

NAUTILUS, INC.
Form 10-Q
August 08, 2013

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

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 (I.R.S. Employer
incorporation or organization) Identification No.)
17750 S.E. 6th Way

Vancouver, Washington 98683

(Address of principal executive offices, including zip code)

(360) 859-2900

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer (do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

The number of shares outstanding of the registrant's common stock as of July 31, 2013 was 31,116,508 shares.

NAUTILUS, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2013

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

NAUTILUS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited and in thousands)

	June 30, 2013	December 31, 2012
Assets		
Cash and cash equivalents	\$ 28,370	\$ 23,207
Trade receivables, net of allowances of \$ 93 and \$ 93	8,141	21,767
Inventories	13,348	18,787
Prepays and other current assets	4,363	5,750
Income taxes receivable	77	101
Short-term notes receivable		82
Deferred income tax assets	3,274	193
Total current assets	57,573	69,887
Property, plant and equipment, net	7,502	6,138
Goodwill	2,784	2,940
Other intangible assets, net	13,641	14,666
Long-term deferred income tax assets	28,601	239
Other assets	434	441
Total assets	\$ 110,535	\$ 94,311
Liabilities and Stockholders' Equity		
Trade payables	\$ 16,565	\$ 32,753
Accrued liabilities	5,698	8,171
Warranty obligations, current portion	2,134	2,278
Deferred income tax liabilities		1,275
Total current liabilities	24,397	44,477
Warranty obligations, non-current	28	214
Income taxes payable, non-current	2,873	2,812
Deferred income tax liabilities, non-current		1,484

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Other long-term liabilities	1,812	1,998
Total liabilities	29,110	50,985
Commitments and contingencies (Note 11)		
Stockholders' Equity:		
Common stock, no par value. 75,000 authorized, 31,110 and 30,924 shares issued and outstanding	6,512	6,103
Retained earnings	74,620	36,598
Accumulated other comprehensive income	293	625
Total stockholders' equity	81,425	43,326
Total liabilities and stockholders' equity	\$ 110,535	\$ 94,311

See accompanying Notes to Condensed Consolidated Financial Statements.

NAUTILUS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited and in thousands, except per share amounts)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
Net sales	\$ 36,242	\$ 39,583	\$ 95,456	\$ 90,845
Cost of sales	18,913	22,415	47,433	49,772
Gross profit	17,329	17,168	48,023	41,073
Operating expenses:				
Selling and marketing	13,768	12,557	32,394	28,623
General and administrative	3,982	4,291	8,929	8,301
Research and development	1,303	919	2,430	1,919
Total operating expenses	19,053	17,767	43,753	38,843
Operating income (loss)	(1,724)	(599)	4,270	2,230
Other income (expense):				
Interest income		7	1	13
Interest expense	(6)	(3)	(15)	75
Other	130	(84)	21	(86)
Total other income (expense)	124	(80)	7	2
Income (loss) from continuing operations before income taxes	(1,600)	(679)	4,277	2,232
Income tax provision (benefit)	(34,268)	(193)	(33,915)	71
Income (loss) from continuing operations	32,668	(486)	38,192	2,161
Discontinued operation:				
Income (loss) from discontinued operation before income taxes	113	237	(261)	114
Income tax benefit of discontinued operation	(82)	(85)	(91)	(83)
Income (loss) from discontinued operation	195	322	(170)	197
Net income (loss)	\$ 32,863	\$ (164)	\$ 38,022	\$ 2,358
Basic income (loss) per share from continuing operations	\$ 1.05	\$ (0.02)	\$ 1.23	\$ 0.07
Basic income (loss) per share from discontinued operation	0.01	0.01	(0.01)	0.01
Basic net income (loss) per share ⁽¹⁾	\$ 1.06	\$ (0.01)	\$ 1.23	\$ 0.08
Diluted income (loss) per share from continuing operations	\$ 1.04	\$ (0.02)	\$ 1.22	\$ 0.07
Diluted income (loss) per share from discontinued operation	0.01	0.01	(0.01)	0.01

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Diluted net income (loss) per share	\$	1.05	\$	(0.01)	\$	1.21	\$	0.08
Shares used in per share calculations:								
Basic		31,058		30,878		31,003		30,878
Diluted		31,430		30,878		31,360		30,987

(1) May not add due to rounding.

See accompanying Notes to Condensed Consolidated Financial Statements.

