NAUTILUS, INC.
Form 10-Q
October 30, 2018

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us-gaap:MaterialReconcilingItemsMember 2017-01-01 2017-09-30 0001078207 us-gaap:OperatingSegmentsMember 2018-01-01 2018-09-30 0001078207 us-gaap:MaterialReconcilingItemsMember 2018-07-01 2018-09-30 0001078207 us-gaap:OperatingSegmentsMember nls:RetailMember 2018-07-01 2018-09-30 0001078207 us-gaap:OperatingSegmentsMember nls:RetailMember 2017-01-01 2017-09-30 0001078207 us-gaap:OperatingSegmentsMember nls:RetailMember 2017-07-01 2017-09-30 0001078207 us-gaap:OperatingSegmentsMember nls:UnallocatedRoyaltyIncomeMember 2017-07-01 2017-09-30 0001078207 us-gaap:OperatingSegmentsMember nls:DirectMember 2018-01-01 2018-09-30 0001078207 us-gaap:OperatingSegmentsMember nls:UnallocatedRoyaltyIncomeMember 2017-01-01 2017-09-30 0001078207 us-gaap:OperatingSegmentsMember nls:UnallocatedRoyaltyIncomeMember 2018-01-01 2018-09-30 0001078207 us-gaap:SalesRevenueNetMember us-gaap:CustomerConcentrationRiskMember nls:Amazon.comMember 2018-07-01 2018-09-30 0001078207 us-gaap:SalesRevenueNetMember us-gaap:CustomerConcentrationRiskMember nls:DicksSportingGoodsMember 2017-07-01 2017-09-30 0001078207 us-gaap:SalesRevenueNetMember us-gaap:CustomerConcentrationRiskMember nls:DicksSportingGoodsMember 2018-01-01 2018-09-30 0001078207 us-gaap:SalesRevenueNetMember us-gaap:CustomerConcentrationRiskMember nls:Amazon.comMember 2017-07-01 2017-09-30 0001078207 us-gaap:SalesRevenueNetMember us-gaap:CustomerConcentrationRiskMember nls:DicksSportingGoodsMember 2018-07-01 2018-09-30 0001078207 us-gaap:SalesRevenueNetMember us-gaap:CustomerConcentrationRiskMember nls:Amazon.comMember 2017-01-01 2017-09-30 0001078207 us-gaap:SalesRevenueNetMember us-gaap:CustomerConcentrationRiskMember nls:Amazon.comMember 2018-01-01 2018-09-30 0001078207 us-gaap:InventoriesMember 2018-09-30 xbrli:shares iso4217:USD nls:segment xbrli:pure iso4217:USD xbrli:shares

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

FORM 10-Q

(Mark One)

[x] **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2018
or

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

For the transition period from ________ to ________

Commission file number: 001-31321

NAUTILUS, INC.

(Exact name of Registrant as specified in its charter)

Washington	**94-3002667**
(State or other jurisdiction of incorporation or organization)	**(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)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 [x]   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 (§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 [x]   No [ ]
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]	Accelerated filer [x]	Non-accelerated filer [ ]	Smaller reporting company [ ]	Emerging growth company [ ]
		(Do not check if a smaller reporting company)		If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).   Yes [ ]   No [x]
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 October 26, 2018 was 29,787,082 shares.

NAUTILUS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	As of September 30, 2018	December 31, 2017 *
Assets		
Cash and cash equivalents	$30,753	$27,893
Available-for-sale securities	40,352	57,303
Trade receivables, net of allowances of $45 and $119	46,130	42,685
Inventories	55,549	53,354
Prepaids and other current assets	11,174	7,257
Total current assets	183,958	188,492
Property, plant and equipment, net	19,580	15,827
Goodwill	61,969	62,030
Other intangible assets, net	55,364	57,743
Other assets	631	684
Total assets	$321,502	$324,776
Liabilities and Shareholders' Equity		
Trade payables	$67,675	$66,899
Accrued liabilities	7,846	10,764
Warranty obligations, current portion	3,904	3,718
Note payable, current portion, net of unamortized debt issuance costs of $7 and $7	15,993	15,993
Total current liabilities	95,418	97,374
Warranty obligations, non-current	1,802	2,399
Income taxes payable, non-current	3,317	2,955
Deferred income tax liabilities, non-current	10,141	8,558
Other non-current liabilities	1,967	2,315
Note payable, non-current, net of unamortized debt issuance costs of $9 and $14	19,991	31,986
Total liabilities	132,636	145,587
Commitments and contingencies (Note 14)		
Shareholders' equity:		
Common stock - no par value, 75,000 shares authorized, 30,131 and 30,305 shares issued and outstanding	216	—
Retained earnings	189,107	179,448
Accumulated other comprehensive loss	(457)	(259)
Total shareholders' equity	188,866	179,189
Total liabilities and shareholders' equity	$321,502	$324,776

