ROCKFORD CORPORATION

Rockford Corporation

December 31

2009

Consolidated Financial Statements

Rockford Corporation

Consolidated Financial Statements

Years Ended December 31, 2009, 2008 and 2007

Contents

Ernst & Young LLP
Ernst & Young Tower
One Renaissance Square
Suite 2300
2 North Central Avenue
Phoenix, AZ 85004

Tel: +1 602 322 3000
Fax: +1 602 322 3023
www.ey.com

Report of Independent Auditors

Board of Directors and Shareholders
Rockford Corporation

We have audited the accompanying consolidated balance sheets of Rockford Corporation and subsidiaries (collectively, the Company) as of December 31, 2009 and 2008, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2009. These consolidated 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 the 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 consolidated financial position of Rockford Corporation and subsidiaries at December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 31, 2010

Rockford Corporation and Subsidiaries

Consolidated Balance Sheet

(In Thousands, Except Share Data)

	December 31 2009	December 31 2008
Assets		
Current assets:		
Cash and cash equivalents	**$ –**	$ –
Accounts receivable, less allowances of $940 and $1,441 at December 31, 2009 and 2008, respectively	**9,946**	12,856
Inventories	**5,754**	13,043
Prepaid expenses and other	**378**	551
Total current assets	**16,078**	26,450
Property and equipment, net	**1,540**	1,743
Other assets	**177**	332
Total assets	**$ 17,795**	$ 28,525
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	**$ 5,269**	$ 3,980
Accrued salaries and incentives	**737**	1,367
Accrued warranty and returns	**740**	700
Other accrued expenses	**1,934**	1,838
Current portion of capital leases	**–**	52
Notes payable, less unaccreted discount of $20 at December 31, 2008	**2,603**	5,089
Asset-based credit facility	**1,630**	7,547
Total current liabilities	**12,913**	20,573
Notes payable, less unaccreted discount of $10 at December 31, 2008	**–**	2,593
Long-term portion of capital lease and other long-term liabilities	**213**	66
Total liabilities	**13,126**	23,232
Commitment and contingencies		
Shareholders' equity:		
Common stock, $.01 par value, authorized shares – 40,000,000, issued shares – 9,395,720 shares at December 31, 2009 and 2008	**94**	94
Additional paid-in capital	**38,680**	38,554
Accumulated deficit	**(32,794)**	(32,044)
Less: Treasury stock, at cost (814,512 shares at December 31, 2009 and 2008, respectively	**(1,311)**	(1,311)
Total shareholders' equity	**4,669**	5,293
Total liabilities and shareholders' equity	**$ 17,795**	$ 28,525

See accompanying notes.

Rockford Corporation and Subsidiaries

Consolidated Statements of Operations

(In Thousands, Except Share Data)

	Year Ended December 31		
	2009	**2008**	**2007**
Net sales	**$ 52,975**	$ 68,874	$ 88,745
Cost of goods sold	**36,124**	47,670	59,868
Gross profit	**16,851**	21,204	28,877
Operating expenses:			
Sales and marketing	**7,990**	11,805	13,273
General and administrative	**7,981**	11,201	11,215
Research and development	**1,758**	2,646	2,817
Total operating expenses	**17,729**	25,652	27,305
Operating income (loss)	**(878)**	(4,448)	1,572
Interest expense	**525**	850	1,423
Other income	**(653)**	(847)	(537)
Income (loss) before income taxes	**(750)**	(4,451)	686
Income tax expense	**–**	24	–
Net income (loss)	**$ (750)**	$ (4,475)	$ 686
Income (loss) per common share:			
Net income (loss):			
Basic	**$ (0.09)**	$ (0.51)	$ 0.07
Diluted	**$ (0.09)**	$ (0.51)	$ 0.07
Weighted average shares:			
Basic	**8,581**	8,697	9,325
Diluted	**8,581**	8,697	9,342

See accompanying notes.