NAUTILUS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited and in thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
Net income (loss)	\$ 32,863	\$ (164)	\$ 38,022	\$ 2,358
Other comprehensive income (loss):				
Foreign currency translation, net of income tax expense of \$ 12, \$9, \$21 and \$1	(185)	(254)	(332)	(75)
Comprehensive income (loss)	\$ 32,678	\$ (418)	\$ 37,690	\$ 2,283

See accompanying Notes to Condensed Consolidated Financial Statements.

NAUTILUS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited and in thousands)

	For the Six Months Ended June 30,	
	2013	2012
Cash flows from operating activities:		
Income from continuing operations	\$ 38,192	\$ 2,161
Income (loss) from discontinued operation	(170)	197
Net income	38,022	2,358
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,644	1,528
Bad debt expense (reduction)	417	(123)
Stock-based compensation	134	294
Reduction of previously estimated asset disposal loss		(77)
Loss on asset dispositions	4	14
Deferred income taxes, net of valuation allowance	(34,414)	385
Changes in operating assets and liabilities:		
Trade receivables, net	13,082	13,234
Inventories	5,426	(993)
Prepaid and other current assets	1,377	1,445
Income taxes	(34)	(200)
Trade payables	(16,155)	(11,645)
Accrued liabilities, including warranty obligations	(2,678)	(1,676)
Net cash provided by operating activities	6,825	4,544
Cash flows from investing activities:		
Proceeds from sale of assets of discontinued operation	110	217
Purchases of software and equipment	(1,941)	(1,110)
Net cash used in investing activities	(1,831)	(893)
Cash flows from financing activities:		
Repayment of long-term borrowings		(5,000)
Proceeds from exercise of stock options	275	89
Net cash provided by (used in) financing activities	275	(4,911)
Effect of exchange rate changes on cash and cash equivalents	(106)	(36)
Increase (decrease) in cash and cash equivalents	5,163	(1,296)

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Cash and cash equivalents:			
Beginning of period		23,207	17,427
End of period	\$	28,370	\$ 16,131
Supplemental disclosure of cash flow information:			
Cash paid for interest	\$	16	\$ 524
Cash paid (refunded) for income taxes, net		188	(119)

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, 2012 (the 2012 Form 10-K).

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Further information regarding significant estimates can be found in our 2012 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, 2013 and December 31, 2012 and our results of operations, comprehensive income and cash flows for the three and six months ended June 30, 2013 and 2012. Interim results are not necessarily indicative of results for a full year. Our revenues typically vary seasonally and this seasonality can have a significant effect on operating results, inventory levels and working capital needs.

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

New Accounting Pronouncements

ASU 2012-02

In July 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2012-02, Intangibles Goodwill and Other: Testing Indefinite-Lived Intangible Assets for Impairment, which permits an entity to make a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset, other than goodwill, is impaired. Entities are required to test indefinite-lived intangible assets for impairment at least annually and more frequently if indicators of impairment exist. If an entity concludes, based on an evaluation of all relevant qualitative factors, that it is not more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount, it is not required to perform the quantitative impairment test for that asset. Because the qualitative assessment is optional, an entity is permitted to bypass it for any indefinite-lived intangible asset in any period and apply the quantitative test. ASU 2012-02 also permits the entity to resume performing the qualitative assessment in any subsequent period. ASU 2012-02 is effective for impairment tests performed for fiscal years beginning after September 15, 2012 and early adoption is permitted. The adoption of ASU 2012-02 in January 2013 did not have any impact on our financial position, results of operations or cash flows.

ASU 2013-02

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. Under ASU 2013-02, an entity is required to provide information about the amounts reclassified out of Accumulated Other Comprehensive Income (AOCI) by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those

amounts. The adoption of ASU 2013-02 in January 2013 did not have any impact on our financial position, results of operations or cash flows.

(2) DISCONTINUED OPERATION

On September 25, 2009, in light of continuing operating losses in our Commercial business and in order to focus exclusively on managing our Direct and Retail businesses, we committed to a plan for the complete divestiture of our Commercial business, which qualified for held-for-sale accounting treatment. The Commercial business is presented as a Discontinued Operation in our Condensed Consolidated Statements of Operations for all periods.

The disposal of the Commercial business assets was completed in April 2011. We reached substantial completion of asset liquidation at December 2012. However, we continue to have minor legal and accounting expenses as we work with authorities on final deregistration of certain European entities. There was no revenue related to the Commercial business for the year ended December 31, 2012 or the six-month period ended June 30, 2013.