*See Note 2.

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017** *
Net sales	$91,057	$88,132	$281,368	$278,413
Cost of sales	52,551	46,817	150,343	136,975
Gross profit	38,506	41,315	131,025	141,438
Operating expenses:				
Selling and marketing	20,635	18,028	79,482	79,321
General and administrative	7,503	6,305	20,740	21,106
Research and development	4,208	3,617	12,744	11,114
Total operating expenses	32,346	27,950	112,966	111,541
Operating income	6,160	13,365	18,059	29,897
Other income (expense):				
Interest income	269	170	835	476
Interest expense	(244)	(377)	(805)	(1,233)
Other, net	188	46	206	109
Total other income (expense), net	213	(161)	236	(648)
Income from continuing operations before income taxes	6,373	13,204	18,295	29,249
Income tax expense	1,870	4,862	4,645	10,156
Income from continuing operations	4,503	8,342	13,650	19,093
Discontinued operations:				
Loss from discontinued operations before income taxes	(159)	(40)	(187)	(1,695)
Income tax expense (benefit) of discontinued operations	35	61	167	(425)
Loss from discontinued operations	(194)	(101)	(354)	(1,270)
Net income	$4,309	$8,241	$13,296	$17,823
Basic income per share from continuing operations	$0.15	$0.27	$0.45	$0.62
Basic loss per share from discontinued operations	(0.01)	—	(0.01)	(0.04)
Basic net income per share	$0.14	$0.27	$0.44	$0.58
Diluted income per share from continuing operations	$0.15	$0.27	$0.45	$0.61
Diluted loss per share from discontinued operations	(0.01)	—	(0.01)	(0.04)
Diluted net income per share	$0.14	$0.27	$0.44	$0.57
Shares used in per share calculations:				
Basic	30,185	30,749	30,230	30,739
Diluted	30,433	31,075	30,500	31,098

*See Note 2.

See accompanying Notes to Condensed Consolidated Financial Statements.

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NAUTILUS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited and in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017 *
Net income	$4,309	$8,241	$13,296	$17,823
Other comprehensive income (loss):				
Unrealized gain (loss) on available-for-sale securities, net of income tax expense (benefit) of $13, $13, $6 and $(4)	40	22	37	(6)
Gain (loss) on derivative securities, effective portion, net of income tax expense (benefit) of $(6), $14, $26 and $79	(18)	23	138	130
Foreign currency translation, net of income tax expense of $7, $1, $7 and $3	82	371	(373)	772
Other comprehensive income (loss)	104	416	(198)	896
Comprehensive income	$4,413	$8,657	$13,098	$18,719

*See Note 2.

