

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON D.C. 20549

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d)  
OF THE SECURITIES AND EXCHANGE ACT OF 1934

For Quarter Ended  
**June 30, 2002**

Commission File Number:  
**0-21026**

**ROCKY SHOES & BOOTS, INC.**  
(Exact name of registrant as specified in its charter)

**Ohio**  
(State of Incorporation)

**31-1364046**  
(IRS Employer Identification Number)

**39 E. Canal Street**  
**Nelsonville, Ohio 45764**  
(Address of principal executive offices)

**(740) 753-1951**  
(Registrant's telephone number, including area code)

(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 twelve (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 ninety (90) days.

Yes  No

4,505,465 common shares, no par value, outstanding at August 6, 2002.

# Rocky Shoes & Boots, Inc. and Subsidiaries

## Form 10-Q

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**PART 1 - FINANCIAL INFORMATION**  
**ITEM 1 - FINANCIAL STATEMENTS**

**Rocky Shoes & Boots, Inc. and Subsidiaries**  
**Condensed Consolidated Balance Sheets**

|   | June 30, 2002<br>Unaudited  | December 31, 2001           | June 30, 2001<br>Unaudited  |
|---|-----------------------------|-----------------------------|-----------------------------|
| <b>ASSETS:</b>  |                             |                             |                             |
| <b>CURRENT ASSETS:</b>                                    |                             |                             |                             |
| Cash and cash equivalents                                 | \$ 1,514,834                | \$ 2,954,935                | \$ 1,453,055                |
| Trade receivables – net                                   | 15,072,183                  | 15,091,100                  | 20,197,326                  |
| Other receivables   | 2,345,324                   | 2,225,498                   | 4,973,000                   |
| Inventories   | 31,319,150                  | 27,713,664                  | 41,384,116                  |
| Deferred income taxes                                     | 615,609                     | 615,609                     | 502,722                     |
| Prepaid expenses  | 1,491,523                   | 1,053,192                   | 1,454,132                   |
| Total current assets                                      | <u>52,358,623</u>           | <u>49,653,998</u>           | <u>69,964,351</u>           |
| FIXED ASSETS – net  | 19,965,259                  | 20,766,094                  | 22,473,023                  |
| DEFERRED PENSION ASSET                                    | 2,311,806                   | 1,802,922                   | 2,526,603                   |
| DEFERRED INCOME TAXES                                     | 295,784                     | 295,784                     |                             |
| OTHER ASSETS  | 2,469,050                   | 2,141,016                   | 2,157,433                   |
| <b>TOTAL ASSETS</b>                                       | <u><u>\$ 77,400,522</u></u> | <u><u>\$ 74,659,814</u></u> | <u><u>\$ 97,121,410</u></u> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>              |                             |                             |                             |
| <b>CURRENT LIABILITIES:</b>                               |                             |                             |                             |
| Accounts payable  | \$ 4,207,401                | \$ 1,559,444                | \$ 6,091,027                |
| Current maturities - long term debt                       | 480,751                     | 469,143                     | 9,516,681                   |
| Accrued taxes - other                                     | 606,690                     | 991,295                     | 910,612                     |
| Accrued salaries and wages                                | 852,859                     | 985,992                     | 1,063,461                   |
| Accrued plant closing costs                               | 780,499                     | 903,291                     |                             |
| Accrued other   | 282,721                     | 477,938                     | 558,948                     |
| Total current liabilities                                 | <u>7,210,921</u>            | <u>5,387,103</u>            | <u>18,140,729</u>           |
| LONG TERM DEBT-less current maturities                    | 20,004,450                  | 16,976,023                  | 26,212,433                  |
| DEFERRED LIABILITIES                                      | 180,500                     | 1,253,355                   | 2,646,331                   |
| <b>TOTAL LIABILITIES</b>                                  | <u>27,395,871</u>           | <u>23,616,481</u>           | <u>46,999,493</u>           |
| <b>SHAREHOLDERS' EQUITY:</b>                              |                             |                             |                             |
| Common stock, no par value;                               |                             |                             |                             |
| 10,000,000 shares authorized; issued and outstanding      |                             |                             |                             |
| June 30, 2002 - 4,505,465; December 31, 2001 - 4,492,215; |                             |                             |                             |
| June 30, 2001 - 4,489,215                                 | 35,373,578                  | 35,302,159                  | 35,284,159                  |
| Accumulated other comprehensive loss                      | (831,161)                   | (831,161)                   |                             |
| Retained earnings   | 15,462,234                  | 16,572,335                  | 14,837,758                  |
| Total shareholders' equity                                | <u>50,004,651</u>           | <u>51,043,333</u>           | <u>50,121,917</u>           |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>         | <u><u>\$ 77,400,522</u></u> | <u><u>\$ 74,659,814</u></u> | <u><u>\$ 97,121,410</u></u> |

See notes to the interim unaudited condensed consolidated financial statements.