The following table summarizes liabilities for exit costs related to the discontinued operation, included in Accrued Liabilities and Other Long-Term Liabilities in our Condensed Consolidated Balance Sheets (in thousands):

	Facilities Leases
Balance as of December 31, 2012	\$ 1,118
Adjustments	
Payments	(151)
Balance as of June 30, 2013	\$ 967

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

(3) INVENTORIES

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

Net Inventories consisted of the following (in thousands):

	June 30, 2013	December 31, 2012
Finished goods	\$ 11,760	\$ 17,148
Parts and components	1,588	1,639
	\$ 13,348	\$ 18,787

Inventory reserves, primarily related to excess parts inventories, were as follows (in thousands):

	June 30, 2013	December 31, 2012
Inventory reserves	\$ 786	\$ 1,011

(4) PROPERTY, PLANT AND EQUIPMENT

Property, Plant and Equipment consisted of the following (in thousands):

	Estimated Useful Life (in years)	June 30, 2013	December 31, 2012
Leasehold improvements	5 to 20	\$ 2,852	\$ 2,863
Computer equipment	3 to 5	36,386	36,107
Machinery and equipment	3 to 5	5,407	5,359
Furniture and fixtures	5	672	870
Work in progress ¹	N/A	3,576	2,080
		48,893	47,279
Accumulated depreciation		(41,391)	(41,141)
		\$ 7,502	\$ 6,138

¹ Work in progress includes internal use software development and production tooling construction in progress.

(5) GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

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

Balance as of December 31, 2011	\$ 2,873
Currency exchange rate adjustment	67
Balance as of December 31, 2012	2,940
Currency exchange rate adjustment	(156)
Balance as of June 30, 2013	\$ 2,784

Other Intangible Assets

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Other Intangible Assets consisted of the following (in thousands):

	Estimated Useful Life (in years)	June 30, 2013	December 31, 2012
Indefinite-lived trademarks	N/A	\$ 9,052	\$ 9,052
Patents	8 to 16	18,154	18,154
		27,206	27,206
Accumulated amortization - patents		(13,565)	(12,540)
		\$ 13,641	\$ 14,666

Amortization expense was as follows (in thousands):

	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Patent amortization	\$ 512	\$ 512	\$1,025	\$1,025

Future amortization of patents is as follows (in thousands):

Remainder of 2013	\$1,025
2014	2,040
2015	828
2016	430
2017	143
Thereafter	123
	\$4,589

(6) ACCRUED LIABILITIES

Accrued Liabilities consisted of the following (in thousands):

	June 30, 2013	December 31, 2012
Exit costs of discontinued operations	\$ 309	\$ 340
Payroll and related liabilities	2,119	3,327
Royalties	669	1,063
Legal and professional fees	420	834
Other	2,181	2,607
	\$ 5,698	\$ 8,171

(7) PRODUCT WARRANTIES

Our products carry limited, 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 sixty 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,	
	2013	2012
Warranty accrual, beginning of period	\$ 2,492	\$ 2,017

Reductions for warranty charges	(862)	(968)
Adjustments	(186)	(171)
Additions to warranty reserve	718	1,275
Warranty accrual, end of period	\$ 2,162	\$ 2,153

Total outstanding obligations of our former Commercial business included in product Warranty Obligations were \$0.1 million and \$0.4 million, respectively, as of June 30, 2013 and December 31, 2012.

(8) INCOME TAX PROVISION (BENEFIT)

In the second quarter of 2013, we evaluated the potential realization of our Deferred Income Tax Assets, considering both positive and negative evidence, including cumulative income or loss for the past three years and forecasted taxable income. As a result of this evaluation we concluded that, as of June 30, 2013, a majority of the existing valuation allowance on our domestic Deferred Income Tax Assets was no longer required. Accordingly, an income tax benefit of \$35.8 million was recorded during the six-month period ended June 30, 2013 related to the reduction of our existing valuation allowance.

Evaluating the need for, and amount of, a valuation allowance for deferred tax assets often requires significant judgment and extensive analysis of all available evidence on a jurisdiction-by-jurisdiction basis. Such judgments require us to interpret existing tax law and other published guidance as applied to our circumstances. As part of this assessment, we consider both positive and negative evidence. The weight given to the potential effect of positive and negative evidence must be commensurate with the extent to which the strength of the evidence can be objectively verified. We generally consider the following, but are not limited to, objectively verified evidence to determine the likelihood of realization of the deferred tax assets:

Our current financial position and our historical results of operations for recent years. We generally consider cumulative pre-tax losses in the three-year period ending with the current quarter to be significant

negative evidence regarding our future profitability. A pattern of objectively-measured recent financial reporting losses is heavily weighted as a source of negative evidence. Further, we also consider the historical and current financial trends in the recent years.

