

NAUTILUS, INC.
Form 10-Q
August 06, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015
or

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

For the transition period from _____ to _____

Commission file number: 001-31321

NAUTILUS, INC.
(Exact name of Registrant as specified in its
charter)

Washington
(State or other jurisdiction of
incorporation or organization)

94-3002667
(I.R.S. Employer
Identification No.)

17750 S.E. 6th Way
Vancouver, Washington 98683
(Address of principal executive offices, including zip code)

(360) 859-2900
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

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(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐

(do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

The number of shares outstanding of the registrant's common stock as of July 31, 2015 was 31,552,269 shares.

NAUTILUS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2015

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Financial Statements

NAUTILUS, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Unaudited and in thousands)

	As of June 30, 2015	December 31, 2014
Assets		
Cash and cash equivalents	\$37,489	\$45,206
Available-for-sale securities	49,748	26,984
Trade receivables, net of allowances of \$31 and \$108	12,635	26,260
Inventories	28,379	24,896
Prepays and other current assets	4,469	6,987
Income taxes receivable	170	50
Deferred income tax assets, current portion	9,511	12,368
Total current assets	142,401	142,751
Property, plant and equipment, net	10,544	9,634
Goodwill	2,372	2,520
Other intangible assets, net	10,106	10,575
Long-term deferred income tax assets	5,087	9,546
Other assets	485	628
Total assets	\$170,995	\$175,654
Liabilities and Shareholders' Equity		
Trade payables	\$32,702	\$47,574
Accrued liabilities	7,340	9,851
Warranty obligations	2,819	2,246
Total current liabilities	42,861	59,671
Income taxes payable	3,614	3,725
Other long-term liabilities	1,759	1,186
Total liabilities	48,234	64,582
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Common stock - no par value, 75,000 shares authorized, 31,551 and 31,333 shares issued and outstanding	6,905	8,033
Retained earnings	116,503	103,347
Accumulated other comprehensive loss	(647)	(308)
Total shareholders' equity	122,761	111,072
Total liabilities and shareholders' equity	\$170,995	\$175,654

See accompanying Notes to Condensed Consolidated Financial Statements.

NAUTILUS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (Unaudited and in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net sales	\$59,695	\$48,546	\$155,934	\$120,450
Cost of sales	29,039	23,766	71,389	57,189
Gross profit	30,656	24,780	84,545	63,261
Operating expenses:				
Selling and marketing	20,052	15,690	48,451	37,463
General and administrative	4,293	4,959	9,871	10,762
Research and development	2,379	1,752	4,686	3,655
Total operating expenses	26,724	22,401	63,008	51,880
Operating income	3,932	2,379	21,537	11,381
Other income (expense):				
Interest income	59	16	103	24
Interest expense	(6	) (5	) (11	) (12
Other, net	(281	) (56	) (397	) (117
Total other income (expense), net	(228	) (45	) (305	) (105
Income from continuing operations before income taxes	3,704	2,334	21,232	11,276
Income tax provision	1,485	836	8,154	4,030
Income from continuing operations	2,219	1,498	13,078	7,246
Discontinued operations:				
Loss from discontinued operations before income taxes	(160	) (322	) (313	) (834
Income tax provision (benefit) from discontinued operations	(365	) 619	(391	) 481
Income (loss) from discontinued operations	205	(941	) 78	(1,315
Net income	\$2,424	\$557	\$13,156	\$5,931
Basic income per share from continuing operations	\$0.07	\$0.05	\$0.42	\$0.23
Basic income (loss) per share from discontinued operations	0.01	(0.03	) —	(0.04
Basic net income per share	\$0.08	\$0.02	\$0.42	\$0.19
Diluted income per share from continuing operations	\$0.07	\$0.05	\$0.41	\$0.23
Diluted income (loss) per share from discontinued operations	0.01	(0.03	) —	(0.04
Diluted net income per share	\$0.08	\$0.02	\$0.41	\$0.19
Shares used in per share calculations:				
Basic	31,485	31,226	31,441	31,203
Diluted	31,791	31,598	31,801	31,586

See accompanying Notes to Condensed Consolidated Financial Statements.

