

BLUE NILE INC  
Form 10-Q  
August 08, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q**

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

For the quarterly period ended June 29, 2008  
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 000-50763

**BLUE NILE, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
*(State or other jurisdiction of  
incorporation or organization)*

91-1963165  
*(I.R.S. Employer Identification No.)*

705 Fifth Avenue South, Suite 900, Seattle, Washington  
*(Address of principal executive offices)*

98104  
*(Zip code)*

(206) 336-6700

(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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer   
Non-accelerated filer

Accelerated filer   
Smaller reporting  
company

(Do not check if a smaller reporting company)

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

Yes  No

As of July 25, 2008, the registrant had 14,567,609 shares of common stock outstanding.

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**Cautionary Note Regarding Forward-Looking Statements**

This quarterly report on Form 10-Q contains forward-looking statements that involve many risks and uncertainties. These statements, which relate to future events and our future performance, are based on current expectations, estimates, forecasts and projections about the industries in which we operate and the beliefs and assumptions of management as of the date of this filing. In some cases, you can identify forward-looking statements by terms such as would, could, may, will, should, expect, intend, plan, anticipate, believe, estimate, predict, continue, the negative of these terms or other variations of such terms. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our business and other characterizations of future events or circumstances, are forward-looking statements. These statements are only predictions based upon assumptions made that are believed to be reasonable at the time, and are subject to risk and uncertainties. Therefore, actual events or results may differ materially and adversely from those expressed in any forward-looking statement. In evaluating these statements, you should specifically consider the risks described under the caption Item 1A Risk Factors and elsewhere in this quarterly report on Form 10-Q. These factors, and other factors, may cause our actual results to differ materially from any forward-looking statement. Except as required by law, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

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**BLUE NILE, INC.**  
**QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED JUNE 29, 2008**  
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**BLUE NILE, INC.**  
**Condensed Consolidated Balance Sheets**  
**(unaudited)**  
**(in thousands, except par value)**

	<b>June 29, 2008</b>	<b>December 30, 2007</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 47,177	\$ 122,793
Trade accounts receivable	1,323	2,452
Other accounts receivable	586	1,124
Inventories	16,782	20,906
Deferred income taxes	520	799
Prepays and other current assets	1,013	1,072
Total current assets	67,401	149,146
Property and equipment, net	7,530	7,601
Intangible assets, net	271	286
Deferred income taxes	4,586	3,489
Other assets	64	64
Total assets	\$ 79,852	\$ 160,586
 <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 41,077	\$ 85,866
Accrued liabilities	4,827	9,549
Current portion of long-term financing obligation	39	38
Current portion of deferred rent	221	238
Total current liabilities	46,164	95,691
Long-term financing obligation, less current portion	860	880
Deferred rent, less current portion	463	538
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5,000 shares authorized, none issued and outstanding		
Common stock, \$0.001 par value; 300,000 shares authorized; 19,569 shares and 19,513 shares issued, respectively		
15,028 shares and 15,973 shares outstanding, respectively	20	20
Additional paid-in capital	139,328	134,207
Deferred compensation		(3)
Accumulated other comprehensive income	185	75
Retained earnings	30,345	24,569

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Treasury stock, at cost; 4,541 shares and 3,540 shares outstanding, respectively	(137,513)	(95,391)
Total stockholders' equity	32,365	63,477
Total liabilities and stockholders' equity	\$ 79,852	\$ 160,586

The accompanying notes are an integral part of these condensed consolidated financial statements

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**BLUE NILE, INC.**  
**Condensed Consolidated Statements of Operations**  
**(unaudited)**  
**(in thousands, except per share data)**

	Quarter ended		Year to date ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Net sales	\$ 73,706	\$ 72,093	\$ 144,166	\$ 140,003
Cost of sales	58,583	57,150	115,119	111,811
Gross profit	15,123	14,943	29,047	28,192
Selling, general and administrative expenses	10,758	9,909	21,656	19,473
Operating income	4,365	5,034	7,391	8,719
Other income, net:				
Interest income, net	280	803	1,115	1,776
Other income	285	12	376	215
Total other income, net	565	815	1,491	1,991
Income before income taxes	4,930	5,849	8,882	10,710
Income tax expense	1,725	2,068	3,106	3,766
Net income	\$ 3,205	\$ 3,781	\$ 5,776	\$ 6,944
Basic net income per share	\$ 0.21	\$ 0.24	\$ 0.38	\$ 0.44
Diluted net income per share	\$ 0.20	\$ 0.23	\$ 0.36	\$ 0.42

The accompanying notes are an integral part of these condensed consolidated financial statements

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**BLUE NILE, INC.**  
**Condensed Consolidated Statement of Changes in Stockholders' Equity**  
**(unaudited)**  
**(in thousands)**