Rockford Corporation and Subsidiaries

Consolidated Statements of Shareholders' Equity

(In Thousands)

	Common Stock		Additional Paid-In	Accumulated	Accumulated Other Comprehensive	Treasury Stock		
	Shares	Amount	Capital	Deficit	Income	Number	Amount	Total
Balance at December 31, 2006	9,391	$ 94	$ 37,995	$ (28,255)	$ 411	–	$ –	$ 10,245
Currency translation	–	–	–	–	(411)	–	–	(411)
Net income	–	–	–	686	–	–	–	686
Comprehensive income	–	–	–	–	–	–	–	275
Exercise of stock options	5	–	11	–	–	–	–	11
Share-based compensation	–	–	313	–	–	–	–	313
Purchase of treasury stock	–	–	–	–	–	450	(898)	(898)
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

See accompanying notes.

Rockford Corporation and Subsidiaries

Consolidated Statements of Cash Flows

(In Thousands)

	Year Ended December 31		
	2009	**2008**	**2007**
Operating activities			
Net income (loss)	**$ (750)**	$ (4,475)	$ 686
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	**754**	1,654	1,849
Share-based compensation expense	**126**	235	313
Loss on Legal settlement and special charges	**–**	–	1,098
Realized translation gain	**–**	–	(411)
Write-off of asset to fair value	**33**	188	–
Net gain on buyback of notes and warrants	**(497)**	(812)	–
Gain on sale of property and equipment	**(89)**	(98)	(35)
Provision for doubtful accounts	**306**	1,431	111
Provision for inventories	**123**	1,049	507
Changes in operating assets and liabilities:			
Accounts receivable	**2,605**	1,597	3,245
Inventories	**7,167**	260	4,752
Prepaid expense and other	**139**	385	739
Account payable	**1,289**	(1,814)	(1,301)
Accrued salaries and incentives	**(634)**	(111)	(573)
Accrued warranty and returns	**40**	(567)	(932)
Other accrued expenses and deferred liabilities	**263**	170	(1,107)
Net cash provided by (used in) operating activities	**10,875**	(908)	8,941
Investing activities			
Purchases of property and equipment	**(459)**	(1,016)	(1,014)
Proceeds from sale of property and equipment	**89**	116	161
Net proceeds from disposal of assets	**–**	100	400
Increase in other assets	**67**	62	31
Net cash (used in) investing activities	**(303)**	(738)	(422)
Financing activities			
Note payable issuance (payments)	**(4,603)**	(1,277)	317
Proceeds from bank debt and short-term notes	**50,582**	76,620	86,047
Payments on bank debt and short-term notes	**(56,499)**	(72,546)	(92,972)
Payments on capital lease obligations	**(52)**	(47)	(44)
Payments on litigation settlement	**–**	(691)	(980)
Purchase of treasury stock	**–**	(413)	(898)
Proceeds from exercise of stock options	**–**	–	11
Net cash (used in) provided by financing activities	**(10,572)**	1,646	(8,519)
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.

1. Accounting Policies

Organization and Description of Business

Rockford Corporation (Rockford) designs and distributes high performance mobile audio products, primarily under the Rockford Fosgate, Lightning Audio, and Rockford Acoustic Design brands. Prior to 2009 Rockford also assembled certain of its products, but Rockford has now outsourced 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.

Basis of Presentation

The accompanying consolidated financial statements include the activities of Rockford and its wholly owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the 2008 consolidated financial statements to conform to the 2009 presentation.

The accompanying consolidated financial statements have been prepared assuming that Rockford will continue as a going concern. A going concern basis of accounting contemplates the recovery of Rockford's assets and the satisfaction of its liabilities in the normal course of business. In conjunction with the economic slowdown, Rockford incurred a net loss of approximately $0.8 million in 2009 and $4.5 million in 2008. To achieve its goal of returning to profitability, management scaled back its operating structure to be in line with its anticipated sales volumes, and has developed additional cost reduction plans in the event sales levels are lower than those expected.

Rockford believes its plans will enable it to satisfy its liquidity needs as anticipated for the year ended December 31, 2010. However, if demand for Rockford's products declines further than management's projections, or if Rockford is otherwise unable to meet its liquidity needs, Rockford may need to further reduce its operating costs or seek one or more financing alternatives. However, Rockford may not be successful in reducing its costs to the level required should there be unanticipated further reductions in demand or difficulties in obtaining additional funding beyond its current credit facility. While Rockford believes it can maintain compliance with its debt covenants and maintain borrowing capacity and availability under its line of credit (which is Rockford's only current source of liquidity), a failure to maintain compliance with its

1. Accounting Policies (continued)

debt covenants or unanticipated deterioration of its business could compromise Rockford's ability to be assured that amounts would remain available under its line of credit. If Rockford does not generate adequate operating results in 2010, it may require additional equity or debt financing or further reductions in its operating costs, beyond those included in its current operating plan for 2010, in order to meet its working capital requirements through December 31, 2010. If additional financing is not available and management does not make operational adjustments in a timely manner, Rockford's financial condition could be adversely impacted and its ability to operate as a going concern may be adversely affected.

In connection with the preparation of Rockford's consolidated financial statements and in accordance with the May 2009 Statement of Financial Accounting Standards issued accounting guidance, Rockford evaluated subsequent events after the balance sheet date of December 31, 2009 through March 31, 2010, the date the consolidated financial statements were available to be issued.

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, which 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;

1. Accounting Policies (continued)

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; and

Level 3: 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 it 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 liabilities 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 and its remaining $2.5 million of notes payable 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; and
- Collectability is reasonably assured.

Rockford sells almost all 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.

1. Accounting Policies (continued)

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

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, 2009, 2008 and 2007 was approximately $1.7 million, $2.3 million and $2.8 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, 2009 and 2008, net accounts receivable includes approximately $2.4 million and $3.4 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 accounts receivable at December 31, 2009 and 2008, approximates $0.9 million, and $1.3 million respectively, for doubtful accounts.

Rockford also maintains allowances for prompt pay and freight discounts, based on historical rates for discounts offered to customers. The allowance for accounts receivable at December 31, 2009 and 2008, approximates $0.1 million and $0.1 million respectively, with respect to customers expected to use such discounts after year-end.

1. Accounting Policies (continued)

Inventories

Inventories consist principally of finished goods. Inventories are carried at the lower of cost or market computed using the weighted average method. 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 cost basis for the written down inventory.

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 two to ten year life. 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, 2009, 2008 and 2007 was approximately \$0.1 million, \$1.0 million and \$0.2 million, respectively. Such amounts are included in sales and marketing expenses in Rockford's consolidated statements of operations.

1. Accounting Policies (continued)

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 that includes the enactment date.

Rockford assesses the likelihood that it will 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 it estimates are not more-likely-than-not recoverable. As of December 31, 2009 and 2008, 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 historical estimated number of units likely to be returned.

1. Accounting Policies (continued)

Warranty and returns reserve activity is as follows for the years ended December 31, 2009, 2008 and 2007:

	2009	2008	2007
	(In Thousands)		
Balance at beginning of year	**$ 700**	$ 1,267	$ 2,199
Provision for warranties and returns	**2,689**	3,796	3,694
Net settlements made during the year	**(2,649)**	(4,363)	(4,626)
Balance at end of year	**$ 740**	$ 700	$ 1,267

During 2008 Rockford refined its estimates for calculating its allowance for warranty and sales returns. This change in estimate resulted in a decrease of the reserve by approximately $0.4 million, or $0.05 per diluted share, for the year ending December 31, 2008.

Income per Common Share

Diluted income per share includes only the dilutive effects of options, warrants and convertible securities.

Significant Customers

Rockford had sales to one customer representing 19.0%, 16.9% and 19.0%, of net sales for the years ended December 31, 2009, 2008 and 2007, respectively. This customer accounted for approximately 17.6% and 21.1% of the accounts receivable balance at December 31, 2009 and 2008, respectively.

Foreign Currency Translation

Rockford has translated the financial statements of foreign subsidiaries into U.S. dollars. All asset and liability accounts have been translated using the current exchange rates at the balance sheet date. Shareholders' equity accounts were translated at historical exchange rates. Amounts reported in the consolidated statements of operations have been translated using the average exchange rate for the year. The gains and losses resulting from the change in exchange rates from year-to-year have been reported separately as a component of shareholders' equity. The

1. Accounting Policies (continued)

effect on the consolidated statements of operations of transaction gains and losses is insignificant. Rockford recorded in 2007 a currency gain of approximately $0.4 million due to the recognition of Rockford's previously unrealized cumulative translation gains triggered by the dissolution of its European subsidiary which was completed in December of 2007.

Stock-Based Compensation

Rockford 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 consolidated 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 consolidated financial statements and accompanying notes. The actual results experienced by Rockford may differ from management's estimates.

