NAUTILUS, INC.
Form 10-Q
July 31, 2018

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2018-01-01 2018-06-30 0001078207 us-gaap:OperatingSegmentsMember nls:DirectMember 2017-01-01 2017-06-30 0001078207 us-gaap:OperatingSegmentsMember nls:UnallocatedRoyaltyIncomeMember 2018-04-01 2018-06-30 0001078207 us-gaap:MaterialReconcilingItemsMember 2017-01-01 2017-06-30 0001078207 us-gaap:MaterialReconcilingItemsMember 2017-01-01 2017-06-30 0001078207 us-gaap:OperatingSegmentsMember 2018-01-01 2018-06-30 0001078207 us-gaap:MaterialReconcilingItemsMember 2018-04-01 2018-06-30 0001078207 us-gaap:OperatingSegmentsMember nls:RetailMember 2018-04-01 2018-06-30 0001078207 us-gaap:OperatingSegmentsMember nls:RetailMember 2017-01-01 2017-06-30 0001078207 us-gaap:OperatingSegmentsMember nls:RetailMember 2017-04-01 2017-06-30 0001078207 us-gaap:OperatingSegmentsMember nls:UnallocatedRoyaltyIncomeMember 2017-04-01 2017-06-30 0001078207 us-gaap:OperatingSegmentsMember nls:DirectMember 2018-01-01 2018-06-30 0001078207 us-gaap:OperatingSegmentsMember nls:UnallocatedRoyaltyIncomeMember 2017-01-01 2017-06-30 0001078207 us-gaap:OperatingSegmentsMember nls:UnallocatedRoyaltyIncomeMember 2018-01-01 2018-06-30 0001078207 us-gaap:InventoriesMember 2018-06-30 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 June 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 July 27, 2018 was 30,248,133 shares.

NAUTILUS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 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 June 30, 2018	December 31, 2017 *
Assets		
Cash and cash equivalents	$25,929	$27,893
Available-for-sale securities	59,987	57,303
Trade receivables, net of allowances of $54 and $119	25,275	42,685
Inventories	42,262	53,354
Prepaids and other current assets	12,342	7,257
Total current assets	165,795	188,492
Property, plant and equipment, net	17,792	15,827
Goodwill	61,928	62,030
Other intangible assets, net	56,149	57,743
Deferred income tax assets, non-current	78	—
Other assets	614	684
Total assets	$302,356	$324,776
Liabilities and Shareholders' Equity		
Trade payables	$46,633	$66,899
Accrued liabilities	9,194	10,764
Warranty obligations, current portion	3,915	3,718
Note payable, current portion, net of unamortized debt issuance costs of $7 and $7	15,993	15,993
Total current liabilities	75,735	97,374
Warranty obligations, non-current	1,787	2,399
Income taxes payable, non-current	3,186	2,955
Deferred income tax liabilities, non-current	9,978	8,558
Other non-current liabilities	2,091	2,315
Note payable, non-current, net of unamortized debt issuance costs of $11 and $14	23,989	31,986
Total liabilities	116,766	145,587
Commitments and contingencies (Note 14)		
Shareholders' equity:		
Common stock - no par value, 75,000 shares authorized, 30,237 and 30,305 shares issued and outstanding	462	—
Retained earnings	185,689	179,448
Accumulated other comprehensive loss	(561)	(259)
Total shareholders' equity	185,590	179,189
Total liabilities and shareholders' equity	$302,356	$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 June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017** *
Net sales	$75,498	$77,029	$190,311	$190,281
Cost of sales	41,850	38,651	97,792	90,158
Gross profit	33,648	38,378	92,519	100,123
Operating expenses:				
Selling and marketing	22,084	23,628	58,847	61,293
General and administrative	6,327	7,315	13,237	14,801
Research and development	4,035	3,586	8,536	7,497
Total operating expenses	32,446	34,529	80,620	83,591
Operating income	1,202	3,849	11,899	16,532
Other income (expense):				
Interest income	294	175	566	306
Interest expense	(268)	(412)	(561)	(856)
Other, net	31	110	18	63
Total other income (expense), net	57	(127)	23	(487)
Income from continuing operations before income taxes	1,259	3,722	11,922	16,045
Income tax expense	252	1,156	2,775	5,294
Income from continuing operations	1,007	2,566	9,147	10,751
Discontinued operations:				
Loss from discontinued operations before income taxes	(11)	(29)	(28)	(1,655)
Income tax expense (benefit) of discontinued operations	68	48	132	(486)
Loss from discontinued operations	(79)	(77)	(160)	(1,169)
Net income	$928	$2,489	$8,987	$9,582
Basic income per share from continuing operations	$0.03	$0.08	$0.30	$0.35
Basic loss per share from discontinued operations	—	—	(0.01)	(0.04)
Basic net income per share[1]	$0.03	$0.08	$0.30	$0.31
Diluted income per share from continuing operations	$0.03	$0.08	$0.30	$0.35
Diluted loss per share from discontinued operations	—	—	(0.01)	(0.04)
Diluted net income per share	$0.03	$0.08	$0.29	$0.31
Shares used in per share calculations:				
Basic	30,193	30,755	30,253	30,734
Diluted	30,476	31,095	30,533	31,110