Sources of taxable income of the appropriate character. Future realization of deferred tax assets is dependent on projected taxable income of the appropriate character from our continuing operations. Future reversals of existing temporary differences are heavily-weighted sources of objectively verifiable positive evidence. Projections of future taxable income exclusive of reversing temporary differences are a source of positive evidence only when the projections are combined with a history of recent profits and current financial trends and can be reasonably estimated.

Carry-back and carry-forward periods available. The long carry-back and carry-forward periods permitted under the tax law are objectively verified positive evidence.

Tax planning strategies. Tax planning strategies can be, depending on their nature, heavily weighted sources of objectively verifiable positive evidence when the strategies are available and can be reasonably executed. We consider tax planning strategies only if they are feasible and justifiable considering our current operations and our strategic plan. Tax planning strategies, if executed, may accelerate the recovery of a deferred tax asset so the tax benefit of the deferred tax asset can be carried back.

During 2008, we determined that it was no longer more likely than not that the tax benefits from the existing U.S. deferred tax assets would be realized due to the substantial amount of the cumulative accounting losses realized in the recent years in the U.S. and the large taxable losses incurred in the U.S. in 2007 and 2008. Accordingly, we established a full valuation allowance against our U.S. net deferred tax assets in 2008.

Each quarter, we assess the total weight of positive and negative evidence and re-evaluate whether any adjustments or release of all or any portion of valuation allowance is appropriate. In our assessment during the second quarter of 2013, we heavily weighted the positive evidence of 1) cumulative profits realized in recent years combined with the upward financial trends of current periods; and 2) future realization of the existing U.S. deferred tax assets. Given our recent improved financial performance, which includes a sustained cumulative accounting profit through 2013, we are projecting a positive forecasted taxable income in 2013 in the U.S. Accordingly, based on our review of the objective evidence and our detailed analysis during the second quarter of 2013, we determined that a portion of our U.S. domestic valuation allowance was no longer required.

The remaining valuation allowance at June 30, 2013 relates to certain domestic loss carryforwards and other credits that we may not be able to utilize primarily due to their shorter remaining carryforward periods. Should it be determined in the future that it is more likely than not that our Deferred Income Tax Assets will be realized, an additional valuation allowance would be released during the period in which such an assessment is made.

Further, there have been no material changes to our foreign operations since December 31, 2012 and, accordingly, we maintained our existing valuation allowance on foreign Deferred Income Tax Assets in such jurisdictions at June 30,

2013.

(9) INCOME (LOSS) PER SHARE

Basic Income (Loss) Per Share was computed using the weighted average number of common shares outstanding. For the computation of Diluted Income (Loss) Per Share, the number of basic weighted average shares outstanding was increased by dilutive potential common shares related to stock-based awards, as determined by the treasury stock method.

The weighted average numbers of shares outstanding used to compute Income (Loss) Per Share were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Shares used to calculate basic income (loss) per share	31,058	30,878	31,003	30,878
Dilutive effect of outstanding options and performance stock units	372		357	109
Shares used to calculate diluted income (loss) per share	31,430	30,878	31,360	30,987

The weighted average numbers of shares outstanding listed in the table below were anti-dilutive and excluded from the computation of Diluted Income (Loss) Per Share, primarily because the average market price did not exceed the exercise price. These shares may be dilutive potential common shares in the future (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Stock options	307	1,126	306	1,046
Performance stock units	75	197	88	49

(10) SEGMENT INFORMATION

We have two reportable segments Direct and Retail. Contribution is the measure of profit or loss, defined as net sales less product costs and directly attributable expenses. Directly attributable expenses include Selling and Marketing expenses, General and Administrative expenses, and Research and Development expenses that are directly related to segment operations. Segment assets are those directly assigned to an operating segment's operations, primarily Accounts Receivable, Inventories and Intangible Assets. Unallocated assets primarily include shared information technology infrastructure, distribution centers, corporate headquarters, Prepaids and Other Current Assets, Deferred Income Tax Assets and Other Assets. Capital expenditures directly attributable to the Direct and Retail segments were not significant in any period.

Following is summary information by reportable segment (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net sales:				
Direct	\$ 25,314	\$ 24,707	\$ 67,949	\$ 58,441
Retail	10,175	14,030	25,309	30,669
Unallocated royalty income	753	846	2,198	1,735
Consolidated net sales	\$ 36,242	\$ 39,583	\$ 95,456	\$ 90,845

Contribution: