Financial Statements

Rockford Corporation
Years Ended December 31, 2010, 2009 and 2008
With Report of Independent Auditors

Ernst & Young LLP

Ernst & Young

Rockford Corporation

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Contents

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Report of Independent Auditors

Board of Directors and Shareholders
Rockford Corporation

We have audited the accompanying balance sheets of Rockford Corporation as of December 31, 2010 and 2009, and the related statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Rockford Corporation at December 31, 2010 and 2009, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 31, 2011

Rockford Corporation

Balance Sheets

(In Thousands, Except Share Data)

	December 31	
	2010	**2009**
Assets		
Current assets:		
Cash and cash equivalents	**$ –**	$ –
Accounts receivable, less allowances of $793 and $940 at December 31, 2010 and 2009, respectively	**8,684**	9,946
Inventories	**5,818**	5,754
Prepaid expenses and other	**547**	378
Total current assets	**15,049**	16,078
Property and equipment, net	**1,525**	1,540
Other assets	**262**	177
Total assets	**$ 16,836**	$ 17,795
Liabilities and shareholders’ equity		
Current liabilities:		
Accounts payable	**$ 4,262**	$ 5,269
Accrued salaries and incentives	**785**	737
Accrued warranty and returns	**546**	740
Accrued customer programs	**651**	645
Other accrued expenses	**1,403**	1,289
Notes payable	**–**	2,603
Asset-based credit facility	**1,509**	1,630
Total current liabilities	**9,156**	12,913
Other long-term liabilities	**109**	213
Total liabilities	**9,265**	13,126
Commitments and contingencies		
Shareholders’ equity:		
Common stock, $.01 par value, authorized shares – 40,000,000; issued shares – 9,541,227 and 9,395,720 at December 31, 2010 and 2009, respectively	**96**	94
Additional paid-in capital	**38,867**	38,680
Accumulated deficit	**(30,081)**	(32,794)
Less: treasury stock, at cost (814,512 shares at December 31, 2010 and 2009, respectively)	**(1,311)**	(1,311)
Total shareholders’ equity	**7,571**	4,669
Total liabilities and shareholders’ equity	**$ 16,836**	$ 17,795

See accompanying notes.

Rockford Corporation

Statements of Operations

(In Thousands, Except Per Share Data)

	Year Ended December 31		
	2010	**2009**	**2008**
Net sales	**$ 54,231**	$ 52,975	$ 68,874
Cost of goods sold	**34,251**	36,124	47,670
Gross profit	**19,980**	16,851	21,204
Operating expenses:			
Sales and marketing	**7,972**	7,990	11,805
General and administrative	**7,196**	7,981	11,201
Research and development	**1,993**	1,758	2,646
Total operating expenses	**17,161**	17,729	25,652
Operating income (loss)	**2,819**	(878)	(4,448)
Interest expense	**209**	525	850
Other income	**(32)**	(653)	(847)
Income (loss) before income taxes	**2,642**	(750)	(4,451)
Income tax (benefit) expense	**(71)**	–	24
Net income (loss)	**$ 2,713**	$ (750)	$ (4,475)
Net income (loss) per common share:			
Basic	**$ 0.32**	$ (0.09)	$ (0.51)
Diluted	**$ 0.30**	$ (0.09)	$ (0.51)
Weighted-average common shares outstanding:			
Basic	**8,593**	8,581	8,697
Diluted	**9,170**	8,581	8,697

See accompanying notes.

Rockford Corporation

Statements of Shareholders' Equity

(In Thousands)