	Common Stock Shares	Additional Deferred		Accumulated			Treasury Stock Shares	Total Stockholders Equity	
		Paid-in Capital	Stock Compensation	Retained Earnings	Other Comprehensive Income	Treasury Stock Amount			
Balance, December 30, 2007	19,513	\$ 20	\$ 134,207	\$ (3)	\$ 24,569	\$ 75	(3,540)	\$ (95,391)	\$ 63,477
Net income				5,776					5,776
Other comprehensive income: Foreign currency translation adjustment						110			110
Total comprehensive income									5,886
Tax benefit from exercise of stock options			282						282
Amortization of deferred stock compensation				3					3
Exercise of common stock options	55		1,093						1,093
Issuance of common stock to directors	1		60						60
Stock-based compensation			3,686						3,686
Repurchase of common stock							(1,001)	(42,122)	(42,122)
Balance, June 29, 2008	19,569	\$ 20	\$ 139,328	\$	\$ 30,345	\$ 185	(4,541)	\$ (137,513)	\$ 32,365

The accompanying notes are an integral part of these condensed consolidated financial statements





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**BLUE NILE, INC.**  
**Condensed Consolidated Statements of Cash Flows**  
**(unaudited)**  
**(in thousands)**

	<b>Year to date ended</b>	
	<b>June 29, 2008</b>	<b>July 1, 2007</b>
<b>Operating activities:</b>		
Net income	\$ 5,776	\$ 6,944
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	953	776
Loss (gain) on disposal of property and equipment	18	(6)
Stock-based compensation	3,708	2,723
Deferred income taxes	(818)	(563)
Tax benefit from exercise of stock options	281	2,974
Excess tax benefit from exercise of stock options	(141)	(320)
Changes in assets and liabilities:		
Receivables	1,667	62
Inventories	4,124	(53)
Prepaid federal income taxes		(1,596)
Prepaid expenses and other assets	59	(246)
Accounts payable	(44,789)	(24,124)
Accrued liabilities	(4,751)	(3,134)
Deferred rent and other	(33)	(95)
Net cash used in operating activities	(33,946)	(16,658)
<b>Investing activities:</b>		
Purchases of property and equipment	(880)	(2,066)
Proceeds from the sale of property and equipment	7	8
Purchases of marketable securities		(20,230)
Proceeds from the maturity of marketable securities		40,000
Transfers of restricted cash		120
Net cash (used in) provided by investing activities	(873)	17,832
<b>Financing activities:</b>		
Repurchase of common stock	(42,122)	(13,532)
Proceeds from stock option exercises	1,093	2,668
Excess tax benefit from exercise of stock options	141	320
Principal payments under long-term financing obligation	(19)	
Net cash used in financing activities	(40,907)	(10,544)

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Effect of exchange rate changes on cash and cash equivalents	110	(5)
Net decrease in cash and cash equivalents	(75,616)	(9,375)
Cash and cash equivalents, beginning of period	122,793	78,540
Cash and cash equivalents, end of period	\$ 47,177	\$ 69,165

The accompanying notes are an integral part of these condensed consolidated financial statements

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**Blue Nile, Inc.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

*(Dollar amounts in thousands except for ratios and per share data, unless noted otherwise)*

**Note 1. Description of Our Business and Summary of Significant Accounting Policies**

***The Company***

Blue Nile, Inc. (the Company) was formed in March 1999. We are the leading online retailer of diamonds, fine jewelry and watches. We offer in-depth educational materials and unique online tools that place consumers in control of the jewelry shopping process. We ship our products to over 25 countries across the globe. We maintain our primary website at www.bluenile.com and we also operate the www.bluenile.co.uk and www.bluenile.ca websites.

***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Notes to Consolidated Financial Statements contained in our Annual Report on Form 10-K filed for the year ended December 30, 2007 and filed with the Securities and Exchange Commission (SEC) on February 27, 2008. The same accounting policies are followed for preparing quarterly and annual financial statements. In the opinion of management, all adjustments necessary for the fair presentation of the financial position, results of operations and cash flows for the interim period have been included and are of a normal, recurring nature.

The financial information as of December 30, 2007 is derived from our audited consolidated financial statements and notes thereto for the fiscal year ended December 30, 2007, included in Item 8 of the Annual Report on Form 10-K for the year ended December 30, 2007.

Due to a number of factors, including the seasonal nature of the retail industry and other factors described in this report, quarterly results are not necessarily indicative of the results for the full fiscal year or any other subsequent interim period.

***Principles of Consolidation***

The accompanying unaudited condensed consolidated financial statements include the accounts of Blue Nile, Inc. and its wholly-owned subsidiaries, Blue Nile, LLC (LLC), Blue Nile Worldwide, Inc. (Worldwide) and Blue Nile Jewellery, Ltd. (Jewellery). The Company, LLC, and Worldwide are Delaware corporations located in Seattle, Washington. Jewellery is an Irish limited company located in Ireland. All significant intercompany transactions and balances are eliminated in consolidation.

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Some of the more significant estimates include the allowance for sales returns and the estimated fair value of stock options granted. Actual results could differ materially from those estimates.