**Rocky Shoes & Boots, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Operations**  
**(Unaudited)**

|  | Three Months Ended<br>June 30, |                   | Six Months Ended<br>June 30, |                     |
|--|--------------------------------|-------------------|------------------------------|---------------------|
|  | <u>2002</u>                    | <u>2001</u>       | <u>2002</u>                  | <u>2001</u>         |
| NET SALES  | \$ 19,194,071                  | \$ 22,006,132     | \$ 32,943,659                | \$ 38,070,027       |
| COST OF GOODS SOLD                               | <u>14,256,438</u>              | <u>15,854,003</u> | <u>25,665,373</u>            | <u>28,750,824</u>   |
| GROSS MARGIN                                     | 4,937,633                      | 6,152,129         | 7,278,286                    | 9,319,203           |
| SELLING, GENERAL AND<br>ADMINISTRATIVE EXPENSES  | <u>4,517,033</u>               | <u>4,691,982</u>  | <u>8,416,534</u>             | <u>8,700,481</u>    |
| INCOME (LOSS) FROM OPERATIONS                    | 420,600                        | 1,460,147         | (1,138,248)                  | 618,722             |
| OTHER INCOME AND (EXPENSES):                     |                                |                   |                              |                     |
| Interest expense                                 | (332,959)                      | (632,685)         | (616,068)                    | (1,211,782)         |
| Other – net                                      | <u>78,198</u>                  | <u>147,041</u>    | <u>167,029</u>               | <u>280,027</u>      |
| Total other - net                                | (254,761)                      | (485,644)         | (449,039)                    | (931,755)           |
| INCOME (LOSS) BEFORE INCOME<br>TAXES             | 165,839                        | 974,503           | (1,587,287)                  | (313,033)           |
| INCOME TAX (BENEFIT) EXPENSE                     | <u>48,752</u>                  | <u>272,164</u>    | <u>(477,186)</u>             | <u>(109,278)</u>    |
| NET INCOME (LOSS)                                | <u>\$ 117,087</u>              | <u>\$ 702,339</u> | <u>\$ (1,110,101)</u>        | <u>\$ (203,755)</u> |
| NET INCOME (LOSS) PER SHARE                      |                                |                   |                              |                     |
| Basic  | <u>\$ 0.03</u>                 | <u>\$ 0.16</u>    | <u>\$ (0.25)</u>             | <u>\$ (0.05)</u>    |
| Diluted  | <u>\$ 0.03</u>                 | <u>\$ 0.16</u>    | <u>\$ (0.25)</u>             | <u>\$ (0.05)</u>    |
| WEIGHTED AVERAGE NUMBER OF<br>SHARES OUTSTANDING |                                |                   |                              |                     |
| Basic  | <u>4,502,608</u>               | <u>4,489,215</u>  | <u>4,498,240</u>             | <u>4,489,215</u>    |
| Diluted  | <u>4,680,002</u>               | <u>4,522,039</u>  | <u>4,489,240</u>             | <u>4,489,215</u>    |

See notes to the interim unaudited condensed consolidated financial statements.

**Rocky Shoes & Boots, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Cash Flows**  
**(Unaudited)**

|  | Six Months Ended    |                     |
|--|---------------------|---------------------|
|  | June 30,            |                     |
|  | <u>2002</u>         | <u>2001</u>         |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                     |                     |
| Net loss   | \$ (1,110,101)      | \$ (203,755)        |
| Adjustments to reconcile net loss to net cash provided<br>by (used in) operating activities: |                     |                     |
| Depreciation and amortization  | 2,069,977           | 2,304,910           |
| Deferred taxes and liabilities - net   | (1,581,738)         | 195,743             |
| Loss on sale of fixed assets   | 9,508               | 7,434               |
| Change in assets and liabilities:  |                     |                     |
| Receivables  | (100,909)           | (4,157,545)         |
| Inventories  | (3,605,486)         | (9,348,879)         |
| Prepaid expenses   | (438,331)           | (158,845)           |
| Other assets   | (347,810)           | 20,602              |
| Accounts payable   | 2,643,981           | 2,598,861           |
| Accrued and other liabilities  | <u>(835,747)</u>    | <u>309,344</u>      |
| Net cash used in operating activities  | <u>(3,296,656)</u>  | <u>(8,432,130)</u>  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                     |                     |
| Purchase of fixed assets   | (1,267,649)         | (452,772)           |
| Proceeds from sale of fixed assets   | <u>12,750</u>       | <u>6,498</u>        |
| Net cash used in investing activities  | <u>(1,254,899)</u>  | <u>(446,274)</u>    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                     |                     |
| Proceeds from Long Term Debt   | 40,122,478          | 45,171,590          |
| Payments on Long Term Debt   | (37,082,443)        | (36,958,125)        |
| Proceeds from exercise of stock options  | <u>71,419</u>       | <u>          </u>   |
| Net cash provided by financing activities  | <u>3,111,454</u>    | <u>8,213,465</u>    |
| DECREASE IN CASH AND CASH EQUIVALENTS  | (1,440,101)         | (664,939)           |
| CASH AND CASH EQUIVALENTS,<br>BEGINNING OF PERIOD  | <u>2,954,935</u>    | <u>2,117,994</u>    |
| CASH AND CASH EQUIVALENTS,<br>END OF PERIOD  | <u>\$ 1,514,834</u> | <u>\$ 1,453,055</u> |

See notes to the interim unaudited condensed consolidated financial statements.

**Rocky Shoes & Boots, Inc.  
and Subsidiaries**

**Notes to the Interim Unaudited Condensed Consolidated Financial Statements**

**1. INTERIM FINANCIAL REPORTING**

In the opinion of management, the accompanying interim unaudited condensed consolidated financial statements reflect all adjustments which are necessary for a fair presentation of the financial results. All such adjustments reflected in the unaudited interim consolidated financial statements are considered to be of a normal and recurring nature. The results of the operations for the three month and six month periods ended June 30, 2002 and 2001 are not necessarily indicative of the results to be expected for the whole year. Accordingly, these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report to the Shareholders on Form 10-K for year ended December 31, 2001.

Certain reclassifications have been made to the prior year amounts in order to conform to the current year presentation.

**2. CLOSURE OF MANUFACTURING OPERATIONS**

In September 2001, the Board of Directors approved a restructuring plan to consolidate and realign the Company's footwear manufacturing operations. Under this plan, the Company moved the footwear manufacturing operations at its Nelsonville, Ohio factory to the Company's factory in Puerto Rico. The restructuring plan was completed in fourth quarter 2001.

The execution of this plan, which started in September 2001, resulted in the elimination of 67 employees at the Nelsonville, Ohio facility and transfer of a significant amount of machinery and equipment to the Company's Moca, Puerto Rico facility.

A reconciliation of the plant closing costs and accrual for the quarter ended June 30, 2002 is as follows:

|                                      | <u>2001 Total<br/>Expenses</u> | <u>Accrued<br/>Balance<br/>Dec. 31, 2001</u> | <u>First Quarter<br/>2002 Payments</u> | <u>Second Quarter<br/>2002 Payments</u> | <u>Accrued<br/>Balance<br/>June 30, 2002</u> |
|--------------------------------------|--------------------------------|--|--|---|--|
| Severance                            |                                |  |  |   |  |
| Non-union                            | \$ 71,668                      | \$ 71,668                                    | \$ 20,483                              | \$ 5,091                                | \$ 46,094                                    |
| Union                                | 292,653                        |  |  |   |  |
| Curtailment of pension plan benefits | 690,000                        | 690,000                                      |  |   | 690,000                                      |
| Employee benefits                    | 34,223                         | 33,000                                       | 6,808                                  | 22,739                                  | 3,453  |
| Factory lease                        | 90,000                         | 85,000                                       | 13,000                                 | 9,000                                   | 63,000                                       |
| Equipment and relocation costs       | 260,626                        | 5,000  |  |   | 5,000  |
| Legal and other costs                | 60,830                         | 18,623                                       | 11,825                                 | 33,847                                  | (27,049)                                     |
| Total                                | <u>\$ 1,500,000</u>            | <u>\$ 903,291</u>                            | <u>\$ 52,116</u>                       | <u>\$ 70,677</u>                        | <u>\$ 780,498</u>                            |

### 3. INVENTORIES

Inventories are comprised of the following:

|  | <u>June 30, 2002</u> | <u>December 31, 2001</u> | <u>June 30, 2001</u> |
|--|----------------------|--------------------------|----------------------|
| Raw materials  | \$ 5,348,288         | \$ 4,537,865             | \$ 6,791,263         |
| Work-in Process  | 1,798,754            | 1,578,107                | 2,969,247            |
| Finished goods   | 23,049,609           | 20,077,999               | 29,369,379           |
| Factory outlet finished goods                          | 1,283,499            | 1,680,693                | 2,814,227            |
| Reserve for obsolescence or<br>lower of cost or market | <u>(161,000)</u>     | <u>(161,000)</u>         | <u>(560,000)</u>     |
| Total  | <u>\$ 31,319,150</u> | <u>\$ 27,713,664</u>     | <u>\$ 41,384,116</u> |

### 4. SUPPLEMENTAL CASH FLOW INFORMATION

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

|  | Six Months Ended<br>June 30, |                    |
|--|------------------------------|--------------------|
|  | <u>2002</u>                  | <u>2001</u>        |
| Interest                                 | <u>\$624,184</u>             | <u>\$1,279,884</u> |
| Federal, state and local<br>income taxes | <u>\$ 75,000</u>             | <u>\$ 77,348</u>   |

Accounts payable at June 30, 2002 and December 31, 2001 include a total of \$9,286 and \$5,310, respectively, relating to the purchase of fixed assets.

### 5. PER SHARE INFORMATION

Basic earnings/(loss) per share (EPS) is computed by dividing net income (loss) applicable to common shareholders by the basic weighted average number of common shares outstanding during each period. The diluted earnings per share computation

includes common share equivalents, when dilutive. There are no adjustments to net income necessary in the calculation of basic and diluted earnings per share.

A reconciliation of the shares used in the basic and diluted income per common share computation for the three months and six months ended June 30, 2002 and 2001 is as follows:

|  | Three Months Ended<br>June 30, |                  | Six Months Ended<br>June 30, |                  |
|--|--------------------------------|------------------|------------------------------|------------------|
|  | <u>2002</u>                    | <u>2001</u>      | <u>2002</u>                  | <u>2001</u>      |
| Basic Weighted average<br>shares outstanding   | 4,502,608                      | 4,489,215        | 4,498,240                    | 4,489,215        |
| Diluted securities:                            |                                |                  |                              |                  |
| Stock options                                  | <u>177,394</u>                 | <u>32,824</u>    | <u>-</u>                     | <u>-</u>         |
| Diluted Weighted average<br>shares outstanding | <u>4,680,002</u>               | <u>4,522,039</u> | <u>4,498,240</u>             | <u>4,489,215</u> |

## 6. RECENTLY ADOPTED FINANCIAL ACCOUNTING STANDARDS

Effective January 1, 2002, the Company adopted Financial Accounting Standards Board (FASB) Statement No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. The adoption of this statement did not have a material impact on its consolidated financial statements. SFAS No. 142 changes the accounting for goodwill and certain other intangible assets from an amortization method to an impairment only approach. The Company has no goodwill recorded. However, the total net book value of indefinite-lived intangible assets at June 30, 2002 was \$413,869. Indefinite-lived intangible assets represent the cost of acquiring the licensing rights to ROCKY(R) Kids from Philip's Kids, LLC. These rights have previously been determined to have an indefinite useful life and accordingly are not subject to amortization. In addition, the Company has intangible assets consisting of patents and trademarks totaling approximately \$500,000 at June 30, 2002 that are being amortized over 15 years. Amortization expense related to these intangible assets in the first six months of fiscal 2002 and 2001 was \$34,972 and \$18,904 respectively.