NAUTILUS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited and in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	\$2,424	\$557	\$13,156	\$5,931
Other comprehensive income (loss):				
Unrealized gain (loss) on available-for-sale securities, net of income tax expense of \$5, \$0, \$5 and \$0	14	3	13	(10)
Foreign currency translation, net of income tax expense (benefit) of \$(1), \$(4), \$4 and \$1	132	176	(352)	12
Other comprehensive income (loss)	\$146	\$179	\$(339)	\$2
Comprehensive income	\$2,570	\$736	\$12,817	\$5,933

See accompanying Notes to Condensed Consolidated Financial Statements.

NAUTILUS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited and in thousands)

	Six Months Ended June 30,	
	2015	2014
Cash flows from operating activities:		
Income from continuing operations	\$13,078	\$7,246
Income (loss) from discontinued operations	78	(1,315)
Net income	13,156	5,931
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	1,718	1,832
Provision for (benefit from) allowance for doubtful accounts	(118)	32
Inventory lower-of-cost-or-market adjustments	68	863
Stock-based compensation expense	669	520
Loss on asset dispositions	258	—
Deferred income taxes, net of valuation allowance	7,322	2,851
Excess tax deficiency related to stock-based awards	1	174
Changes in operating assets and liabilities:		
Trade receivables	13,899	16,297
Inventories	(3,537)	(8,253)
Prepays and other current assets	2,679	1,938
Income taxes	(121)	372
Trade payables	(15,281)	(5,193)
Accrued liabilities, including warranty obligations	(2,008)	(179)
Net cash provided by operating activities	18,705	17,185
Cash flows from investing activities:		
Purchases of available-for-sale securities	(43,240)	(19,050)
Proceeds from maturities of available-for-sale securities	17,095	—
Proceeds from sales of available-for-sale securities	3,381	—
Purchases of property, plant and equipment	(1,252)	(987)
Net cash used in investing activities	(24,016)	(20,037)
Cash flows from financing activities:		
Proceeds from exercise of stock options	975	234
Payments for stock repurchases	(1,996)	—
Tax payments related to stock award issuances	(775)	—
Excess tax deficiency related to stock-based awards	(1)	(174)
Net cash provided by (used in) financing activities	(1,797)	60
Effect of exchange rate changes on cash and cash equivalents	(609)	98
Decrease in cash and cash equivalents	(7,717)	(2,694)
Cash and cash equivalents:		
Beginning of period	45,206	40,979
End of period	\$37,489	\$38,285
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$(11)	\$(12)
Cash paid for income taxes, net	\$(760)	\$(261)
Supplemental disclosure of non-cash investing activities:		
Capital expenditures incurred but not yet paid	\$1,166	\$—

See accompanying Notes to Condensed Consolidated Financial Statements.

NAUTILUS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) GENERAL INFORMATION

Basis of Consolidation and Presentation

The accompanying condensed consolidated financial statements present the financial position, results of operations and cash flows of Nautilus, Inc. and its subsidiaries, all of which are wholly owned. Intercompany transactions and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements have not been audited. We have condensed or omitted certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Management believes the disclosures contained herein are adequate to make the information presented not misleading. However, these condensed consolidated financial statements should be read in conjunction with our consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2014 (the "2014 Form 10-K").

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Further information regarding significant estimates can be found in our 2014 Form 10-K.

In the opinion of management, the accompanying condensed consolidated financial statements reflect all adjustments necessary to present fairly our financial position as of June 30, 2015 and December 31, 2014, and our results of operations, comprehensive income and cash flows for the three and six months ended June 30, 2015 and 2014. Interim results are not necessarily indicative of results for a full year. Our revenues typically vary seasonally and this seasonality can have a significant effect on operating results, inventory levels and working capital needs.

Unless indicated otherwise, all information regarding our operating results pertain to our continuing operations.

New Accounting Pronouncements

ASU 2015-11

In July 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-11, "Simplifying the Measurement of Inventory (Topic 330)." ASU 2015-11 simplifies the accounting for the valuation of all inventory not accounted for using the last-in, first-out ("LIFO") method by prescribing inventory be valued at the lower of cost and net realizable value. ASU 2015-11 is effective for public companies' annual periods, including interim periods within those fiscal years, beginning after December 15, 2016 on a prospective basis. Early adoption is permitted. We do not expect the adoption of ASU 2015-11 to have a material effect on our financial position, results of operations or cash flows.