*See Note 2.
(1) May not add due to rounding.

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 June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017 *
Net income	$928	$2,489	$8,987	$9,582
Other comprehensive income (loss):				
Unrealized gain (loss) on available-for-sale securities, net of income tax expense (benefit) of $11, $(5), $(7) and $(17)	34	(9)	(3)	(28)
Gain (loss) on derivative securities, effective portion, net of income tax expense (benefit) of $4, $(7), $32 and $65	12	(12)	156	107
Foreign currency translation, net of income tax expense of $3, $2, $0 and $2	(338)	330	(455)	401
Other comprehensive income (loss)	(292)	309	(302)	480
Comprehensive income	$636	$2,798	$8,685	$10,062

*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)

	Six Months Ended June 30,	
	2018	**2017** *
Cash flows from operating activities:		
Income from continuing operations	$9,147	$10,751
Loss from discontinued operations	(160)	(1,169)
Net income	8,987	9,582
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	4,468	4,518
Provision (recovery) of allowance for doubtful accounts	(39)	221
Inventory lower-of-cost-or-market/NRV adjustments	179	258
Stock-based compensation expense	747	1,130
Loss on asset dispositions	1	—
Deferred income taxes, net of valuation allowance	1,323	67
Other	23	(65)
Changes in operating assets and liabilities:		
Trade receivables	17,506	20,982
Inventories	10,821	4,226
Prepaids and other current assets	(734)	2,141
Income taxes receivable	(4,115)	(809)
Trade payables	(20,659)	(19,477)
Accrued liabilities, including warranty obligations	(1,919)	(4,897)
Net cash provided by operating activities	16,589	17,877
Cash flows from investing activities:		
Purchases of available-for-sale securities	(29,522)	(53,573)
Proceeds from maturities of available-for-sale securities	26,815	21,735
Purchases of property, plant and equipment	(4,228)	(1,084)
Net cash used in investing activities	(6,935)	(32,922)
Cash flows from financing activities:		
Payments on long-term debt	(8,000)	(8,000)
Payments for stock repurchases	(3,127)	(3,427)
Proceeds from exercise of stock options	492	490
Tax payments related to stock award issuances	(396)	(741)
Net cash used in financing activities	(11,031)	(11,678)
Effect of exchange rate changes on cash and cash equivalents	(587)	660
Decrease in cash and cash equivalents	(1,964)	(26,063)
Cash and cash equivalents:		
Beginning of period	27,893	47,874
End of period	$25,929	$21,811
Supplemental disclosure of cash flow information:		
Cash paid for interest	$558	$851
Cash paid for income taxes, net	6,366	5,289
Supplemental disclosure of non-cash investing activities:		
Capital expenditures incurred but not yet paid	$437	$338

*See Note 2.

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, 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." 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 June 30, 2018 and December 31, 2017, and our results of operations, comprehensive income and cash flows for the three and six months ended June 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") 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. With the adoption of ASU 2018-05 under the provisions of SAB 118, we made an effort to reasonably estimate the impact of the TCJA, however, we have not completed our accounting under Topic 740 as of June 30, 2018.

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.