As previously reported, FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" in April 2002. It is effective for the first quarter in the year ended December 31, 2003. The Company does not believe the adoption of SFAS No. 145 will have a significant impact on its consolidated financial statements.

## PART 1 - FINANCIAL INFORMATION

### 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 the Company's 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 the Interim Unaudited Condensed Consolidated Financial Statements of the Company.

|   | Percentage of Net Sales |              |                  |              |
|---|-------------------------|--------------|------------------|--------------|
|   | Three Months Ended      |              | Six Months Ended |              |
|   | June 30,                | June 30,     | June 30,         | June 30,     |
|   | 2002                    | 2001         | 2002             | 2001         |
| Net Sales                                       | 100.0%                  | 100.0%       | 100.0%           | 100.0%       |
| Cost of Goods Sold                              | <u>74.3%</u>            | <u>72.0%</u> | <u>77.9%</u>     | <u>75.5%</u> |
| Gross Margin                                    | 25.7%                   | 28.0%        | 22.1%            | 24.5%        |
| Selling, General and<br>Administrative Expenses | <u>23.5%</u>            | <u>21.4%</u> | <u>25.6%</u>     | <u>22.9%</u> |
| Income (Loss) from Operations                   | <u>2.2%</u>             | <u>6.6%</u>  | <u>(3.5%)</u>    | <u>1.6%</u>  |

##### Three Months Ended June 30, 2002 Compared to Three Months Ended June 30, 2001

###### *Net Sales*

Net sales decreased \$2,812,061, or 12.8%, to \$19,194,071 for the quarter ended June 30, 2002 compared to \$22,006,132 for the same period a year ago. Continuation of weak market conditions, particularly in the rugged outdoor segment, resulted in the decline in net sales for second quarter 2002 compared to last year. In addition, unusually warm weather conditions throughout most of the 2001-2002 winter selling season for rugged outdoor footwear adversely affected sales for the Company's retail customers and therefore orders during 2002.

The Company had increased sales of military boots and Wild Wolf<sup>®</sup> by Rocky<sup>®</sup> footwear during second quarter 2002 compared to last year, and made initial shipments of ROCKY<sup>®</sup> Kids footwear and ROCKY<sup>®</sup> Gear clothing and accessories during the quarter. These sales gains were offset by lower sales in the rugged outdoor footwear, occupational and casual footwear categories. The Company began shipping military footwear in second quarter 2001 pursuant to a contract with the U.S. Government. Second quarter 2002 net sales included \$2,600,000 of military boots versus \$1,700,000 for the same period in 2001. All orders under this contract have been shipped and the contract was completed as of June 30, 2002.

### *Gross Margin*

Gross margin decreased \$1,214,496, or 19.7%, to \$4,937,633 for the quarter ended June 30, 2002 compared to \$6,152,129 for the same period in 2001. As a percentage of net sales, gross margin was 25.7% this year compared to 28.0% a year ago. The change in product mix, with military boots representing a higher percentage of net sales in second quarter 2002, negatively affected the gross margin. Military boots are produced at lower gross margin than footwear in the Company's other categories. Positive contributions were realized from the manufacturing realignment announced during third quarter 2001 and incremental benefits are expected in future periods.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses ("SG&A") decreased \$174,949, or 3.7%, to \$4,517,033 for the quarter ended June 30, 2002 compared to \$4,691,982 for the same period a year ago. As a percentage of net sales, SG&A increased to 23.5% versus 21.4% a year ago. Despite the shortfall in sales, progress was achieved regarding controllable costs. Cost reduction programs have been implemented during the past 18 months to streamline operations and improve operating efficiency. These savings enhanced the Company's results in second quarter 2002 despite the challenging retail environment, and incremental benefits are expected in future periods.

### *Interest Expense*

Interest expense decreased \$299,726, or 47.4%, to \$332,959 in the quarter ended June 30, 2002 compared to \$632,685 the same quarter a year ago. The Company benefited from lower outstanding balances and, to a lesser extent, more favorable interest rates compared with second quarter 2001. The Company's funded debt decreased 42.7% to \$20,485,201 at June 30, 2002 versus \$35,729,114 a year ago due to a \$10,064,966 reduction in inventory and a \$5,125,143 decline in accounts receivable at June 30, 2002 compared with last year.

### *Income Taxes*

Income taxes for the three months ended June 30, 2002 decreased to \$48,752 compared to \$272,164 for the same period a year ago. The decrease in income tax expense is due to reduced operating income in the current quarter as compared with the prior year. The Company's effective tax rate of 29.4% for the three months ended June 30, 2002 compares with an effective tax rate of 27.9% for the same period last year.

## **Six Months Ended June 30, 2002 compared to the Six Months Ended June 30, 2001**

### *Net Sales*

Net sales for the six months ended June 30, 2002 decreased \$5,126,368 or 13.5% to \$32,943,659 versus \$38,070,027 for the same period a year ago. This decline is generally attributable to the continuation of weak market conditions combined with the inventory impact from the unusually warm 2001-2002 winter season. These factors particularly affected sales in the rugged outdoor category. Sales of occupational and casual footwear were primarily impacted by weak market conditions.