***Foreign Currency Translation***

The assets and liabilities of Jewellery have been translated to U.S. dollars using the exchange rates effective on the balance sheet date, while income and expense accounts are translated at the average rates in effect during the periods presented. The resulting translation adjustments are recorded in accumulated other comprehensive income.

Table of Contents**Blue Nile, Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)*****Recent Accounting Pronouncements***

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standard ( SFAS ) No. 157, Fair Value Measurements ( SFAS 157 ). SFAS 157 establishes a common definition for fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. In January 2008, the FASB issued FSP FAS 157-2, delaying the effective date of SFAS 157 by one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. For these items, SFAS 157 will go into effect in fiscal years beginning after November 15, 2008.

Adoption of the SFAS 157 provisions for financial assets in the first quarter of 2008 did not have a material impact on our consolidated results of operations or financial condition. We will adopt the SFAS 157 provisions for nonfinancial assets in the first quarter of fiscal 2009 in accordance with FSP 157-2, and we do not anticipate this statement to have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 permits all entities to elect to measure certain financial instruments and other items at fair value with changes in fair value reported in earnings. We adopted SFAS 159 in the first quarter of 2008 and there was no material impact on our consolidated results of operations or financial condition.

**Note 2. Stock-based Compensation**

We account for stock-based compensation arrangements in accordance with the provisions of FASB Statement No. 123R, Share-Based Payment ( SFAS 123R ). Stock options are granted at prices equal to the fair market value of our common stock on the date of grant. Stock-based compensation is reduced for estimated forfeitures and compensation expense is recognized on a straight-line basis over the requisite service period for each stock option grant. Stock options granted generally provide for 25% vesting on the first anniversary of the date of grant, with the remainder vesting monthly in equal amounts over three years, and expire 10 years from the date of grant. As of June 29, 2008, we had four stock option plans. Additional information regarding these plans is disclosed in our Annual Report on Form 10-K for the year ended December 30, 2007.

The fair value of each option on the date of grant is estimated using the Black-Scholes-Merton option valuation model. The following weighted-average assumptions were used for the valuation of options granted during the quarters and years to date ended June 29, 2008 and July 1, 2007, respectively:

	Quarter ended		Year to date ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Expected term	4.0 years	4.5 years	4.0 years	4.5 years
Expected volatility	48.2%	36.0%	47.2%	36.0%
Expected dividend yield	0.0%	0.0%	0.0%	0.0%
Risk-free interest rate	2.95%	4.65%	2.40%	4.66%
Estimated fair value per option granted	\$ 19.25	\$ 20.16	\$ 17.92	\$ 17.99

The assumptions used to calculate the fair value of options granted are evaluated and revised, if necessary, to reflect market conditions and our experience.

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A summary of stock option activity for the year to date ended June 29, 2008 is as follows:

	<b>Options (in thousands)</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (in years)</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Balance, December 30, 2007	2,037	\$ 32.84		
Granted	324	45.52		
Exercised	(55)	19.99		
Cancelled	(79)	62.16		
Balance, June 29, 2008	2,227	\$ 33.96	6.82	\$ 38,362
Vested and expected to vest at June 29, 2008	2,010	\$ 32.46	6.67	\$ 36,718
Exercisable, June 29, 2008	1,279	\$ 21.97	5.67	\$ 32,154

The aggregate intrinsic value in the table above is before applicable income taxes and represents the amount option recipients would have received if all options had been exercised on the last business day of the period indicated, based on our closing stock price.

The total intrinsic value of options exercised during the year to date ended June 29, 2008 was \$1.8 million. During the year to date ended June 29, 2008, the total fair value of options vested was \$2.5 million. As of June 29, 2008, we had total unrecognized compensation costs related to unvested stock options of \$14.0 million. We expect to recognize this cost over a weighted average period of 2.7 years.

**Note 3. Inventories**

Inventories are stated at cost and consist of the following:

	<b>June 29, 2008</b>	<b>December 30, 2007</b>
Loose diamonds	\$ 906	\$ 690
Fine jewelry, watches and other	15,876	20,216
	\$ 16,782	\$ 20,906

**Table of Contents****Blue Nile, Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****Note 4. Net Income Per Share**

Basic net income per share is based on the weighted average number of common shares outstanding. Diluted net income per share is based on the weighted average number of common shares and common share equivalents outstanding. Common share equivalents included in the computation represent common shares issuable upon assumed exercise of outstanding stock options, except when the effect of their inclusion would be antidilutive.

The following table sets forth the computation of basic and diluted net income per share:

	<b>Quarter ended</b>		<b>Year to date ended</b>	
	<b>June 29, 2008</b>	<b>July 1, 2007</b>	<b>June 29, 2008</b>	<b>July 1, 2007</b>
Net income	\$ 3,205	\$ 3,781	\$ 5,776	\$ 6,944
Weighted average common shares outstanding	15,018	15,802	15,309	15,838
Basic net income per share	\$ 0.21	\$ 0.24	\$ 0.38	\$ 0.44