	Common Stock		Additional Paid-In	Accumulated	Treasury Stock		
	Shares	Amount	Capital	Deficit	Number	Amount	Total
Balance at December 31, 2007	9,396	$ 94	$ 38,319	$ (27,569)	450	$ (898)	9,946
Net loss	–	–	–	(4,475)	–	–	(4,475)
Share-based compensation	–	–	235	–	–	–	235
Purchase of treasury stock	–	–	–	–	365	(413)	(413)
Balance at December 31, 2008	9,396	94	38,554	(32,044)	815	(1,311)	5,293
Net loss	–	–	–	(750)	–	–	(750)
Share-based compensation	–	–	126	–	–	–	126
Balance at December 31, 2009	9,396	94	38,680	(32,794)	815	(1,311)	4,669
Net income	**–**	**–**	**–**	**2,713**	**–**	**–**	**2,713**
Share-based compensation	**–**	**–**	**107**	**–**	**–**	**–**	**107**
Exercised share-based awards	**145**	**2**	**80**	**–**	**–**	**–**	**82**
Balance at December 31, 2010	**9,541**	**$ 96**	**$ 38,867**	**$ (30,081)**	**815**	**$ (1,311)**	**$ 7,571**

See accompanying notes.

Rockford Corporation

Statements of Cash Flows
(In Thousands)

	Year Ended December 31		
	2010	**2009**	**2008**
Operating activities			
Net income (loss)	**$ 2,713**	$ (750)	$ (4,475)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	**589**	754	1,654
Share-based compensation	**107**	126	235
Write-down of asset to fair value	**–**	33	188
Net gain on buyback of notes and warrants	**–**	(497)	(812)
Gain on sale of property and equipment	**(21)**	(89)	(98)
Provision for doubtful accounts	**179**	306	1,431
Provision for inventories	**251**	123	1,049
Changes in operating assets and liabilities:			
Accounts receivable	**1,084**	2,605	1,597
Inventories	**(316)**	7,167	260
Prepaid expenses and other	**(168)**	139	385
Accounts payable	**(1,007)**	1,289	(1,814)
Accrued salaries and incentives	**48**	(634)	(111)
Accrued warranty and returns	**(194)**	40	(567)
Accrued customer programs	**5**	29	(50)
Other accrued expenses	**114**	234	220
Net cash provided by (used in) operating activities	**3,384**	10,875	(908)
Investing activities			
Purchases of property and equipment	**(765)**	(459)	(1,016)
Proceeds from sale of property and equipment	**77**	89	116
Net proceeds from disposal of assets	**–**	–	100
Increase in other assets	**(54)**	67	62
Net cash used in investing activities	**(742)**	(303)	(738)
Financing activities			
Payments on notes payable	**(2,603)**	(4,603)	(1,277)
Proceeds from bank debt and short-term notes	**55,519**	50,582	76,620
Payments on bank debt and short-term notes	**(55,640)**	(56,499)	(72,546)
Payments on capital lease obligations	**–**	(52)	(47)
Payments on litigation settlement	**–**	–	(691)
Purchase of treasury stock	**–**	–	(413)
Proceeds from share-based awards	**82**	–	–
Net cash (used in) provided by financing activities	**(2,642)**	(10,572)	1,646
Net increase (decrease) in cash and cash equivalents	**–**	–	–
Cash and cash equivalents at beginning of year	**–**	–	–
Cash and cash equivalents at end of year	**$ –**	$ –	$ –

See accompanying notes.

Rockford Corporation

Notes to Financial Statements

December 31, 2010

1. Background

Organization and Description of Business

Rockford Corporation (Rockford) designs and distributes high-performance mobile audio products, primarily under the Rockford Fosgate, Lightning Audio, Renegade, and Rockford Acoustic Design brands. Prior to 2009, Rockford also assembled certain of its products but it now outsources all of its production. Rockford was organized and incorporated under the laws of the state of Arizona on July 22, 1980. Rockford's corporate headquarters and distribution facility are located in Arizona. Manufacturing is performed by third-party manufacturers in Asia.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid investments with remaining maturities of three months or less when acquired. Rockford's cash equivalents have consisted of commercial paper, certificates of deposit and money market accounts. Accounts receivable from credit card processors are also considered cash equivalents because they are both short-term and highly liquid in nature and are typically converted to cash within two to three days of the sales transactions.