Sales of military boots increased during the first half of 2002. In addition, the Company made initial shipments of ROCKY® Kids footwear and ROCKY® Gear clothing and accessories during this period. The Company began shipping military footwear in second quarter 2001 pursuant to a contract with the U.S. Government. Military boot sales totaled \$6,400,000 during the first six months of 2002 compared to \$1,700,000 for the same period last year. All orders under this contract were shipped as of June 30, 2002.

### *Gross Margin*

Gross margin for the six months ended June 30, 2002 decreased \$2,040,917, to \$7,278,286 versus \$9,319,203 for the same period a year ago. As a percentage of net sales, gross margin was 22.1% in the first half of 2002 versus 24.5% for the same period a year ago. Similar to the second quarter, higher sales of military boots, which are produced at a lower margin than the Company's branded footwear, affected product mix and gross margin for the first six months of 2002 compared to last year. Positive contributions were realized from the manufacturing realignment announced during third quarter 2001 and incremental benefits are expected in future periods.

### *Selling, General and Administrative Expenses*

Selling, general, and administrative expenses (SG&A) for the six months ended June 30, 2002 were \$8,416,534 compared with \$8,700,481 for the same period a year ago. SG&A expenses were 25.5% of net sales in the first half of 2002 versus 22.9% in 2001. Cost reduction programs have been implemented during the past 18 months to streamline operations and improve operating efficiency. These savings enhanced the Company's results for the first six months of 2002 despite the challenging retail environment.

### *Interest Expense*

Interest expense for the six months ended June 30, 2002 decreased \$595,714 or 49.2% to \$616,068 versus \$1,211,782 for the same period a year ago. The significant reduction is principally due to lower borrowings, and, to a lesser extent, the decline in interest rates versus the prior year. The Company's funded debt decreased 42.7% to \$20,485,201 at June 30, 2002 versus \$35,729,114 a year ago. This was primarily due to the \$10,064,966 reduction in inventory and a \$5,125,143 reduction in accounts receivable compared to the same date in 2001.

### *Income Taxes*

Income tax benefit increased to \$477,186 for the six months ended June 30, 2002 from \$109,278 for the comparable period last year. The Company's effective tax benefit rate of 30.1% for the first half of 2002 compares with 34.9% for the same period last year.

### *Liquidity and Capital Resources*

The Company has principally funded working capital requirements and capital expenditures through borrowings under its line of credit and other indebtedness. Working capital is primarily used to support changes in accounts receivable and inventory principally as a result of the Company's seasonal business cycle. These requirements are generally lowest in the months of January through March of each year, and highest during the months of May through October. In addition, the Company requires financing to develop and introduce new footwear styles, and, to a lesser extent, for machinery, equipment and facilities due to the increased percentage of sourced footwear sold and the recently completed manufacturing realignment. At June 30, 2002, the Company had working capital of \$45,147,702 versus \$44,266,895, at December 31, 2001.

The Company's line of credit, which extends through September 2003, provides for advances based on a percentage of eligible accounts receivable and inventory with maximum borrowings under the line of credit of \$50,000,000. The Company had borrowed \$14,272,775 against its currently available line of credit of \$19,228,129 at June 30, 2002.

The Company's cash flow used in operations decreased to \$3,296,656 in first half of 2002 from \$8,432,130 for the same period in the prior year. The period over period comparison reflects smaller increases in accounts receivable and inventory in the current year, which were partially offset by the increased net loss. All of the related balance sheet fluctuations reflect the seasonal nature of the Company's business and are normal when consideration is given to reduced net sales for the 2002 year-to-date period and the Company's emphasis on inventory management.

The principal use of cash flows in investing activities for the first six months of 2002 and 2001 has been for investment in property, plant, and equipment. In the first half of 2002, property, plant, and equipment expenditures were approximately \$1,268,000 versus \$453,000 for the same period in 2001. During the first half of 2002, the Company made investments in its Puerto Rico factory that enhanced manufacturing capabilities. In addition, projects have been initiated to upgrade sales and customer support capabilities.

The Company's cash flows from financing activities reflect the increases and decreases in borrowings under its revolving credit facility and long-term mortgage facility to finance working capital requirements and other operating capital expenditures.

### *Inflation*

The Company cannot determine the precise effects of inflation; however, inflation continues to have an influence on the cost of materials, salaries, and employee benefits. The Company attempts 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 the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its estimates and judgments, including those related to accounts receivable, inventories, pension benefits, income taxes, and restructuring costs. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Management believes the following critical accounting policies, among others, affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

### *Accounts receivable allowances*

Management maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of the Company's 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 the Company, additional allowances may be required.

### *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 the Company's inventories are considered saleable and the Company has been able to liquidate any slow moving or obsolete inventories through the Company's factory clearance center or through various discounts to customers. Should management encounter difficulties liquidating slow moving or obsolete inventories, additional provisions may be required.

### *Pension benefits*

Management records an accrual for pension costs associated with the Company sponsored noncontributory defined benefit pension plans covering the union and non-union workers of the Company's operations. Future adverse changes in market conditions or poor operating results of underlying plan assets could result in losses or a higher accrual.

### *Income taxes*

Currently, management has not recorded a valuation allowance to reduce its deferred tax assets to the amount that it believes is more likely than not to be realized. The Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, however in the event the Company were to determine that it would not be able to realize all or part of its 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. Likewise, should the Company determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax assets would increase income in the period such determination was made.

### *Restructuring costs*

As disclosed in Note 2 of Notes to the Interim Unaudited Condensed Consolidated Financial Statements, in 2001 management established an accrual for estimated restructuring and realignment costs associated with the closing of its Nelsonville manufacturing facility. The Company expects no additional restructuring and realignment costs associated with this plan, however should the Company incur additional costs related to the closing of the manufacturing facility, additional accruals may be required.