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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 2018-10
In July 2018, the FASB issued ASU 2018-10, "Codification Improvements to Topic 842, Leases." The amendments in ASU 2018-10 clarify, correct or remove inconsistencies in the guidance provided under ASU 2016-02 (see below) related to sixteen specific issues identified. ASU 2018-10 is effective for public companies' annual periods, and interim periods within those fiscal years, beginning after December 15, 2018, in accordance with Topic 842. We will be evaluating the potential impact of ASU 2018-10 to our company, however, as with other Topic 842 updates, we expect ASU 2018-10 to have a material impact on our financial position, results of operations and cash flows. Further, we also anticipate significant additional disclosure requirements associated with the new standard.

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. 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

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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.

ASU 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 companies and other organizations to include lease obligations on their balance sheets, including a dual approach for lessee accounting under which a lessee would account for leases as finance leases or operating leases. Both finance leases and operating leases will result in the lessee recognizing a right-of-use ("ROU") asset and a corresponding lease liability. 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. Lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. ASU 2016-02, as amended, is effective for public companies' annual periods, and interim periods within those fiscal years, beginning after December 15, 2018. We are currently assessing the impact that ASU 2016-02 will have on our consolidated financial statements, and expect that the primary impact upon adoption will be the recognition, on a discounted basis, of our minimum commitments under non-cancellable operating leases on our consolidated balance sheets, resulting in the recording of ROU assets and lease liabilities, as well as additional disclosures. Based on initial high-level assessments of our main facilities leases related to our domestic operations, we expect ASU 2016-02 to have a material impact on our financial position, results of operations and cash flows. Further, analysis of our leases population is still in progress. We also anticipate significant additional disclosure requirements associated with the new standard.

(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

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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.

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 June 30,		**Six Months Ended June 30,**	
	2018	**2017**	**2018**	**2017**
Product sales	$71,470	$73,399	$181,220	$181,241
Extended warranties and services	1,737	2,061	5,219	5,862
Other[1]	2,291	1,569	3,872	3,178
Net sales	$75,498	$77,029	$190,311	$190,281

[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 June 30,		**Six Months Ended June 30,**	
	2018	**2017**	**2018**	**2017**
United States	$65,498	$66,731	$169,079	$167,768
Canada	3,283	3,597	9,066	10,717
All other	6,717	6,701	12,166	11,796
Net sales	$75,498	$77,029	$190,311	$190,281

As of June 30, 2018, estimated revenue expected to be recognized in the future totaled $1.1 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 $0.6 million and Direct orders of $0.6 million comprise our backlog as of June 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 June 30,		**Six Months Ended June 30,**	
	2018	**2017**	**2018**	**2017**
Balance, beginning of period	$693	$1,066	$1,084	$1,096
Cash additions	304	314	993	1,060
Revenue recognition	(249)	(424)	(1,329)	(1,200)
Balance, end of period	$748	$956	$748	$956

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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.

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(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 June 30, 2018 and December 31, 2017 were as follows (in thousands):

	June 30, 2018			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash Equivalents				
Money market funds	$1,821	$—	$ —	$1,821
Commercial paper	—	4,990	—	4,990
Total cash equivalents	1,821	4,990	—	6,811
Available-for-Sale Securities				
Certificates of deposit[1]	—	20,380	—	20,380
Corporate bonds	—	24,631	—	24,631
U.S. government bonds	—	14,976	—	14,976
Total available-for-sale securities	—	59,987	—	59,987
Derivatives				
Interest rate swap contract	—	561	—	561
Total derivatives	—	561	—	561
Total assets measured at fair value	$1,821	$65,538	$ —	$67,359
Liabilities:				
Derivatives				
Foreign currency forward contracts	$—	$(667)	$ —	$(667)
Total liabilities measured at fair value	$—	$(667)	$ —	$(667)

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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 six months ended June 30, 2018, nor for the year ended December 31, 2017.

We did not have any changes to our valuation techniques during the six months ended June 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 six 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 six months ended June 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 June 30, 2018, we had a $40.0 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 June 30, 2018, the one-month LIBOR rate was 1.98%.