2. Inventories

Inventories consisted of the following:

	December 31	
	2009	**2008**
	(In Thousands)	
Raw materials	**$ 269**	$ 501
Work in progress	**19**	49
Finished goods	**5,466**	12,493
	$ 5,754	$ 13,043

3. Property and Equipment

Property and equipment, net, consisted of the following:

	December 31 2009	December 31 2008
	(In Thousands)	
Machinery and equipment	**$ 3,295**	$ 3,469
Tooling equipment	**3,230**	2,964
Leasehold improvements	**1,745**	2,094
Furniture and fixtures	**206**	214
Computer software and hardware	**2,502**	2,297
Assets in process	**89**	369
Assets under capital leases	**–**	182
	11,067	11,589
Less accumulated depreciation and amortization	**(9,527)**	(9,846)
	$ 1,540	$ 1,743

Depreciation expense was approximately $0.7 million, $1.2 million and $1.5 million in 2009, 2008, and 2007, respectively. Depreciation of assets under capital leases is included in depreciation expense. Accumulated depreciation on assets under capital leases totaled $0 and $91,000 and at December 31, 2009 and 2008, respectively.

4. Notes Payable and Long-Term Debt

Notes payable and long-term debt consisted of the following:

	December 31 2009	December 31 2008
	(In Thousands)	
Asset-based credit facility	**$ 1,630**	$ 7,547
Convertible senior subordinated secured notes	**–**	7,500
Senior subordinated secured notes	**2,500**	–
Other	**103**	212
	4,233	15,259
Less debt discount	**–**	(30)
Less current portion	**(4,233)**	(12,636)
	$ –	$ 2,593

Interest payments were approximately $0.5 million, $1.2 million and $1.4 million for the years ended December 31, 2009, 2008 and 2007, respectively.

Rockford entered into an asset-based credit facility with Wachovia Capital Financial Corporation (Western) as Agent and Wachovia Bank, National Association as Arranger on March 29, 2004 and as amended most recently on March 23, 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 fixed and variable rate pricing options will increase to LIBOR plus 400 bps to 450 bps. The LIBOR and prime interest rate options were approximately 2.25% and 3.25% at December 31, 2009. As of December 31, 2009, Rockford was in compliance with its applicable covenants which were unchanged in the March 23, 2010 amendment. The availability under the credit facility at December 31, 2009 was approximately $5.6 million in excess of the outstanding balance of $1.6 million.

The Wachovia credit facility requires that Rockford maintain blocked lock box accounts, whereby Wachovia 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 $1.6 million and

4. Notes Payable and Long-Term Debt (continued)

$7.5 million outstanding balances as of December 31, 2009 and 2008, respectively, on the Wachovia credit facility as short-term. Rockford expects to maintain the facility for its entire term.

In January 2009, Rockford had 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.

At April 1, 2009, Rockford had $5 million of convertible notes outstanding which were to become due on June 10, 2009. In April of 2009, Rockford agreed with the sole holder of the convertible notes to amend their terms, 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. Until June 10, 2009, the notes were convertible into Rockford common stock and had associated warrants to purchase additional shares of Rockford common stock. 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. As a result of the amendment and payments, at December 31, 2009 Rockford had outstanding $2.5 million of its senior subordinated secured notes. Rockford may repay early any or all of the outstanding principal without penalty. The notes are secured by a second priority lien on certain Rockford assets. Rockford was in compliance with all applicable covenants under the indenture for the senior subordinated secured notes as of December 31, 2009.

The aggregate principal payments due on long-term debt (including the Wachovia credit facility that is classified as short term for the reasons described above) are as follows (in thousands):

Years ending December 31:	
2010	$ 2,603
2011	–
2012	–
2013	–
2014	1,630
Thereafter	–
	$ 4,233

5. Leases

Rockford leases certain manufacturing, warehouse and office facilities, and computer hardware and software under noncancelable operating leases that expire in various years through September 2014.

Future minimum payments under noncancelable operating leases with initial terms of one year or more consisted of the following at December 31, 2009:

	Operating Leases *(In Thousands)*
2010	$ 869
2011	801
2012	459
2013	354
2014	271
Thereafter	–
Total minimum lease payments	$ 2,754

Total rental expense for all operating leases was approximately $1.0 million, $1.8 million and $1.8 million for the years ended December 31, 2009, 2008 and 2007, respectively.