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Nine Months Ended September 30,	
	2018	**2017** *
Cash flows from operating activities:		
Income from continuing operations	$13,650	$19,093
Loss from discontinued operations	(354)	(1,270)
Net income	13,296	17,823
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	6,646	6,386
Provision (recovery) of allowance for doubtful accounts	(42)	375
Inventory lower-of-cost-or-market/NRV adjustments	255	294
Stock-based compensation expense	1,394	1,938
Loss on asset dispositions	32	58
Deferred income taxes, net of valuation allowance	1,476	(193)
Other	40	(101)
Changes in operating assets and liabilities:		
Trade receivables	(3,352)	6,532
Inventories	(2,503)	(11,056)
Prepaids and other current assets	1,075	1,644
Income taxes receivable	(4,712)	3,170
Trade payables	(525)	(4,275)
Accrued liabilities, including warranty obligations	(3,254)	(5,875)
Net cash provided by operating activities	9,826	16,720
Cash flows from investing activities:		
Purchases of available-for-sale securities	(29,522)	(57,054)
Proceeds from maturities of available-for-sale securities	46,475	41,620
Purchases of property, plant and equipment	(6,557)	(2,726)
Proceeds from sale of property, plant and equipment	4	—
Net cash provided by (used in) investing activities	10,400	(18,160)
Cash flows from financing activities:		
Payments on long-term debt	(12,000)	(12,000)
Payments for stock repurchases	(4,989)	(4,848)
Proceeds from employee stock purchases	232	252
Proceeds from exercise of stock options	338	296
Tax payments related to stock award issuances	(396)	(741)
Net cash used in financing activities	(16,815)	(17,041)
Effect of exchange rate changes on cash and cash equivalents	(551)	1,088
Increase (decrease) in cash and cash equivalents	2,860	(17,393)
Cash and cash equivalents:		
Beginning of period	27,893	47,874
End of period	$30,753	$30,481

(continued on next page)

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

	Nine Months Ended September 30,	
	2018	**2017** *
Supplemental disclosure of cash flow information:		
Cash paid for interest	$799	$1,228
Cash paid for income taxes, net	8,622	5,686
Supplemental disclosure of non-cash investing activities:		
Capital expenditures incurred but not yet paid	$1,352	$336

*See Note 2.

See accompanying Notes to Condensed Consolidated Financial Statements.

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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, 2017 (the "2017 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. We have reclassified certain amounts in prior-period financial statements to conform to the current period's presentation. On the condensed consolidated balance sheets, we have reclassified income taxes receivable to "prepaids and other current assets," and non-current deferred income tax assets to "other assets." Further information regarding significant estimates can be found in our 2017 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 September 30, 2018 and December 31, 2017, and our results of operations and comprehensive income for the three and nine months ended September 30, 2018 and 2017, and our cash flows for the nine months ended September 30, 2018 and 2017. 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.

Recent Accounting Pronouncements

Recently Adopted Pronouncements

ASU 2018-05
In March 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-05, "Income Taxes (Topic 740)." ASU 2018-05 provides amendments to SEC paragraphs pursuant to Staff Accounting Bulletin ("SAB") No. 118 related to the accounting for the income tax effects of the Tax Cuts and Jobs Act ("TCJA" or the "Act") enacted as of December 22, 2017. ASU 2018-05 clarifies the income tax effects of the TCJA when accounting under Topic 740 is (1) complete, (2) incomplete, but for which a reasonable estimate can be determined, or (3) incomplete, but for which a reasonable estimate cannot be determined. The adoption of ASU 2018-05 as of the March 13, 2018 issuance date had no material impact on our financial position, results of operations

or cash flows. Upon further analysis of our transition tax calculation, we recorded an increase to the provisional amount of less than $0.1 million, which equates to a less than 1.0% impact to the effective tax rate, in the third quarter of 2018. This amount is included as a component of income tax expense from continuing operations. Items not yet completed include the U.S. state impact of the TCJA. We expect to finalize our calculation of the tax effects of the TCJA in the fourth quarter of 2018, and any adjustments to the provisional amounts will be recorded as a component of income tax expense from continuing operations at that time.

ASU 2017-09

In May 2017, the FASB issued ASU 2017-09, "Compensation - Stock Compensation (Topic 718) - Scope in Modification Accounting." ASU 2017-09 provides clarity and reduces diversity in practice and cost and complexity when applying the guidance in Topic 718 to a change to the terms or conditions of a share-based payment award. An entity should account for the effects of a modification unless all of certain criteria are met. Those criteria relate to fair value, vesting conditions and classification of the modified award. If all three conditions are the same for the modified award as for the original award, then the entity should not account for the effects of the modification. ASU 2017-09 is effective for all entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017. Our adoption of ASU 2017-09 as of January 1, 2018 had no material impact on our financial position, results of operations or cash flows.