Fair Value of Financial Instruments

Fair value guidance defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, fair value guidance establishes a three-tier fair value hierarchy that prioritizes the inputs used in measuring fair value as follows:

> Level 1: Observable inputs, such as quoted prices in active markets for identical assets or liabilities at the measurement date;
>
> Level 2: Observable inputs, other than Level 1 inputs in active markets, for similar assets or liabilities that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data, by correlation or other measure

2. Summary of Significant Accounting Policies (continued)

Level 3: Price or valuation techniques that require unobservable inputs for which there is little or no market data, which require the reporting entity to develop its own assumptions

Rockford determines the estimated fair value of financial instruments using available market information and valuation methodologies. Considerable judgment is required in estimating fair values. Accordingly, the estimates may not be indicative of the amounts that the financial instruments could realize in a current market exchange.

The carrying amounts of accounts receivable, accounts payable, accrued salaries and incentives, accrued warranty and returns and other accrued expenses approximate fair values based on the liquidity of these financial instruments or based on their short-term nature. The carrying value of Rockford's borrowings under its asset-based credit facility approximates fair value.

Revenue Recognition

Rockford recognizes revenue and records sales, net of related discounts, when all of the following criteria are met:

- Persuasive evidence of an arrangement exists
- Ownership has transferred to the customer
- The price to the customer is fixed or determinable
- Collectability is reasonably assured

Rockford sells the majority of its products F.O.B. place of shipment, so that upon shipment of products, the above criteria are met and revenue is recognized. Rockford also records reductions to revenue for estimated customer returns and additional sales incentive offerings, such as growth and volume incentive rebates and prompt pay discounts, based on historical rates.

In addition, Rockford earns royalties by licensing its brand names and know-how to its customers for use in their products. Royalty revenue is recognized as the customer produces products using Rockford's brand names and know-how based upon the terms of the agreement and the production information provided by the licensee. The royalties are included in net sales on the statement of operations.

2. Summary of Significant Accounting Policies (continued)

Shipping and Handling Costs

Rockford records outbound product shipping costs as freight expense in sales and marketing expense. Freight expense for the years ended December 31, 2010, 2009 and 2008 was approximately $1.7 million, $1.7 million and $2.3 million, respectively.

Accounts Receivable and Allowances

Rockford sells its products principally to mobile audio dealers and distributors in North America, South America, Europe and Asia. Rockford also sells certain portions of its product line to major mass retailers in the United States and Canada. At December 31, 2010 and 2009, net accounts receivable included approximately $2.5 million and $2.4 million, respectively, due from international businesses.

Rockford maintains an allowance for doubtful accounts, based on historical rates and an assessment of the attributes of its customer amounts due at year end, for estimated losses resulting from the inability of its customers to make required payments. The allowance for doubtful accounts at December 31, 2010 and 2009, approximates $0.7 million and $0.9 million, respectively.

Rockford also maintains allowances for prompt pay discounts based on historical rates for discounts offered to customers. The allowance for prompt pay discounts at December 31, 2010 and 2009, approximates $0.1 million and $0.1 million, respectively, with respect to customers expected to use such discounts after year-end.

Inventories

Inventories consist principally of finished goods. Inventories are carried at the lower of cost or market computed using the weighted-average cost of purchased products plus freight. Rockford writes down estimated obsolete or unmarketable inventory by an amount equal to the difference between the cost of inventory and the estimated market value based upon assumptions regarding future demand, average selling price and market conditions. Such write downs establish a new inventory cost basis.

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment is stated at cost. Depreciation and amortization are computed principally on the straight-line method for financial reporting purposes over a period of two to ten years. Leasehold improvements are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the asset.

Impairment of Long-Lived Assets

Rockford records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets and is recorded in the period in which the determination is made.

Advertising

Rockford expenses advertising costs as incurred. Advertising expense for the years ended December 31, 2010, 2009 and 2008 was approximately $0.1 million, $0.1 million and $1.0 million, respectively. Such amounts are included in sales and marketing expense on the statements of operations.

Income Taxes

Rockford accounts for income taxes utilizing an asset and liability method, whereby deferred tax assets and liabilities are recognized in order to account for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled, net of valuation allowances. The effect on deferred tax assets and liabilities of a change in tax laws (including rates) is recognized in income in the period of the enactment date.