6. Income Taxes

Income tax expense (benefit) consisted of the following:

	Year Ended December 31 2009	2008	2007
	(In Thousands)		
Current:			
Federal expense	$ –	$ –	$ –
State expense	–	24	–
Foreign expense	–	–	–
Total current expense	–	24	–
Deferred:			
Federal expense	–	–	–
State expense	–	–	–
Foreign expense	–	–	–
Total deferred expense	–	–	–
Income tax expense	$ –	$ 24	$ –

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

	Year Ended December 31 2009	2008	2007
	(In Thousands)		
Federal statutory rate	$ (255)	$ (1,513)	$ 233
State tax operating loss carryforward	(19)	(73)	(136)
Nondeductible items	21	33	68
Amount not taxable due to dissolution of subsidiary	–	–	(2,531)
Federal and state tax credits	(105)	(132)	(138)
Loss of state net operating losses	388	–	–
Change in valuation allowance	(70)	2,188	2,567
Uncertain tax positions	–	(505)	–
Other, net	40	26	(63)
Income tax benefit	$ –	$ 24	$ –

6. Income Taxes (continued)

Rockford's deferred tax assets consisted of the following:

	December 31 2009	December 31 2008
	(In Thousands)	
Deferred tax assets:		
Inventory basis	**$ 552**	$ 885
Basis in receivables	**296**	534
Book over tax depreciation	**416**	559
Accrued warranty	**274**	259
Net operating loss carryforward	**20,227**	19,615
Capital loss carryforward	**945**	945
Federal and state credit carryforwards	**2,211**	2,106
Accrued liabilities and other	**606**	694
Gross deferred tax assets	**25,527**	25,597
Valuation allowance	**(25,527)**	(25,597)
Net deferred tax assets	**$ –**	$ –

In 2009, 2008, and 2007 Rockford has maintained a valuation allowance recorded on the entire amount of its deferred tax assets. During 2009, the valuation allowance decreased by $0.1 million to an ending balance of $25.5 million at December 31, 2009. The Company does not believe that it is more likely than not that the benefits associated with its deferred tax assets will be realized. 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. Any utilization of this portion of Rockford's net operating loss carryforwards would be recorded as an increase in additional paid in capital.

6. Income Taxes (continued)

At December 31, 2009, Rockford had the following carryforward tax attributes:

- Approximately $57.3 million and $16.4 million of gross federal and state net operating loss carryforwards that begin to expire in 2024 and 2010, respectively.
- Approximately $1.9 million of the federal net operating loss carryforward is from international operations and subject to an annual limitation under Section 382 and will begin to expire in 2011, if not utilized.
- 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.

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

	Year Ended December 31		
	2009	**2008**	**2007**
	(In Thousands)		
Balance at beginning of year	**$ 566**	$ 1,071	$ 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	$ 1,071

6. Income Taxes (continued)

In 2008, Rockford's unrecognized tax benefits decreased by $0.5 million due to the completion of an IRS 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 consolidated statement of operations for 2009, 2008 and 2007. Rockford's 2006-2009 years remain subject to examination for federal income tax purposes, whereas the 2005-2009 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 twelve months.

7. Common Stock Grants and Options

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. The options generally have a term of ten years and become exercisable over three years commencing on the date of the grant. Under certain circumstances, Rockford has the right to repurchase common stock acquired under some of the options at their fair market value.

At December 31, 2009 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, 2009 there were 654,029 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 will vest in one year from the November 2009 grant date. Forty optionees participated in the

7. Common Stock Grants and Options (continued)

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.

Stock-based compensation expense for the years ended December 31, 2009, 2008, and 2007 were approximately $0.1 million, $0.2 million, and $0.3 million respectively. This stock-based compensation expense increased basic and diluted loss per share by $0.01 and $0.03 for the years ended December 31, 2009 and 2008, respectively, and lowered basic and diluted income per share by $0.04 for the year ended December 31, 2007. The total value of stock option awards is expensed ratably over the service period of the employees receiving the awards. As of December 31, 2009, total unrecognized compensation cost related to non vested 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 1.5 years. The total fair value of options that vested during the years ended December 31, 2009, 2008, and 2006 was $0.1 million, $0.2 million and $0.3 million, respectively. The intrinsic value of options exercised during the years ended December 31, 2009, 2008, and 2007 was $0, $0 and $2,000 respectively. Options to purchase 582,787 shares, 350,000 shares, and 70,000 shares respectively were granted during the years ended December 31, 2009, 2008 and 2007. The weighted average fair value of options granted during the years ended December 31, 2009, 2008 and 2007, was $0.13, $0.49 and $1.17, 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, 2009, 2008, and 2007.