ASU 2016-16
In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory." Current GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset is sold to an outside party. The amendments in ASU 2016-16 eliminate the exception for an intra-entity transfer of an asset other than inventory, and allows recognition of the income tax consequences when the transfer occurs. ASU 2016-16 is effective for public companies' fiscal years, including interim periods within those fiscal years, beginning after December 15, 2017, applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings. Our adoption of ASU 2016-16 as of January 1, 2018 had no material effect on our financial position, results of operations or cash flows.

ASU 2016-15
In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments." The amendments in ASU 2016-15 are intended to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows, with the intent of reducing diversity in practice for the eight types of cash flows identified. ASU 2016-15 is effective for public companies' fiscal years, including interim periods within those fiscal years, beginning after December 15, 2017. Our adoption of ASU 2016-15 as of January 1, 2018 had no 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 (Topic 606)." ASU 2014-09 replaces most existing revenue recognition guidance, and requires companies to recognize revenue based upon the transfer of promised goods and/or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and/or services. In addition, the standard requires disclosures related to the nature, timing, and uncertainty of revenue and cash flows arising from contracts with customers. We applied the five-step method outlined in the ASU to all revenue streams and elected the full retrospective method for our adoption of the standard as of January 1, 2018. The additional disclosures required by the ASU are included in Note 2, *Revenues*.

Recently Issued Pronouncements Not Yet Adopted

ASU 2018-15
In August 2018, the FASB issued ASU 2018-15, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract." The amendments in ASU 2018-15 align the requirements for capitalizing implementation costs incurred in a cloud computing hosting arrangement ("CCA") that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The accounting for the service element of a hosting arrangement that is a service contract is not affected. ASU 2018-15 also includes provisions for expensing the capitalized implementation costs over the term of the hosting arrangement, and application of impairment and abandonment guidance under Subtopics 350-40 and 360-10, respectively. Further, the amendments include presentation requirements in the entity's financial statements for the capitalized implementation costs and related amortization expense. ASU 2018-15 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted, and the amendments should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. We expect to have presentation changes to our consolidated balance sheets, otherwise, we do not expect the adoption of ASU 2018-15 to have a material impact to our financial statements or to our business

processes.

ASU 2018-13

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement." The amendments in ASU 2018-13 modify the disclosure requirements on fair value measurements in Topic 820 based on the concepts in the FASB Concepts Statement, *Conceptual Framework for Financial Reporting - Chapter 8: Notes to Financial Statements*, which was finalized in August 2018. The main provisions include removals, modifications, and additions of specific disclosure requirements. ASU 2018-13 is effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments should be applied prospectively for only the most recent interim or annual period presented in the initial year of adoption, while all other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted, and an entity may early adopt upon issuance of ASU 2018-13 those amendments that remove or modify disclosures and delay adoption of the additional disclosures until the effective date. While we do not expect the adoption of ASU 2018-13 to have a material effect on our business, we are evaluating the potential impact that the new ASU may have on our financial position, results of operations and cash flows.

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ASUs 2018-11, 2018-10, 2018-01 and 2016-02
In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 replaces the existing guidance in Accounting Standards Codification ("ASC") 840, Leases. The new standard requires lessees to recognize leases on-balance sheet and disclose key information about leasing arrangements. Topic 842 was subsequently amended by ASU 2018-01, "Land Easement Practical Expedient for Transition to Topic 842"; ASU 2018-10, "Codification Improvements to Topic 842, Leases"; and ASU 2018-11, "Targeted Improvements". The new standard establishes a right-of-use model ("ROU") that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases will be classified as finance or operating. For finance leases the lessee would recognize interest expense and amortization of the ROU asset, and for operating leases the lessee would recognize a straight-line total lease expense.

The new standard is effective for us on January 1, 2019, with early adoption permitted. We expect to adopt the new standard on its effective date. A modified retrospective transition approach is required, applying the new standard to all leases existing at the date of initial application. An entity may choose to use either (1) its effective date or (2) the beginning of the earliest comparative period presented in the financial statements as its date of initial application. We expect to adopt the new standard on January 1, 2019 and use the effective date as our date of initial application. Consequently, financial information will not be updated and the disclosures required under the new standard will not be provided for dates and periods before January 1, 2019.