2. Summary of Significant Accounting Policies (continued)

Rockford assesses the likelihood that it will be able to recover its deferred tax assets. If recovery is not likely, Rockford will increase the provision, or decrease the benefit, by recording a valuation allowance against the deferred tax assets that Rockford estimates are not more-likely-than-not recoverable. As of December 31, 2010 and 2009, Rockford had a full valuation allowance against its deferred tax assets.

Product Warranty Cost and Returns

Rockford's return policy is to replace, repair or issue credit for product under warranty. Returns received are charged against the reserve maintained for future returns. Management provides a reserve for estimated returns at the time of sale and re-evaluates the reserve adequacy using historical return experiences by brand. These reserves are reviewed and adjusted periodically, as actual results become available.

Rockford maintains a warranty reserve, based on historical rates, for costs associated with the repair or replacement of product that fails to meet Rockford's standard warranty against defects in material and workmanship. The estimate is based upon a trend analysis of historical costs and the number of units expected to be subject to warranty claims using the historical estimated number of units likely to be returned.

Net Income per Common Share

Diluted net income per common share includes only the dilutive effects of stock options.

Significant Customers

Rockford had sales to one customer representing 0.8%, 19.0% and 16.9% of net sales for the years ended December 31, 2010, 2009 and 2008, respectively. This customer accounted for approximately 0.0% and 17.6% of the accounts receivable balance at December 31, 2010 and 2009, respectively.

Foreign Currency Translation

Monetary assets and liabilities denominated in foreign currencies are translated using the current exchange rates at the balance sheet date. The effect of translation on the statements of operations is insignificant.

2. Summary of Significant Accounting Policies (continued)

Share-Based Compensation

Rockford generally grants stock options for a fixed number of shares to employees, with an exercise price equal to the fair market value of the shares at the date of grant. Fair market value of the underlying shares is determined by the market price at the date of the grant.

Use of Estimates

The preparation of Rockford's financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The actual results experienced by Rockford may differ from management's estimates.

3. Inventories

Inventories consisted of the following:

	December 31	
	2010	**2009**
	(In Thousands)	
Raw materials	**$ 98**	$ 269
Work in progress	**16**	19
Finished goods	**5,704**	5,466
	$ 5,818	$ 5,754

4. Property and Equipment, Net

Property and equipment, net, consisted of the following:

	December 31 2010	December 31 2009
	(In Thousands)	
Machinery and equipment	**$ 3,466**	$ 3,295
Tooling equipment	**2,386**	3,230
Leasehold improvements	**1,788**	1,745
Furniture and fixtures	**366**	206
Computer software and hardware	**2,339**	2,502
Assets in process	**244**	89
	10,589	11,067
Less accumulated depreciation and amortization	**(9,064)**	(9,527)
	$ 1,525	$ 1,540

Depreciation expense was approximately $0.7 million, $0.7 million and $1.2 million for the years ended 2010, 2009 and 2008, respectively.

5. Notes Payable and Asset-Based Credit Facility

Notes payable and asset-based credit facility consisted of the following:

	December 31 2010	December 31 2009
	(In Thousands)	
Asset-based credit facility	**$ 1,509**	$ 1,630
Senior subordinated secured notes	–	2,500
Other	–	103
	$ 1,509	$ 4,233

Interest payments were approximately $0.2 million, $0.5 million and $1.2 million for the years ended December 31, 2010, 2009 and 2008, respectively.

5. Notes Payable and Asset-Based Credit Facility (continued)

Rockford entered into an asset-based credit facility with Wells Fargo Capital Financial (Wells Fargo) on March 29, 2004, which was amended most recently on April 1, 2010. This credit facility, as amended, is a $10 million asset-based credit facility, has a term expiring on March 24, 2014 and is collateralized by substantially all of Rockford's assets. Rockford's credit agreement prohibits the payment of cash dividends. Under the agreement, current pricing options based on LIBOR and prime rates are available to Rockford through March 31, 2011. Starting in April 2011, variable rate pricing options will increase to LIBOR plus 400 to 450 basis points. The LIBOR and prime interest rate options were approximately 2.26% and 3.25%, respectively, at December 31, 2010. As of December 31, 2010, Rockford was in compliance with all covenants under the asset-based credit facility. The availability under the credit facility at December 31, 2010 was approximately $6.8 million in excess of the outstanding balance of $1.5 million.

