

BLUE NILE INC
Form 10-Q
August 11, 2010

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

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the quarterly period ended July 4, 2010

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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a smaller reporting company)

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

As of August 6, 2010, the registrant had 14,317,767 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.
Condensed Consolidated Balance Sheets
(in thousands, except par value)

	July 4, 2010	January 3, 2010
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 47,105	\$ 78,149
Short-term investments		15,000
Trade accounts receivable	1,855	1,594
Other accounts receivable	245	241
Inventories	18,466	19,434
Deferred income taxes	231	449
Prepays and other current assets	1,218	977
Total current assets	69,120	115,844
Property and equipment, net	6,783	7,332
Intangible assets, net	299	325
Deferred income taxes	7,861	6,769
Other assets	98	145
Total assets	\$ 84,161	\$ 130,415
 LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 46,720	\$ 76,128
Accrued liabilities	5,791	9,805
Current portion of long-term financing obligation	45	44
Current portion of deferred rent	168	205
Total current liabilities	52,724	86,182
Long-term financing obligation, less current portion	773	796
Deferred rent, less current portion	90	168
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; 19,981 shares and 19,810 shares issued, respectively		
14,310 shares and 14,644 shares outstanding, respectively	20	20
Additional paid-in capital	163,624	156,030
Accumulated other comprehensive (loss) income	(173)	61
Retained earnings	54,190	48,999
Treasury stock, at cost; 5,671 and 5,166 shares outstanding, respectively	(187,087)	(161,841)

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Total stockholders' equity	30,574	43,269
Total liabilities and stockholders' equity	\$ 84,161	\$ 130,415

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	
	July 4, 2010	July 5, 2009	July 4, 2010	July 5, 2009
Net sales	\$ 76,599	\$ 69,852	\$ 150,659	\$ 132,255
Cost of sales	60,400	54,822	118,659	104,022
Gross profit	16,199	15,030	32,000	28,233
Selling, general and administrative expenses	11,951	10,692	24,172	20,991
Operating income	4,248	4,338	7,828	7,242
Other income, net:				
Interest income, net	7	11	12	78
Other income, net	52	27	120	40
Total other income, net	59	38	132	118
Income before income taxes	4,307	4,376	7,960	7,360
Income tax expense	1,504	1,532	2,769	2,576
Net income	\$ 2,803	\$ 2,844	\$ 5,191	\$ 4,784
Basic net income per share	\$ 0.19	\$ 0.20	\$ 0.36	\$ 0.33
Diluted net income per share	\$ 0.19	\$ 0.19	\$ 0.34	\$ 0.32

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		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)		Treasury Stock		Total Stockholders Equity
	Shares	Amount			Shares	Amount			
Balance, January 3, 2010	19,810	\$ 20	\$ 156,030	\$ 48,999	\$ 61	(5,166)	\$ (161,841)	\$ 43,269	
Net income				5,191				5,191	
Other comprehensive income (loss):									
Foreign currency translation adjustment					(234)			(234)	
Total comprehensive income								4,957	
Tax benefit from exercise of stock options			2,808					2,808	
Exercise of common stock options	164		954					954	
Issuance of common stock to directors	1		60					60	
Vesting of restricted stock units	6								
Stock-based compensation			3,772					3,772	
Repurchase of common stock						(505)	(25,246)	(25,246)	
Balance, July 4, 2010	19,981	\$ 20	\$ 163,624	\$ 54,190	\$ (173)	(5,671)	\$ (187,087)	\$ 30,574	

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)

	Year to date ended	
	July 4, 2010	July 5, 2009
Operating activities:		
Net income	\$ 5,191	\$ 4,784
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	1,525	1,213
Loss on disposal of property and equipment		9
Stock-based compensation	3,758	3,748
Deferred income taxes	(874)	(267)
Tax benefit from exercise of stock options	2,808	92
Excess tax benefit from exercise of stock options	(158)	(23)
Changes in assets and liabilities:		
Receivables	(265)	327
Inventories	968	3,101
Prepaid expenses and other assets	(193)	(291)
Accounts payable	(29,434)	(16,619)
Accrued liabilities	(4,039)	(1,889)
Deferred rent and other	(116)	(106)
Net cash used in operating activities	(20,829)	(5,921)
Investing activities:		
Purchases of property and equipment	(907)	(1,208)
Maturity of short-term investments	15,000	
Net cash provided by (used in) investing activities	14,093	(1,208)
Financing activities:		
Repurchase of common stock	(25,246)	
Proceeds from stock option exercises	954	697
Excess tax benefit from exercise of stock options	158	23
Principal payments under long-term financing obligation	(22)	(20)
Net cash (used in) provided by financing activities	(24,156)	700
Effect of exchange rate changes on cash and cash equivalents	(152)	7
Net decrease in cash and cash equivalents	(31,044)	(6,422)
Cash and cash equivalents, beginning of period	78,149	54,451