The new standard provides a number of optional practical expedients in transition. We expect to elect the ‘package of practical expedients’, which permits us not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. We do not expect to elect the use-of-hindsight or the practical expedient pertaining to land easements; the latter not being applicable to us.

We expect the new standard to have a material effect on our financial statements. While we continue to assess all of the effects of adoption, we currently believe the most significant effects relate to the recognition of new ROU assets and lease liabilities on our balance sheet for our facilities operating leases, and providing significant new disclosures about our leasing activities. Based on our analyses to date, we have identified potential accounting and financial reporting impacts to our business processes, controls and systems as a result of the new standard, and we are planning for those changes.

We are continuing to review our existing vendor contracts for potential embedded leases as well as renewal options and whether exercises of renewal options are reasonably certain. Based on our analyses to date of our existing operating and financing leases, we currently expect to recognize additional operating lease liabilities of approximately $18 million, with corresponding ROU assets of the same amount based on the present value of the remaining minimum lease payments under current leasing standards for existing operating leases, net of reductions for the impacts of deferred rents and lease incentives.

The new standard also provides practical expedients for an entity’s ongoing accounting. We currently expect to elect the short-term lease recognition exemption for all leases that qualify. This means, for those leases that qualify, we will not recognize ROU assets or lease liabilities, and this includes not recognizing ROU assets or lease liabilities for existing short-term leases of those assets in transition. We also currently expect to elect the practical expedient to not separate lease and non-lease components for all of our leases.

ASU 2018-09
In July 2018, the FASB issued ASU 2018-09, "Codification Improvements." The FASB has a standing project to address suggestions received from stakeholders on the Accounting Standards Codification ("ASC" or "Codification") and to make other incremental improvements to GAAP. This perpetual project facilitates ASC updates for technical

corrections, clarifications, and other minor improvements, and these amendments are referred to as Codification improvements. ASU 2018-09 includes amendments affecting a wide variety of topics and applies to all reporting entities within the scope of the affected accounting guidance. The transition and effective date guidance is based on the facts and circumstances of each amendment. Some of the amendments in the ASU do not require transition guidance and are effective upon issuance of the ASU. However, many of the amendments in the ASU have transition guidance with effective dates for annual periods beginning after December 15, 2018, for public business entities. While we do not expect the adoption of ASU 2018-09 to have a material effect on our business, we are evaluating the potential impact that the new ASU may have on our financial position, results of operations and cash flows.

ASU 2018-07

In June 2018, the FASB issued ASU 2018-07, "Compensation - Stock Compensation (Topic 718) - Improvements to Nonemployee Share-Based Payment Accounting." ASU 2018-07 expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. An entity should apply the requirements of Topic 718 to nonemployee awards with certain exceptions. ASU 2018-07 specifies that Topic 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor’s own operations by issuing share-based payment awards.

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Further, Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under Topic 606, *Revenue from Contracts with Customers*. ASU 2018-07 is effective for public companies' fiscal years, including interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. While we do not expect the adoption of ASU 2018-07 to have a material effect on our business, we are evaluating the potential impact that the new ASU may have on our financial position, results of operations and cash flows.

ASU 2018-02

In February 2018, the FASB issued ASU 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220)." ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the TCJA, thereby eliminating the stranded tax effects and improving the usefulness of reported information to financial statement users. ASU 2018-02 is effective for all entities for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period, for public business entities for which financial statements have not yet been issued. While we do not expect the adoption of ASU 2018-02 to have a material effect on our business, we are evaluating the potential impact that ASU 2018-02 may have on our financial position, results of operations and cash flows.

ASU 2017-12

In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815) - Targeted Improvements to Accounting for Hedging Activities." ASU 2017-12 provides better alignment of an entity's risk management activities and financial reporting of hedges through changes to both the designation and measurement guidance for qualifying hedging relationships. In addition, the amendments in ASU 2017-12 also simplify the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements to increase the understandability of the results of an entity's intended hedging strategies. ASU 2017-12 is effective for public companies' fiscal years, including interim periods within those fiscal years, beginning after December 15, 2018. Early application is permitted in any interim period after issuance of the new standard, with effect of adoption reflected as of the beginning of the fiscal year of adoption. For cash flow and net investment hedges existing as of the adoption date, an entity should apply a cumulative-effect adjustment related to eliminating the separate measurement of ineffectiveness to accumulated other comprehensive income and opening retaining earnings. Amended presentation and disclosure guidance is required only prospectively, and certain transition elections are available upon adoption. While we do not expect the adoption of ASU 2017-12 to have a material effect on our business, we are evaluating the potential impact that ASU 2017-12 may have on our financial position, results of operations and cash flows.