The Wells Fargo credit facility requires that Rockford maintain blocked lock box accounts, whereby Wells Fargo takes possession of all cash receipts on a daily basis and these amounts are applied to reduce Rockford's outstanding debt. Rockford has recorded the outstanding balances on the Wells Fargo credit facility as short-term. Rockford expects to maintain the facility for its entire term.

In January 2009, Rockford repurchased $2.5 million of convertible notes for approximately $2.0 million. In connection with this repurchase, Rockford recorded a gain to other income of approximately $0.5 million.

In April 2009, Rockford agreed with the sole holder of the remaining $5.0 million of convertible notes to amend the terms of the notes, increasing the interest rate from 4.5% to 10% as of June 10, 2009, and requiring four equal payments of $1.25 million on June 10, 2009; December 10, 2009; June 10, 2010 and December 10, 2010. All conversion rights and warrants were terminated at June 10, 2009. Rockford made $1.25 million payments on each of June 10, 2009 and December 10, 2009 and elected to repay the remaining $2.5 million in April 2010. As a result of the amendment and payments, Rockford had no outstanding senior subordinated secured notes at December 31, 2010. The notes were secured by a second priority lien on certain Rockford assets.

6. Leases

Rockford leases certain warehouse and office facilities and computer hardware and software under noncancelable operating leases that expire in various years through March 2015.

Future minimum payments under noncancelable operating leases with initial terms of one year or more consisted of the following at December 31, 2010 (in thousands):

2011	$	746
2012		758
2013		775
2014		690
2015		105
Thereafter		–
Total future minimum lease payments	$	3,074

Total rental expense for all operating leases was approximately $0.9 million, $1.0 million and $1.8 million for the years ended December 31, 2010, 2009 and 2008, respectively.

7. Income Taxes

Income tax (benefit) expense consisted of the following:

	Year Ended December 31		
	2010	**2009**	**2008**
		(In Thousands)	
Current:			
Federal expense	**$ –**	$ –	$ –
State (benefit) expense	**(71)**	–	24
Foreign (benefit) expense	**–**	–	–
Total current (benefit) expense	**(71)**	–	24
Deferred:			
Federal expense	**–**	–	–
State expense	**–**	–	–
Foreign expense	**–**	–	–
Total deferred expense	**–**	–	–
Income tax (benefit) expense	**$ (71)**	–	$ 24

7. Income Taxes (continued)

A reconciliation of Rockford's effective income tax rate to the federal statutory rate follows:

	Year Ended December 31		
	2010	**2009**	**2008**
	(In Thousands)		
Federal statutory rate	**$ 898**	$ (255)	$ (1,513)
State tax, net of federal benefit	**77**	–	–
State tax operating loss carryforwards	–	(19)	(73)
Nondeductible items	**28**	21	33
Federal and state tax credits	**(71)**	(105)	(132)
Loss of federal and state net operating loss carryforwards	**803**	388	–
Change in valuation allowance	**(1,751)**	(70)	2,188
Uncertain tax positions	–	–	(505)
Other, net	**(55)**	40	26
Income tax (benefit) expense	**$ (71)**	$ –	$ 24

Rockford's deferred tax assets consisted of the following:

	December 31	
	2010	**2009**
	(In Thousands)	
Deferred tax assets:		
Basis in inventories	**$ 588**	$ 552
Basis in receivables	**294**	296
Book over tax depreciation	**674**	416
Accrued warranty	**202**	274
Net operating loss carryforward	**17,610**	20,227
Capital loss carryforward	**945**	945
Federal and state credit carryforwards	**2,211**	2,211
Capitalized research expenditures	**654**	–
Accrued expenses and other	**598**	606
Gross deferred tax assets	**23,776**	25,527
Valuation allowance	**(23,776)**	(25,527)
Net deferred tax assets	**$ –**	$ –