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

The foregoing Management's Discussion and Analysis of Financial Condition and Results of Operations 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 intent, beliefs, expectations, projections, forecasts, and plans of the Company and its management, and include any statements regarding gross margin (paragraphs 4 and 10), and selling, general and administrative expenses (paragraph 5). Investors are cautioned that such statements involve risks and uncertainties, including, but not limited to, changes in consumer demand, seasonal fluctuations, impact of weather, competition, reliance on suppliers, changing retailing trends, reliance on foreign manufacturing, changes in tax rates, capital expenditures, limited protection of proprietary technology, and other risks, uncertainties and factors described in the Company's most recent Annual Report on Form 10-K and other filings from time to time with the Securities and Exchange Commission. One or more of these factors have affected, and in the future could affect the Company's business and financial results and cause actual results to differ materially from plans and projections. Although the Company and its management 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 contained herein, the inclusion of such information should not be regarded as a representation by the Company, its management or any other person that the Company's objectives and plans will be achieved. All forward-looking statements made herein are based on information presently available to the management of the Company. The Company undertakes no obligation to publicly update or revise any forward-

looking statements.

## **PART 1 - FINANCIAL INFORMATION**

### **Item 3 - Quantitative and Qualitative Disclosures About Market Risk**

There have been no material changes since December 31, 2001.

## **PART II -- OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

None

### **Item 2. Changes in Securities and Use of Proceeds.**

None

### **Item 3. Defaults Upon Senior Securities.**

None

### **Item 4. Submission of Matters to a Vote of Security Holders.**

The 2002 Annual Meeting of Shareholders was held on May 15, 2002, and the following proposals were acted upon:

Proposal 1: The election of Class II Directors of the Company, each to serve until the 2004 Annual Meeting of Shareholders or until their successors are elected and qualified:

|                    | Number of Shares Voted |                       |           |
|--------------------|------------------------|-----------------------|-----------|
|                    | FOR                    | WITHHOLD<br>AUTHORITY | TOTAL     |
| Leonard L. Brown   | 3,689,453              | 324,050               | 4,013,503 |
| David Fraedrich    | 3,070,718              | 942,785               | 4,013,503 |
| Curtis A. Loveland | 3,690,503              | 323,000               | 4,013,503 |
| Robert D. Rockey   | 3,688,603              | 324,900               | 4,013,503 |

Proposal 2: To approve and adopt amendments to the Company's 1995 Stock Option Plan.

| Number of Shares Voted |                       |           |           |
|------------------------|-----------------------|-----------|-----------|
| FOR                    | WITHHOLD<br>AUTHORITY | ABSTAINED | TOTAL     |
| 3,178,196              | 828,732               | 6,575     | 4,013,503 |

Proposal 3: To ratify appointment of Deloitte & Touche LLP to serve as the Company's independent public accountants for the fiscal year ending December 31, 2002.

| Number of Shares Voted |         |           |           |
|------------------------|---------|-----------|-----------|
| FOR                    | AGAINST | ABSTAINED | TOTAL     |
| 4,007,593              | 3,550   | 2,360     | 4,013,503 |

**Item 5. Other Information.**

None

**Item 6. Exhibits and Reports on Form 8-K.**

(a) Exhibits.

|              |  |
|--------------|--|
| Exhibit 10.1 | Fifth Amendment to Loan and Security Agreement, dated June 21, 2002, among the Company, Lifestyle Footwear, Inc., and GMAC Business Credit, LLC. |
| Exhibit 99.1 | Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002.                          |
| Exhibit 99.2 | Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002.                          |

(b) Reports on Form 8-K. None

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 SHOES & BOOTS, INC.

Date: August 13, 2002

/s/ James E. McDonald  
James E. McDonald, Vice President and  
Chief Financial Officer\*

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

**AMENDMENT TO LOAN AND SECURITY AGREEMENT**

**THIS AMENDMENT TO LOAN AND SECURITY AGREEMENT** (this “Amendment”) is entered into as of the 21st day of June, 2002, by and between GMAC BUSINESS CREDIT, LLC, a Delaware limited liability company (“Lender”), and ROCKY SHOES & BOOTS, INC., an Ohio corporation, and LIFESTYLE FOOTWEAR, INC., a Delaware corporation (each a “Borrower” and collectively, the “Borrowers”).

**WITNESSETH:**

**WHEREAS**, Lender and Borrowers entered into that certain Loan and Security Agreement dated as of September 18, 2000, as amended from time to time (collectively, the “Agreement”); and

**WHEREAS**, as a result of certain changes in law regarding the granting and perfection of security interests, the parties hereto now desire to amend the Agreement to reflect such changes in the law.

**NOW, THEREFORE**, for and in consideration of the premises and mutual agreements herein contained and for the purposes of setting forth the terms and conditions of this Amendment, the parties, intending to be bound, hereby agree as follows:

1. Incorporation of the Agreement. All capitalized terms that are not defined hereunder shall have the same meanings as set forth in the Agreement, and the Agreement, to the extent not inconsistent with this Amendment, is incorporated herein by this reference as though the same were set forth in its entirety. To the extent any terms and provisions of the Agreement are inconsistent with the amendments set forth in Paragraph 2 below, such terms and provisions shall be deemed superseded hereby. Except as specifically set forth herein, the Agreement shall remain in full force and effect and its provisions shall be binding on the parties hereto.