(2) REVENUES

Adoption of Topic 606

On January 1, 2018, we adopted ASU 2014-09 and all subsequent ASUs that modified ASC 606. We elected to apply the standard and all related ASUs retrospectively to each prior reporting period presented. The implementation of the new standard had no material impact on the measurement or recognition of revenue, resulting in no adjustments to prior periods. Additional disclosures, however, have been added in accordance with the ASU.

Revenue Recognition

Revenues are recognized when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services. Our product sales and shipping revenues are reported net of promotional discounts, returns allowances, contractual rebates, and consideration payable to our customers. We estimate the revenue impact of retail sales incentive programs based on the planned duration of the program and historical experience. If the amount of sales incentives is reasonably estimable, the impact of such incentives is recorded at the later of the time the customer is notified of the sales incentive or the time of the sale. We estimate our liability for product returns based on historical experience, and record the expected customer refund liability as a reduction of revenue, and the expected inventory right of recovery, net of estimated scrap, as a reduction of cost of sales. If actual return costs differ from previous estimates, the amount of the liability and corresponding revenue are adjusted in the period in which such costs occur.

We provide standard assurance-type warranties on our products which cover defective materials or nonconforming products, and is included with each product at no additional charge. In addition, we offer service-type/extended warranties for an additional fee to our Direct channel customers and Retail specialty and commercial customers. These warranty contracts provide coverage on labor and parts beyond the standard assurance warranty period.

For our product sales, services, and freight and delivery fees, we are the principal in the contract and recognize revenue at a point in time. For our Direct channel extended warranty contracts, we are the agent and recognize revenue on a net basis because our performance obligation is to facilitate the arrangement between our customers and the third-party performance obligor.

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For customer contracts that include multiple performance obligations, we allocate revenue to each performance obligation based on its relative standalone selling price. We generally determine standalone selling price based on prices charged to customers or using expected cost plus margin.

Our revenues from contracts with customers disaggregated by revenue source, excluding sales-based taxes, were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Product sales	$88,068	$84,816	$269,288	$266,057
Extended warranties and services	1,611	1,927	6,830	7,789
Other[(1)]	1,378	1,389	5,250	4,567
Net sales	$91,057	$88,132	$281,368	$278,413

[(1)] Other revenue is primarily freight and delivery and royalty income.

Our revenues disaggregated by geographic region, based on ship-to address, were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
United States	$81,423	$74,597	$250,502	$242,365
Canada	4,306	6,984	13,372	17,701
All other	5,328	6,551	17,494	18,347
Net sales	$91,057	$88,132	$281,368	$278,413

As of September 30, 2018, estimated revenue expected to be recognized in the future totaled $3.0 million, primarily related to customer order backlog which includes firm orders for future shipment to our Retail customers, as well as unfulfilled consumer orders within the Direct channel. Retail orders of $2.4 million and Direct orders of $0.6 million comprise our backlog as of September 30, 2018. The estimated future revenues are net of contractual rebates and consideration payable for applicable Retail customers, and net of current promotional programs and sales discounts for our Direct customers.

The following table provides information about our liabilities from contracts with customers, primarily customer deposits and deferred revenue, all of which are short-term in nature. The revenue recognized from contract liabilities and the remaining balances are shown below (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Balance, beginning of period	$748	$956	$1,084	$1,096
Cash additions	354	99	1,347	1,159
Revenue recognition	(227)	(185)	(1,556)	(1,385)
Balance, end of period	$875	$870	$875	$870

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Exemptions and Elections
We apply the practical expedient as per ASC 606-10-50-14 and do not disclose information related to remaining performance obligations due to their original expected durations are one year or less.

We expense sales commissions when incurred because the amortization period would have been less than one year. These costs are recorded in selling and marketing expense.