7. Income Taxes (continued)

In 2010, 2009 and 2008, Rockford maintained a valuation allowance recorded on the entire amount of its deferred tax assets. During 2010, the valuation allowance decreased by $1.7 million to $23.8 million at December 31, 2010 as the result of utilizing net operating loss carryfowards in 2010 to offset taxable income and expiration of federal and state net operating losses. The Company does not believe that it is more likely than not that the benefits associated with its deferred tax assets will be realized in the near future. The valuation allowance includes approximately $0.1 million for net operating loss carryforwards that relate to stock option compensation expense and warrants expense for income tax reporting purposes. Rockford uses the "with-and-without" or "incremental" approach for determining the order in which tax benefits derived from share-based payments awards are utilized. Using the with-and-without approach, actual income taxes payable for the period are compared to the amount of income taxes that would have been payable if there had been no share-based compensation expense for tax purposes in excess of the compensation expense recognized for financial reporting purposes. As a result of this approach, tax net operating loss carryforwards not related to share-based compensation are utilized before the current period's share-based compensation deduction. As a result of this accounting treatment, the Company has a fully reserved deferred tax asset related to tax net operating loss carryforwards related to deductions for excess tax benefits. The benefit of the valuation allowance release related to these deductions will be recorded directly to equity as additional paid-in-capital when such benefits are realized.

At December 31, 2010, Rockford had the following carryforward tax attributes:

- Approximately $50.3 million of gross federal net operating loss carryforwards begin to expire in 2024. Approximately $11.0 million of state net operating loss carryforwards began to expire in 2011.

- Rockford has a capital loss carryforward for federal income tax purposes of $2.8 million that expires in 2012.

- Rockford also has approximately $2.2 million of federal and state tax credits for alternative minimum tax and research and experimentation. The research and experimentation credits begin to expire in 2022 and 2017 for federal and state tax purposes, respectively. However, the alternative minimum tax credits can be carried forward indefinitely.

7. Income Taxes (continued)

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	Year Ended December 31		
	2010	**2009**	**2008**
	(In Thousands)		
Balance at beginning of year	**$ 566**	$ 566	$ 1,071
Additions based on tax positions relating to current year	–	–	–
Additions for tax positions of prior years	–	–	–
Reductions for tax positions of prior years	–	–	(505)
Settlements	–	–	–
Balance at end of year	**$ 566**	$ 566	$ 566

In 2008, Rockford's unrecognized tax benefits decreased by $0.5 million due to the completion of an Internal Revenue Service review of Rockford's 2006 federal income tax return that was completed in October 2008. The recording of this unrecognized tax benefit reduced certain carryover attributes but had no effect on the effective tax rate because of the existence of a full valuation allowance.

Rockford recognizes interest and penalties related to uncertain tax positions in income tax expense. Rockford has not recorded any related expense in its statement of operations for 2010, 2009 and 2008. Rockford's 2007–2010 years remain subject to examination for federal income tax purposes, whereas the 2006–2010 years remain subject to examination for certain state taxing jurisdictions where Rockford operates. The statute of limitations for certain years may be extended if Rockford were to utilize certain of its carryover attributes from years outside of this range. Rockford does not expect the amount of unrecognized tax benefits to significantly increase or decrease over the next 12 months.

8. Share-Based Compensation

Rockford has established stock option plans for selected employees, directors and consultants. Under the stock option plans, options to purchase common stock of Rockford are granted to select employees, directors and consultants at the fair market value of the underlying common stock. Under certain circumstances, Rockford has the right to repurchase common stock acquired under some of the options at its fair market value.

8. Share-Based Compensation (continued)

At December 31, 2010, Rockford had three active share-based employee compensation plans. Stock option awards granted from these plans are granted at the fair market value on the date of grant and vest over a period determined at the time the options are granted, ranging from one to three years, and have a maximum term of ten years. Some options provide for accelerated vesting if there is a change in control (as defined in the plans). When options under any of the plans are exercised, new shares of Rockford's common stock are issued. At December 31, 2010, there were 281,925 shares available for grant under these plans.