2. Amendment of the Agreement. The Agreement is hereby amended as follows:

(a) Any and all references to the Agreement shall be deemed to refer to and include this Amendment, as the same may be further amended, modified, restated or supplemented from time to time.

(b) The definitions of the terms “Commercial Tort Claim,” “Deposit Account,” “Electronic Chattel Paper,” “Letter-of-Credit Rights,” “Payment Intangibles,” “Software,” “Supporting Obligations” and “Tangible Chattel Paper” shall have the meanings assigned thereto in the Uniform Commercial Code.

(c) The definitions of the terms “Computer Hardware and Software,” “New Collateral,” “Organizational I.D. Number,” “Type of Organization” and “Uniform Commercial Code” are hereby appended to Section 2 of the Agreement to read in their entirety as follows:

“Computer Hardware and Software” means all rights (including rights as licensee and lessee) with respect to (i) computer and other electronic data processing hardware, including all integrated computer systems, central processing units, memory units, display terminals, printers, computer elements, card readers, tape drives, hard and soft disk drives, cables, electrical supply hardware, generators, power equalizers, accessories, peripheral devices and other related computer hardware; (ii) all Software and all software programs designed for use on the computers and electronic data processing hardware described in clause (i) above, including all operating system software, utilities and application programs in whatsoever form (source code and object code in magnetic tape, disk or hard copy format or any other listings whatsoever); (iii) any firmware associated with any of the foregoing; and (iv) any documentation for hardware, software and firmware described in clauses (i), (ii) and (iii) above, including flow charts, logic diagrams, manuals, specifications, training materials, charts and pseudo codes; including all rights with respect thereto, including any and all licenses, options, warranties, service contracts, program services, test rights and indemnifications, and any substitutions, replacements, additions or model conversions of any of the foregoing.

“New Collateral” shall mean, collectively, Accounts, Commercial Tort Claims, Deposit Accounts, Electronic Chattel Paper, Letter-of-Credit Rights, Payment Intangibles, Software, Supporting Obligations, Tangible Chattel Paper and Computer Hardware and Software; provided, however, notwithstanding anything to the contrary contained herein, the term “New Collateral” shall not include any Excluded Property, “Excluded Property” means (i) any Equipment that is subject to a “purchase money security interest”, as such term is now or hereafter defined in the UCC, which (x) constitutes a Permitted Lien under the Agreement and (y) prohibits the creation by a Borrower of a junior security interest therein, unless the holder thereof has consented to the creation of such a junior security interest; (ii) any Computer Hardware and Software, General Intangibles, contract right, license agreement or any other agreement if and to the extent that (A) in the case of any such Collateral, (x) any contract evidencing the same contains a contractual restriction or limitation which prohibits the grant or creation of a security interest therein, or (y) a restriction or limitation imposed by applicable law, regulation, rule, order or other directive of any governmental body, agency or authority, or the order of any court of competent jurisdiction, prohibits the grant or creation of a security interest in such item of Collateral, or (B) in the case of any such item of Collateral, such item would be subject to loss or forfeiture upon the grant or creation of a security interest therein by reason of (x) a contractual restriction or limitation contained in any such contract evidencing the same, or (y) a restriction or limitation imposed by applicable law, regulation, rule, order or other directive of any governmental body, agency or authority, or the order of any court of competent jurisdiction; and (iii) any depository account maintained by any Borrower used solely (A) for petty cash purposes; (B) for payroll; (C) for charitable contributions; or (D) for medical expenses or payments, pension benefits, employee benefits, employee taxes, stock options and like special purpose employee accounts.

“Organizational I.D. Number” means, with respect to a Borrower, the organizational identification number assigned to such Borrower by the applicable governmental unit or agency of the jurisdiction of organization for the Borrower.

“Type of Organization” means, with respect to a Borrower, the kind or type of entity of such Borrower, such as a corporation or limited liability company.

“Uniform Commercial Code” means the Uniform Commercial Code as in effect in the State of Michigan on the date of this Agreement, as may be amended or otherwise modified and in effect from time to time; provided that, if the context so requires, “Uniform Commercial Code” shall mean the Uniform Commercial Code as in effect from time to time in any applicable jurisdiction.

(d) The definition of the terms “Accounts” and “General Intangibles” appearing in Section 2 of the Agreement are hereby amended and restated in their entirety to read as follows:

“Accounts” shall have the meaning given to such term in the Uniform Commercial Code.

“General Intangibles” shall have the meaning given to such term in the Uniform Commercial Code.

(e) The definition of the term “Collateral” appearing in Section 2 of the Agreement is deemed amended to add thereto and include, without limitation (including for purposes of this Amendment), the New Collateral as of the date of the original grant of security interest by each Borrower to Lender.

(f) The introductory paragraph of Section 2 is hereby amended by inserting the following sentence at the beginning of such paragraph:

Except as otherwise defined in this Agreement or the Loan Documents, all words, terms and/or phrases used herein and therein shall be defined by the applicable definition therefor (if any) in the Uniform Commercial Code.

(g) Section 5.1 is hereby amended by renumbering the current text of Section 5.1 as subparagraph (a) and inserting the following text as Section 5.1(b):

(b) In addition to the grant of security interest set forth above, each Borrower hereby grants to Lender, to secure payment when due (at maturity or otherwise) of such Borrower's Obligations, a continuing, first priority lien and security interest in and to each item of New Collateral (subject to Permitted Liens), whether now existing or owned, or hereafter arising or acquired, regardless of where located.