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 six months ended June 30, 2018, there was no ineffectiveness. As of June 30, 2018, we expect to reclassify a gain of $0.3 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 June 30, 2018, total outstanding contract notional amounts were $16.3 million. At June 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 June 30, 2018**	**December 31, 2017**
Derivative instruments designated as cash flow hedges:			
Interest rate swap contract	Prepaids and other current assets	$ 332	$ 134
	Other assets	229	238
		$ 561	$ 372
Derivative instruments not designated as cash flow hedges:			
Foreign currency forward contracts	Prepaids and other current assets	$ —	$ 390
	Accrued liabilities	667	—
		$ 667	$ 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 June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Derivative instruments designated as cash flow hedges:					
Income (loss) recognized in other comprehensive income before reclassifications	---	$54	$(53)	$214	$(2)
Income (loss) reclassified from accumulated other comprehensive income to earnings for the effective portion	Interest expense	54	(61)	75	(163)
Income tax benefit (expense)	Income tax expense	(12)	20	(17)	54
Derivative instruments not designated as cash flow hedges:					
Income recognized in earnings	Other, net	$895	$—	$1,924	$—
Income tax expense	Income tax expense	(204)	—	(448)	—

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 June 30, 2018	December 31, 2017
Finished goods	$37,965	$ 48,771
Parts and components	4,297	4,583
Total inventories	$42,262	$ 53,354

(6) PROPERTY, PLANT AND EQUIPMENT

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

	Estimated Useful Life (in years)	As of June 30, 2018	December 31, 2017
Automobiles	5 to 6	$23	$ 23
Leasehold improvements	4 to 20	3,676	3,542
Computer software and equipment	3 to 7	16,213	17,024
Machinery and equipment	3 to 5	15,961	15,178
Furniture and fixtures	5 to 20	2,792	2,295
Work in progress[(1)]	N/A	3,816	1,052
Total cost		42,481	39,114
Accumulated depreciation		(24,689)	(23,287)
Total property, plant and equipment, net		$17,792	$ 15,827

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

Depreciation expense was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Depreciation expense	$1,244	$1,457	$2,873	$2,884

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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	(105)	3	(102)
Balance, June 30, 2018	$2,230	$59,698	$61,928

Other Intangible Assets

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

	Estimated Useful Life (in years)	As of June 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	15,187	15,187
Customer relationships	10 to 15	24,700	24,700
		65,739	65,739
Accumulated amortization - definite-lived intangible assets		(9,590)	(7,996)
Other intangible assets, net		$56,149	$ 57,743

Amortization expense was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Amortization expense	$785	$817	$1,595	$1,634

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

Remainder of 2018	$1,569
2019	3,134
2020	3,108
2021	3,078
2022	3,078
Thereafter	18,930
	$32,897

(8) ACCRUED LIABILITIES

Accrued liabilities consisted of the following (in thousands):

	As of June 30, 2018	December 31, 2017

Payroll and related liabilities	$3,565	$ 3,659
Other	5,629	7,105
Total accrued liabilities	$9,194	$ 10,764

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(9) PRODUCT WARRANTIES

Our products carry defined warranties for defects in materials or workmanship which, according to their terms, generally obligate us to pay the costs of supplying and shipping replacement parts to customers and, in certain instances, pay for labor and other costs to service products. Outstanding product warranty periods range from thirty days to, in limited circumstances, the lifetime of certain product components. We record a liability at the time of sale for the estimated costs of fulfilling future warranty claims. If necessary, we adjust the liability for specific warranty-related matters when they become known and are reasonably estimable. Estimated warranty expense is included in cost of sales, based on historical warranty claim experience and available product quality data. Warranty expense is affected by the performance of new products, significant manufacturing or design defects not discovered until after the product is delivered to the customer, product failure rates, and higher or lower than expected repair costs. If warranty expense differs from previous estimates, or if circumstances change such that the assumptions inherent in previous estimates are no longer valid, the amount of product warranty obligations is adjusted accordingly.

Changes in our product warranty obligations were as follows (in thousands):

	Six Months Ended June 30,	
	2018	2017
Balance, beginning of period	$6,117	$7,450
Accruals	1,834	1,470
Payments	(2,249)	(2,269)
Balance, end of period	$5,702	$6,651

(10) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following tables set forth the changes in accumulated other comprehensive income (loss), net of tax (in thousands) for the periods presented:

	Unrealized Gain (Loss) on Available-for-Sale Securities	Gain on Derivative Securities	Foreign Currency Translation Adjustments	Accumulated Other Comprehensive Loss
Balance, April 1, 2018	$ (101)	$ 360	$ (528)	$ (269)
Current period other comprehensive income (loss) before reclassifications	34	54	(338)	(250)
Reclassification of amounts to earnings	—	(		