We generally account for our shipping and handling activities as a fulfillment activity, consistent with the timing of revenue recognition; that is, when our customer takes control of the transferred goods. In the event that a customer were to take control of a product prior to shipment, we make an accounting policy election to treat such shipping and handling activities as a fulfillment cost.

(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 and liabilities measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017 were as follows (in thousands):

	September 30, 2018			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Cash Equivalents				
Money market funds	$8,464	$—	$ —	$8,464
Commercial paper	—	4,986	—	4,986
Total cash equivalents	8,464	4,986	—	13,450
Available-for-Sale Securities				
Certificates of deposit[(1)]	—	18,474	—	18,474
Corporate bonds	—	10,050	—	10,050
U.S. government bonds	—	11,828	—	11,828
Total available-for-sale securities	—	40,352	—	40,352
Derivatives				
Interest rate swap contract	—	537	—	537
Total derivatives	—	537	—	537
Total assets measured at fair value	$8,464	$45,875	$ —	$54,339
Liabilities:				
Derivatives				
Foreign currency forward contracts	$—	$(224)	$ —	$(224)
Total liabilities measured at fair value	$—	$(224)	$ —	$(224)

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	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash Equivalents				
Money market funds	$10,946	$—	$ —	$10,946
Commercial paper	—	1,996	—	1,996
Total cash equivalents	10,946	1,996	—	12,942
Available-for-Sale Securities				
Certificates of deposit[1]	—	19,875	—	19,875
Corporate bonds	—	29,239	—	29,239
U.S. government bonds	—	8,189	—	8,189
Total available-for-sale securities	—	57,303	—	57,303
Derivatives				
Interest rate swap contract	—	372	—	372
Foreign currency forward contracts	—	390	—	390
Total derivatives	—	762	—	762
Total assets measured at fair value	$10,946	$60,061	$ —	$71,007

(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 December 31, 2017.

For our assets measured at fair value on a recurring basis, 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 nine months ended September 30, 2018, nor for the year ended December 31, 2017.

We did not have any changes to our valuation techniques during the nine months ended September 30, 2018, nor for the year ended December 31, 2017.

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 for identical assets, 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.

The fair values of our interest rate swap contract and our foreign currency forward contracts are calculated as the present value of estimated future cash flows using discount factors derived from relevant Level 2 market inputs, including forward curves and volatility levels.

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 nine months of 2018. During the fourth quarter of 2017, we performed our annual goodwill and indefinite-lived trade names impairment analyses effective as of October 1, 2017. During the nine months ended September 30, 2018, we did not record any other-than-temporary impairments on our financial assets required to be measured at fair value on a nonrecurring basis. For the year ended December 31, 2017, we recorded an impairment to our indefinite-lived Octane Fitness trade name in the amount of $8.8 million.

The carrying values of cash and cash equivalents, trade receivables, prepaids and other current assets, trade payables and accrued liabilities approximate fair value due to their short maturities. The carrying value of our term loan approximates its fair value and falls under Level 2 of the fair value hierarchy, as the interest rate is variable and based on current market rates.

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(4) DERIVATIVES

From time to time, we enter into interest rate swaps to fix a portion of our interest expense, and foreign exchange forward contracts to offset the earnings impacts of exchange rate fluctuations on certain monetary assets and liabilities. We do not enter into derivative instruments for any purpose other than to manage interest rate or foreign currency exposure. That is, we do not engage in interest rate or currency exchange rate speculation using derivative instruments.

As of September 30, 2018, we had a $36.0 million interest rate swap outstanding with JPMorgan Chase Bank, N.A. This interest rate swap matures on December 31, 2020 and has a fixed rate of 1.42% per annum. The variable rate on the interest rate swap is the one-month LIBOR benchmark. At September 30, 2018, the one-month LIBOR rate was 2.08%.

We typically designate all interest rate swaps as cash flow hedges and, accordingly, record the change in fair value for the effective portion of these interest rate swaps in accumulated other comprehensive income rather than current period earnings until the underlying hedged transaction affects earnings. Gains and losses on the derivative representing hedge ineffectiveness are recognized in current earnings. For the three and nine months ended September 30, 2018, there was no ineffectiveness. As of September 30, 2018, we expect to reclassify a gain of $0.4 million from accumulated other comprehensive income to earnings within the next twelve months.