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 for the years ended December 31:

	2009	**2008**	**2007**
Expected life of the award	**4 years**	5 years	5 years
Dividend yield	**0%**	0%	0%
Risk-free interest rate	**2.0%**	3.2%	5.1%
Expected volatility	**0.92**	0.52	0.48

7. Common Stock Grants and Options (continued)

Option activity under the stock option plans during the year ended December 31, 2009 was as follows:

	Outstanding Options			
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2009	1,938,114	$ 3.65		
Granted	582,787	0.40		
Exercised	–	–		
Expired, forfeited or cancelled	(1,595,680)	4.22		
Outstanding at December 31, 2009	925,221	0.62	6.9 years	$ –
Exercisable at December 31, 2009	172,500	$ 1.00	8.6 years	$ –

The following table summarizes information about stock options under the plans outstanding at December 31, 2009:

	Options Outstanding			Options Exercisable	
	Number Outstanding at December 31 2009	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Outstanding at December 31 2009	Weighted Average Exercise Price
Range of exercise prices:					
$0.40	580,221	5.9	$ 0.40	–	$ –
$1.00	345,000	8.6	$ 1.00	172,500	$ 1.00
	925,221			172,500	

8. Income (Loss) Per Share

	Year Ended December 31		
	2009	**2008**	**2007**
	(In Thousands, Except Per Share Data)		
Numerator:			
Net income (loss)	**$ (750)**	$ (4,475)	$ 686
Denominator:			
Denominator for basic net income (loss) per share	**8,581**	8,697	9,325
Effect of dilutive securities:			
Employee stock options	–	–	17
Denominator for diluted net income (loss) per share	**8,581**	8,697	9,342
Income (loss) per common share:			
Net income (loss):			
Basic	**$ (0.09)**	$ (0.51)	$ 0.07
Diluted	**$ (0.09)**	$ (0.51)	$ 0.07

The effect of 17,558 employee stock options which would have increased net shares outstanding using the treasury stock method were 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		
	2009	**2008**	**2007**
	(In Thousands, Except Exercise Prices)		
Outstanding options	**925**	1,592	1,430
Weighted average exercise price	**$ 0.62**	$ 4.23	$ 4.51

9. 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 consolidated financial position or results of operations.

10. Benefit Plan

Rockford has a 401(k) Retirement Savings Plan (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 three percent 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 year ended December 31, 2009, 2008 and 2007, were approximately $0.0 million, $0.2 million and $0.3 million respectively.

11. 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, 814,512 shares for an aggregate purchase price of approximately $1.3 million. Rockford did not repurchase any shares during 2009, and has remaining authority to purchase up to 105,488 shares under the programs.

12. 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		
Region(1)	**% 2009**	**2009**	**2008**	**2007**
			(In Thousands)	
United States	83.3%	**$ 44,111**	$ 55,136	$ 71,771
Other Americas (includes Canada)	5.8	**3,095**	6,076	7,193
Europe	5.3	**2,790**	4,648	6,069
Asia	5.6	**2,979**	3,014	3,712
Total sales to external customers	100.0%	**$ 52,975**	$ 68,874	$ 88,745

(1) Revenues are attributed to geographic regions based on the location of customers.

13. Special Charges

During 2008 Rockford recorded special charges of approximately $1.1 million. The 2008 charges include costs associated with the elimination of two executive officer positions, severance cost for personnel who were discharged associated with 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 expects to complete all payments arising from these special charges by the quarter ending March 31, 2010. The following table summarizes the outstanding liabilities arising from these special charges at December 31, 2009 and 2008.

	2009	**2008**
	(In Thousands)	
Balance at beginning of year	**$ 740**	$ 584
Provision recorded during the year	**119**	1,061
Payments made during the year	**(756)**	(893)
Adjustments to reserve	**–**	(12)
Balance at end of year	**$ 103**	$ 740