(h) A new Section 5.6 is hereby appended to the Agreement to read in its entirety as follows:

5.6 Further Assurances. Each Borrower hereby irrevocably authorizes Lender at any time, and from time to time, to file in any jurisdiction any initial financing statements and amendments thereto with respect of any property in which any of the Borrowers have granted to Lender a security interest or collateral assignment that (A) indicate the Collateral (y) as all assets of a Borrower or words of similar effect, regardless of whether any particular asset comprised in the Collateral falls within the scope of Article 9 of the Uniform Commercial Code of the jurisdiction wherein such financing statement or amendment is filed, or (z) as being of an equal or lesser scope or within greater detail, and (B) contain any other information required by Part 5 of Article 9 of the Uniform Commercial Code of the jurisdiction wherein such financing statement or amendment is filed regarding the sufficiency or filing office acceptance of any financing statement or amendment, including (y) the Type of Organization and the Organizational I.D. Number issued to the Borrower and (z) in the case of a financing statement filed as a fixture filing or indicating Collateral to be extracted collateral or timber to be cut, a sufficient description of real property to which the Collateral relates. Each Borrower further ratifies and affirms its authorization for any financing statements and/or amendments thereto, filed by Lender in any jurisdiction prior to the date of this Agreement.

(i) A new Section 5.7 is hereby appended to the Agreement to read in its entirety as follows:

5.7 Additional Collateral. Each Borrower shall promptly notify Lender, in writing, of the existence of any Collateral consisting of Deposit Accounts, Investment Property, Letter-of-Credit Rights or Electronic Chattel Paper and shall, upon the request of Lender, promptly execute such other documents, and do such other acts or things deemed appropriate by Lender to deliver to Lender control with respect to such Collateral; with respect to Collateral in the possession of a third party, other than Certificated Securities and Goods covered by a Document, an acknowledgment from the third party that it is holding the Collateral for benefit of the Lender; and promptly notify Lender, in writing, upon incurring or otherwise obtaining a Commercial Tort Claim in excess of the sum of \$100,000 after the date hereof against any third party, and, upon the request of Lender, will promptly enter into an amendment to this Agreement, and do such other acts or things deemed reasonably appropriate by Lender to give Lender a security interest in such Commercial Tort Claim.

(j) A new Section 6.25 is hereby appended to the Agreement to read in its entirety as follows:

6.25 Organization. Each Borrower's state of organization, Type of Organization, and Organizational I.D. Number are as follows:

Rocky Shoes & Boots, Inc.

State of Organization: Ohio

Type of Organization: corporation

Organizational I.D. Number: 821674

Lifestyle Footwear, Inc.

State of Organization: Delaware

Type of Organization: corporation

Organizational I.D. Number: 2109896

(k) Section 12.21(d) is hereby amended and restated to read in its entirety as follows:

(d) Reserved.

3. Representations, Covenants and Warranties; No Default. The representations, covenants and warranties set forth in the Agreement shall be deemed remade as of the date hereof by each Borrower (other than representations and warranties made as of a particular date), except that any and all references to the Agreement in such representations and warranties shall be deemed to include this Amendment. Each Borrower hereby represents and confirms that no Event of Default has occurred and is continuing and no event has occurred and is continuing that, with the lapse of time, the giving of notice, or both, would constitute such an Event of Default under the Agreement.

4. Delivery of Documents. Notwithstanding any of the foregoing, prior to or contemporaneously with the making of the Amendment, Lender shall have received from each Borrower a fully executed copy of this Amendment and each other document, instrument or agreement requested by Lender, each in form and substance satisfactory to Lender, and all of the transactions contemplated by each such document shall have been consummated or each condition contemplated by each such document shall have been satisfied.

5. Fees and Expenses. Each Borrower agrees to pay on demand all costs and expenses of or incurred by Lender (including, but not limited to, legal fees and expenses) in connection with the evaluation, negotiation, preparation, execution and delivery of this Amendment and all related documents, instruments and agreements.

6. Effectuation. The amendments to the Agreement contemplated by this Amendment shall be deemed effective immediately upon the full execution of this Amendment and without any further action required by the parties hereto. There are no conditions precedent or subsequent to the effectiveness of this Amendment.

7. Continuing Effect. Except as otherwise specifically set forth herein, the provisions of the Agreement shall remain in full force and effect. Each Borrower hereby reaffirms its grant of the security interest in the Collateral, as amended hereby.

8. Counterparts. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original, and all of which together shall constitute one and the same instrument.

Amendment to Loan and Security Agreement Signature Page

**IN WITNESS WHEREOF**, the parties hereto have duly executed this Amendment to Loan and Security Agreement as of the date first above written.

**ROCKY SHOES & BOOTS, INC.**,  
an Ohio corporation

By:     /s/ James E. McDonald      
Name: James E. McDonald  
Title: V.P. & C.F.O.

**LIFESTYLE FOOTWEAR, INC.**,  
a Delaware corporation

By:     /s/ James E. McDonald      
Name: James E. McDonald  
Title: V.P. & C.F.O.

**GMAC BUSINESS CREDIT, LLC**,  
a Delaware limited liability company

By:     /s/ Kathryn Williams      
Name: Kathryn Williams  
Title: Vice President



**ROCKY SHOES & BOOTS, INC.**  
**CERTIFICATION PURSUANT TO**  
**18 U.S.C. SECTION 1350,**  
**AS ADOPTED PURSUANT TO**  
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Rocky Shoes & Boots, Inc. (the “Company”) on Form 10-Q for the period ending June 30, 2002, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, James E. McDonald, Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ James E. McDonald  
James E. McDonald, Vice President  
and Chief Financial Officer  
August 13, 2002