We may hedge our net recognized foreign currency assets and liabilities with forward foreign exchange contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in foreign currency exchange rates. These derivative instruments hedge assets and liabilities that are denominated in foreign currencies and are carried at fair value with changes in the fair value recorded as other income. These derivative instruments do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being hedged. As of September 30, 2018, total outstanding contract notional amounts were $27.6 million. At September 30, 2018, these outstanding balance sheet hedging derivatives had maturities of 90 days or less.

The fair value of our derivative instruments was included in our condensed consolidated balance sheets as follows (in thousands):

	Balance Sheet Classification	**As of**	
		September 30, 2018	**December 31, 2017**
Derivative instruments designated as cash flow hedges:			
Interest rate swap contract	Prepaids and other current assets	$ 357	$ 134
	Other assets	180	238
		$ 537	$ 372
Derivative instruments not designated as cash flow hedges:			
Foreign currency forward contracts	Prepaids and other current assets	$ —	$ 390
	Accrued liabilities	224	—
		$ 224	$ 390

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The effect of derivative instruments on our condensed consolidated statements of operations was as follows (in thousands):

	Statement of Operations Classification	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Derivative instruments designated as cash flow hedges:					
Income recognized in other comprehensive income before reclassifications	---	$ 28	$ 8	$ 242	$ 6
Income (loss) reclassified from accumulated other comprehensive income to earnings for the effective portion	Interest expense	65	(26)	140	(189)
Income tax benefit (expense)	Income tax expense	(19)	11	(36)	65
Derivative instruments not designated as cash flow hedges:					
Loss recognized in earnings	Other, net	$ (601)	$ (53)	$ (789)	$ (53)
Income tax benefit	Income tax expense	176	18	200	18

For additional information related to our derivatives, see Notes 3 and 10.

(5) INVENTORIES

Inventories are stated at the lower of cost and net realizable value, with cost determined based on the first-in, first-out method. Our inventories consisted of the following (in thousands):

	As of September 30, 2018	December 31, 2017
Finished goods	$51,219	$ 48,771
Parts and components	4,330	4,583
Total inventories	$55,549	$ 53,354

(6) PROPERTY, PLANT AND EQUIPMENT

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

	Estimated Useful Life (in years)	As of September 30, 2018	December 31, 2017
Automobiles	5 to 6	$23	$ 23
Leasehold improvements	4 to 20	3,782	3,542
Computer software and equipment	3 to 7	16,243	17,024
Machinery and equipment	3 to 5	17,234	15,178
Furniture and fixtures	5 to 20	2,823	2,295
Work in progress[1]	N/A	5,556	1,052
Total cost		45,661	39,114
Accumulated depreciation		(26,081)	(23,287)
Total property, plant and equipment, net		$19,580	$ 15,827

[1] Work in progress includes information technology assets and production tooling.

Depreciation expense was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Depreciation expense	$1,393	$1,056	$4,266	$3,940

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(7) GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

The rollforward of goodwill was as follows (in thousands):

	Direct	Retail	Total
Balance, January 1, 2017	$2,180	$59,708	$61,888
Currency exchange rate adjustment	155	(13)	142
Balance, December 31, 2017	2,335	59,695	62,030
Currency exchange rate adjustment	(65)	4	(61)
Balance, September 30, 2018	$2,270	$59,699	$61,969

Other Intangible Assets

Other intangible assets consisted of the following (in thousands):

	Estimated Useful Life (in years)	As of September 30, 2018	December 31, 2017
Indefinite-lived trademarks	N/A	$23,252	$ 23,252
Definite-lived trademarks	10 to 15	2,600	2,600
Patents	8 to 24	13,833	15,187
Customer relationships	10 to 15	24,700	24,700
		64,385	65,739
Accumulated amortization - definite-lived intangible assets		(9,021)	(7,996)
Other intangible assets, net		$55,364	$ 57,743

Amortization expense was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Amortization expense	$785	$812	$2,380	$2,446

Future amortization of definite-lived intangible assets is as follows (in thousands):

Remainder of 2018 $