|----------|
|                                         | 2018                                  | 2017     |
| Operating activities                    | \$ 8.7                                | \$ 6.8   |
| Investing activities                    | (3.5)                                 | (3.1)    |
| Financing activities                    | (4.7)                                 | (6.0)    |
| Net change in cash and cash equivalents | \$ 0.5                                | \$ (2.3) |

**Operating Activities.** Cash provided by operating activities was primarily impacted by an increase in accounts payable, accrued liabilities, and income taxes payable, partially offset by an increase in accounts receivable and inventory for the nine months ended September 30, 2018. Cash provided by operating activities was primarily impacted by an increase in accounts payable and other accrued liabilities, partially offset by increases in accounts receivable and inventory for the nine months ended September 30, 2017.

**Investing Activities.** Cash used in investing activities primarily related to investments in molds and equipment associated with our manufacturing operations, for information technology and for improvements to our distribution facility for the nine months ended September 30, 2018 and 2017.

**Financing Activities.** Cash used in financing activities primarily related to net payments under the revolving credit facility and for the payment of dividends on our common stock for the nine months ended September 30, 2018 and 2017.

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Inflation

Our financial performance is influenced by factors such as higher raw material costs as well as higher salaries and employee benefits. Management attempts to minimize or offset the effects of inflation through increased selling prices, productivity improvements, and cost reductions. We were able to mitigate the effects of inflation during 2017 due to these factors. It is anticipated that any inflationary pressures during 2018 could be offset through possible price increases.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of the Company's Unaudited Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. GAAP, requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. On an ongoing basis, management evaluates these estimates. Estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Historically, actual results have not been materially different from the Company's estimates. However, actual results may differ materially from these estimates under different assumptions or conditions.

We have identified the critical accounting policies used in determining estimates and assumptions in the amounts reported in our Management Discussion and Analysis of Financial Conditions and Results of Operations in our 2017 Form 10-K.

On January 1, 2018, we adopted the new accounting standard ASC 606, Revenue from Contracts with Customers and all the related amendments ("New Revenue Standard") for all contracts not yet completed as of January 1, 2018 using the modified retrospective method. This method requires a cumulative effect adjustment to reflect the impact of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. The New Revenue Standard did not result in a material impact to the opening balance of retained earnings therefore no adjustment was made. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. We expect the impact of the adoption of the New Revenue Standard to be immaterial to our net income on an ongoing basis. For additional information regarding the adoption of ASC 606 see Note 4.

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES REFORM ACT OF 1995

The matters discussed in this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, 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, 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," "predict," "potential," "continue," "strategy," "future," "likely" and similar are intended to identify forward-looking statements. Investors are cautioned that forward-looking statements contained in this Quarterly Report on Form 10-Q and in other statements we make involve risk and uncertainties including, without limitations, dependence on sales forecasts, changes in consumer demand and expectations, seasonality, impact of weather, competition, reliance on suppliers, changing retail trends, risks related to cybersecurity, economic changes, as well as other factors set forth under the caption "Item 1A, Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 (filed March 12, 2018), and other factors detailed from time to time in our filings with the Securities and Exchange Commission. Although we believe that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could be inaccurate. Therefore, there can be no assurance that the forward-looking statements included herein 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. 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 to our market risk as disclosed in Item 7A, “Quantitative and Qualitative Disclosures About Market Risk” in our Annual Report on Form 10-K for the year ended December 31, 2017.

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 and 15d-15 promulgated under the Exchange Act. Based upon this evaluation, our chief executive officer and our chief financial officer concluded that, as of September 30, 2018, 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, 2018, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II -- OTHER INFORMATION

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, 2017.





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

Unregistered Sales of Equity Securities

None.

Use of Proceeds

Not applicable.

The following table sets forth information concerning the Company's purchases of common stock for the periods indicated:

| Period                                 | Total number of shares (or units) purchased (1) | Average price paid per share (or units) | Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs (2) |
|----------------------------------------|-------------------------------------------------|-----------------------------------------|-----------------------------------------------------------------------------------------------------------------------------|
| July 1, 2018 - July 31, 2018           | -                                               | -                                       | \$ 7,500,000                                                                                                                |
| August 1, 2018 - August 31, 2018       | -                                               | -                                       | 7,500,000                                                                                                                   |
| September 1, 2018 - September 30, 2018 | -                                               | -                                       | 7,500,000                                                                                                                   |
| Total                                  | -                                               | -                                       | \$ 7,500,000                                                                                                                |

(1) The reported shares were repurchased pursuant to the Company's publicly announced stock repurchase authorizations.

(2) The number shown represents, as of the end of each period, the maximum number of shares (approximate dollar value) of Common Stock that may yet be purchased under publicly announced stock repurchase authorizations.

The shares may be purchased, from time-to-time, depending on market conditions.

On March 5, 2018, the Company announced a \$7,500,000 share repurchase plan. The repurchase program terminates on March 1, 2019.

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ITEM 6. EXHIBITS

Exhibit

Number Description

- 31.1\* Certification Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a) of the Principal Executive Officer.
- 31.2\* Certification Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a) of the Principal Financial Officer.
- 32\*\* Section 1350 Certification of Principal Executive Officer/Principal Financial Officer.
- 101\* 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 September 30, 2018 formatted in XBRL ("eXtensible Business Reporting Language"): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows, and (vi) related notes to these financial statements.

\* 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 30, 2018 By: /s/TOM ROBERTSON  
Tom Robertson

Executive Vice President, Chief Financial Officer and Treasurer

(Principal Financial and Accounting Officer and Duly Authorized Officer)