ASU 2015-05

In April 2015, the FASB issued ASU 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40)." ASU 2015-05 provides guidance regarding the accounting for a customer's fees paid in a cloud computing arrangement; specifically about whether a cloud computing arrangement includes a software license, and if so, how to account for the software license. ASU 2015-05 is effective for public companies' annual periods, including interim periods, beginning after December 15, 2015. Early adoption is permitted. We do not expect the adoption of ASU

2015-05 to have a material effect on our financial position, results of operations or cash flows.

ASU 2015-03

In April 2015, the FASB issued ASU 2015-03, “Interest - Imputation of Interest (Subtopic 835-30).” ASU 2015-03 simplifies the presentation of debt issuance costs. ASU 2015-03 is effective for public company financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted for financial statements that have not been previously issued. We do not expect the adoption of ASU 2015-03 to have any effect on our financial position, results of operations or cash flows.

ASU 2015-02

In February 2015, the FASB issued ASU 2015-02, "Consolidation (Topic 810)." ASU 2015-02 amends guidance regarding the consolidation of certain legal entities. ASU 2015-02 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. We do not expect the adoption of ASU 2015-02 to have any effect on our financial position, results of operations or cash flows.

ASU 2014-12

In June 2014, the FASB issued ASU No. 2014-12, "Compensation - Stock Compensation (Topic 718)". ASU No. 2014-12 addresses accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. ASU 2014-12 indicates that, in such situations, the performance target should be treated as a performance condition and, accordingly, the performance target should not be reflected in estimating the grant-date fair value of the award. Instead, compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved. ASU 2014-12 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. We do not expect the adoption of ASU 2014-12 to have a material effect on our financial position, results of operations or cash flows.

ASU 2014-09

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." ASU 2014-09 clarifies the principles for recognizing revenue and develops a common revenue standard for U.S. GAAP and the International Accounting Standards Board that:

- removes inconsistencies and weaknesses in revenue requirements;
- provides a more robust framework for addressing revenue issues;
- improves comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets;
- provides more useful information to users of financial statements through improved disclosure requirements; and
- simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer.

ASU 2014-09 is effective, as amended, for annual and interim periods beginning on or after December 15, 2017. While we do not expect the adoption of ASU 2014-09 to have a material effect on our business, we are still evaluating any potential impact that adoption of ASU 2014-09 may have on our financial position, results of operations or cash flows.

ASU 2014-08

In April 2014, the FASB issued ASU No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360) and Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." ASU 2014-08 amends the definition for what types of asset disposals are to be considered discontinued operations, and amends the required disclosures for discontinued operations and assets held for sale. ASU 2014-08 also enhances the convergence of the FASB's and the International Accounting Standard Board's reporting requirements for discontinued operations. ASU 2014-08 is effective for annual periods beginning on or after December 15, 2014, and interim periods within annual periods beginning on or after December 15, 2015. We do not expect the adoption of ASU 2014-08 to have a material effect on our financial position, results of operations or cash flows.

(2) DISCONTINUED OPERATIONS

There was no revenue related to discontinued operations for the six months ended June 30, 2015 or the year ended December 31, 2014. However, we continue to have legal and accounting expenses as we work with authorities on final deregistration of certain foreign entities and product liability expenses associated with product previously sold into the Commercial channel.

The following table summarizes liabilities for exit costs related to discontinued operations, included in accrued liabilities and other long-term liabilities in our Condensed Consolidated Balance Sheets (in thousands):

	Facilities Leases	
Balance, December 31, 2014	\$573	
Payments	(134)
Balance, June 30, 2015	\$439	

We expect the lease obligations to be paid out through 2016.