Based upon a shareholder-approved plan, Rockford exchanged 982,300 outstanding "underwater" options for 582,800 market-priced options in November 2009. The new options vested one year from the November 2009 grant date. Forty optionees participated in the exchange. The exchange ratios were established such that the new options had approximately the same fair value as the options surrendered so that no significant additional compensation expense was recognized.

Share-based compensation expense for the years ended December 31, 2010, 2009 and 2008 was approximately $0.1 million, $0.1 million and $0.2 million, respectively. This share-based compensation expense lowered basic and diluted income per share by $0.01 for the year ended December 31, 2010, and increased basic and diluted loss per share by $0.01 and $0.03 for the years ended December 31, 2009 and 2008, respectively. The total value of stock option awards is expensed ratably over the service period of the employees receiving the awards. As of December 31, 2010, total unrecognized compensation cost related to nonvested stock option awards was approximately $0.1 million and the related weighted-average period over which these costs are expected to be recognized is approximately 1.7 years. The total fair value of options that vested during the years ended December 31, 2010, 2009 and 2008 was $0.6 million, $0.1 million and $0.2 million, respectively. The intrinsic value of options exercised during the years ended December 31, 2010, 2009 and 2008 was $0.1 million, $0 and $0, respectively. Options to purchase 460,000 shares, 582,787 shares and 350,000 shares were granted during the years ended December 31, 2010, 2009 and 2008, respectively. The weighted-average fair value of options granted during the years ended December 31, 2010, 2009 and 2008 was $0.32, $0.13 and $0.49, respectively.

The cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) are classified as financing cash flows. There were no excess tax benefits for the years ended December 31, 2010, 2009 and 2008.

8. Share-Based Compensation (continued)

The fair value of each stock option award was estimated on the date of the grant, using the Black-Scholes option pricing model with the following weighted average assumptions:

	Year Ended December 31		
	2010	**2009**	**2008**
Expected life of the award	**7 years**	4 years	5 years
Dividend yield	**0%**	0%	0%
Risk-free interest rate	**2.9%**	2.0%	3.2%
Expected volatility	**92%**	92%	52%

Option activity under the stock option plans during the year ended December 31, 2010, was as follows:

	Outstanding Options			
	Shares	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term**	**Aggregate Intrinsic Value**
Outstanding at January 1, 2010	925,221	$ 0.62		
Granted	460,000	0.25		
Exercised	(145,507)	0.56		
Expired, forfeited or cancelled	(87,896)	0.39		
Outstanding at December 31, 2010	1,151,818	0.50	6.9 years	$ 1,150,937
Exercisable at December 31, 2010	803,068	$ 0.54	6.1 years	$ 768,437

8. Share-Based Compensation (continued)

The following table summarizes information about stock options under the plans outstanding at December 31, 2010:

	Options Outstanding			Options Exercisable	
	Number Outstanding at December 31, 2010	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Outstanding at December 31, 2010	Weighted-Average Exercise Price
Range of exercise prices:					
$0.25–$0.40	866,818	6.6	$ 0.34	589,318	$ 0.38
$1.00	285,000	7.6	$ 1.00	213,750	$ 1.00
	1,151,818			803,068	

9. Net Income (Loss) Per Common Share

	Year Ended December 31		
	2010	**2009**	**2008**
	(In Thousands, Except Per Share Data)		
Net income (loss)	**$ 2,713**	$ (750)	$ (4,475)
Weighted-average common shares outstanding	**8,593**	8,581	8,697
Effect of dilutive securities:			
Employee stock options	**577**	–	–
Weighted-average common share outstanding for calculating diluted net income (loss) per share	**9,170**	8,581	8,697
Net income (loss) per common share:			
Basic	**$ 0.32**	$ (0.09)	$ (0.51)
Diluted	**$ 0.30**	$ (0.09)	$ (0.51)

9. Net Income (Loss) Per Common Share (continued)

The effect of 17,558 employee stock options, which would have increased net shares outstanding using the treasury stock method, was not included in the diluted loss per share calculation for December 31, 2008, as they were not dilutive due to the net loss for the period.

Outstanding stock options with exercise prices (plus unearned compensation for unvested awards) greater than the average market price of Rockford's common stock during the period are excluded from the computation of diluted net income (loss) per share of common stock. A summary of the excluded amounts follows:

	Year Ended December 31		
	2010	**2009**	**2008**
	(In Thousands, Except Exercise Prices)		
Outstanding options	–	925	1,592
Weighted-average exercise price	$ –	$ 0.62	$ 4.23

10. Commitments and Contingencies

Rockford is a party to legal proceedings arising in the ordinary course of business. Based upon advice from outside legal counsel, management is of the opinion the resolution of these matters will have no material effect on Rockford's financial position or results of operations.

11. Benefit Plan

Rockford has a 401(k) Retirement Savings Plan (the Plan) covering substantially all employees who have completed six consecutive months of service, without regard to hours of service. Under the terms of the Plan, employees may make voluntary contributions subject to Internal Revenue Service limitations. Rockford may match employee contributions up to 3% of the employee's annual compensation. Additional contributions to the Plan can be made at the discretion of the Board of Directors. Contributions to the Plan during the years ended December 31, 2010, 2009 and 2008, were approximately $0.1 million, $0 and $0.2 million, respectively.

12. Stock Purchase Program

In September 2007 and February 2008, Rockford's Board of Directors adopted two common share repurchase programs that authorized Rockford to purchase, in the open market or through negotiated transactions, up to approximately 920,000 of its outstanding common shares. Rockford's credit agreement permits aggregate stock purchases up to $3.5 million. Rockford has repurchased a total of 814,512 shares for an aggregate purchase price of approximately $1.3 million. Rockford did not repurchase any shares during 2010 and 2009 and has remaining authority to purchase up to 105,488 shares under these programs. In March 2011, Rockford's Board of Directors adopted a new repurchase program that authorized Rockford to purchase up to 870,000 shares, or approximately 10%, of the Company's common stock in the open market or through privately negotiated transactions. The new program expires on December 31, 2012, but may be suspended or discontinued at any time.

13. Segment Information

Rockford operates its business almost exclusively under the mobile audio segment. Below is geographic information for Rockford's revenues:

	Year Ended December 31			
	2010		2009	2008
Region[1]	Percent	Amount	Amount	Amount
			(In Thousands)	
United States	**81.0%**	**$ 43,945**	$ 44,111	$ 55,136
Other Americas (includes Canada)	**5.8**	**3,126**	3,095	6,076
Europe	**5.0**	**2,739**	2,790	4,648
Asia	**8.2**	**4,421**	2,979	3,014
Total net sales to external customers	**100.0%**	**$ 54,231**	$ 52,975	$ 68,874

[1]Net sales are attributed to geographic regions based on the location of customers.

14. Special Charges

During 2008, Rockford recorded special charges of approximately $1.1 million. The 2008 charges included costs associated with the elimination of two executive officer positions, severance cost for personnel who were discharged due to the planned closing of Rockford's Tempe manufacturing facility, costs associated with additional restructuring of administrative responsibilities and costs associated with the planned closing of its Michigan distribution facility in the second quarter of 2009.

Each of the special charges increased general and administrative expenses. Rockford completed all payments arising from these special charges by March 31, 2010. The following table summarizes the outstanding liabilities arising from these special charges at December 31, 2010 and 2009:

	2010	**2009**
	(In Thousands)	
Balance at beginning of year	**$ 103**	$ 740
Provision recorded during the year	–	119
Payments made during the year	**(94)**	(756)
Adjustments to reserve	**(9)**	–
Balance at end of year	**$** –	$ 103

15. Subsequent Events

Rockford evaluated subsequent events after the balance sheet date of December 31, 2010, through March 31, 2011, the date the financial statements were available to be issued and determined that any events or transactions occurring during this period that would require recognition or disclosure are appropriately addressed in these financial statements.

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