(3) FAIR VALUE MEASUREMENTS

Factors used in determining the fair value of financial assets and liabilities are summarized into three broad categories:

Level 1 - observable inputs such as quoted prices (unadjusted) in active liquid markets for identical securities as of the reporting date;

Level 2 - other significant directly or indirectly observable inputs, including quoted prices for similar securities, interest rates, prepayment speeds and credit risk; or observable market prices in markets with insufficient volume and/or infrequent transactions; and

Level 3 - significant inputs that are generally unobservable inputs for which there is little or no market data available, including our own assumptions in determining fair value.

Assets measured at fair value on a recurring basis as of June 30, 2015 and December 31, 2014 were as follows (in thousands):

	June 30, 2015			
	Level 1	Level 2	Level 3	Total
Cash Equivalents				
Money market funds	\$ 17,083	\$—	\$—	\$ 17,083
Commercial paper	—	6,498	—	6,498
Corporate bonds	—	6,037	—	6,037
Total cash equivalents	17,083	12,535	—	29,618
Available-for-Sale Securities				
Certificates of deposit ⁽¹⁾	—	24,523	—	24,523
Commercial paper	—	2,999	—	2,999
Corporate bonds	—	22,226	—	22,226
Total available-for-sale securities	—	49,748	—	49,748
Total assets measured at fair value	\$ 17,083	\$ 62,283	\$—	\$ 79,366

⁽¹⁾ All certificates of deposit are within current FDIC insurance limits.

	December 31, 2014			
	Level 1	Level 2	Level 3	Total
Cash Equivalents				
Money market funds	\$ 2,591	\$—	\$—	\$ 2,591
Certificates of deposit ⁽¹⁾	—	980	—	980
Commercial paper	—	12,497	—	12,497
Variable rate demand notes	—	8,000	—	8,000
Total cash equivalents	2,591	21,477	—	24,068
Available-for-Sale Securities				
Certificates of deposit ⁽¹⁾	—	14,202	—	14,202
Corporate bonds	—	12,782	—	12,782
Total available-for-sale securities	—	26,984	—	26,984
Total assets measured at fair value	\$ 2,591	\$ 48,461	\$—	\$ 51,052

⁽¹⁾ All certificates of deposit are within current FDIC insurance limits.

We did not have any liabilities measured at fair value on a recurring basis as of June 30, 2015 or December 31, 2014.

We recognize transfers between levels at the actual date of the event or change in circumstance that caused the transfer. There were no transfers between levels during the six months ended June 30, 2015, nor for the year ended December 31, 2014.

We did not have any changes to our valuation techniques during the six months ended June 30, 2015, nor for the year ended December 31, 2014.

We classify our marketable securities as available-for-sale and, accordingly, record them at fair value. Level 1 investment valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets. Level 2 investment valuations are obtained from inputs, other than quoted market prices in active markets, that are directly or indirectly observable in the marketplace and quoted prices in markets with limited volume or infrequent transactions. The factors or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. Unrealized holding gains and losses are excluded from earnings and are reported net of tax in comprehensive income until realized.

We recognize or disclose the fair value of certain assets, such as non-financial assets, primarily property, plant and equipment, goodwill, other intangible assets and certain other long-lived assets in connection with impairment evaluations. All of our nonrecurring valuations use significant unobservable inputs and therefore fall under Level 3 of the fair value hierarchy. We did not perform any valuations on assets or liabilities that are valued at fair value on a nonrecurring basis during the first six months of 2015. During the fourth quarter of 2014, we performed our annual goodwill and indefinite-lived trade names impairment analyses effective as of October 1, 2014. During the six months ended June 30, 2015 and the year ended December 31, 2014, we did not record any other-than-temporary impairments on our financial assets required to be measured at fair value on a nonrecurring basis.

(4) INVENTORIES

Inventories are stated at the lower of cost or market, with cost determined based on the first-in, first-out method. We establish inventory allowances for excess, slow-moving and obsolete inventory based on inventory levels, expected product life and forecasted sales. Inventories are written down to market value based on historical demand, competitive factors, changes in technology and product lifecycles.

Inventories consisted of the following (in thousands):

	As of June 30, 2015	December 31, 2014
Finished goods	\$26,741	\$23,765
Parts and components	1,638	1,131
Total inventories	\$28,379	\$24,896

(5) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following (in thousands):

Estimated
Useful Life
(in years)