Cash and cash equivalents, end of period	\$ 47,105	\$ 48,029
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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)

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

The Company

Blue Nile, Inc. (the Company) is the leading online retailer of high quality diamonds and fine jewelry. In addition to sales of diamonds, fine jewelry and watches, the Company provides education, guidance and support to enable customers to more effectively learn about and purchase diamonds as well as classically styled fine jewelry. The Company, a Delaware corporation, based in Seattle, Washington, was formed in March 1999. The Company serves consumers in over 40 countries and territories all over the world and maintains its primary website at www.bluenile.com. The Company also operates the www.bluenile.co.uk and www.bluenile.ca websites. Information found on the Company's websites is not incorporated by reference into this Quarterly Report on Form 10-Q or any of its other filings with the Securities and Exchange Commission.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Notes to Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the year ended January 3, 2010, filed with the Securities and Exchange Commission on February 25, 2010. 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 periods have been included and are of a normal, recurring nature.

The financial information as of January 3, 2010 is derived from the Company's audited consolidated financial statements and notes thereto for the fiscal year ended January 3, 2010, included in Item 8 of the Annual Report on Form 10-K for the year ended January 3, 2010.

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 Dublin, Ireland. All 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

The functional currency of Jewellery is the Euro. The assets and liabilities of Jewellery have been translated to U.S. dollars using the exchange rates effective on the balance sheet dates, while income and expense accounts are

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Blue Nile, Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

translated at the average rates in effect during the periods presented. The resulting translation adjustments are recorded in accumulated other comprehensive income (loss).

The Company offers customers the ability to transact in 24 foreign currencies. In addition, some of the Company's entities engage in transactions denominated in currencies other than the entity's functional currency. Gains or losses arising from these transactions are recorded in Other income, net in the consolidated statements of operations.

Recent Accounting Pronouncements

In January 2010, the FASB issued Accounting Standards Update No. 2010-06 (ASU 2010-06), Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. ASU 2010-06 requires reporting entities to make new disclosures about recurring or nonrecurring fair value measurements including significant transfers into and out of Level 1 and Level 2 fair value measurements and information on purchases, sales, issuances, and settlements on gross basis in the reconciliation of Level 3 fair value measurements. ASU 2010-06 is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which are effective for annual periods beginning after December 15, 2010. The adoption of ASU 2010-06 in the first quarter of 2010 did not have a material impact on the Company's consolidated results of operations or financial condition.

Table of Contents**Blue Nile, Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****Note 2. Stock-based Compensation**

Stock options are granted at prices equal to the fair market value of the Company's common stock on the date of 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 the following three years, and expire 10 years from the date of grant. As of July 4, 2010, the Company had four equity plans. Additional information regarding these plans is disclosed in the Company's Annual Report on Form 10-K for the year ended January 3, 2010.

In the first quarter of 2010, the Company granted restricted stock units (RSUs) to an executive under the 2004 Equity Incentive Plan. The RSUs have a grant date fair value of \$49,000 and vest 25% per year over four years, commencing on the first anniversary of the grant date. Each RSU is converted to one share of common stock when it vests. No RSUs were granted in the second quarter of 2010.

Compensation expense, net of estimated forfeitures, is recognized on a straight-line basis over the vesting period for each stock option and restricted stock unit grant.

The fair value of each stock 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 periods presented:

	Quarter ended		Year to date ended	
	July 4, 2010	July 5, 2009	July 4, 2010	July 5, 2009
Expected term	4 years	4 years	4 years	4 years
Expected volatility	58.4%	57.0%	58.4%	54.9%
Expected dividend yield	0.0%	0.0%	0.0%	0.0%
Risk-free interest rate	1.22%	1.39%	1.41%	1.33%

Estimated weighted-average fair value per option granted

	\$ 23.13	\$ 18.58	\$ 22.58	\$ 10.00
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The assumptions used to calculate the fair value of options granted are evaluated and revised, if necessary, to reflect market conditions and the Company's experience.

The fair value of each restricted stock unit is based on the fair market value of the Company's common stock on the date of grant.

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

A summary of stock option activity for the year to date ended July 4, 2010 is as follows:

	Options (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Balance, January 3, 2010	2,636	\$ 33.44		
Granted	224	49.46		
Exercised	(164)	5.82		
Cancelled	(14)	53.24		
Balance, July 4, 2010	2,682	\$ 36.36	6.69	\$ 33,687
Vested and expected to vest at July 4, 2010	2,574	\$ 36.25	6.61	\$ 32,658
Exercisable, July 4, 2010	1,812	\$ 34.46	5.78	\$ 25,667

A summary of restricted stock unit activity for the year to date ended July 4, 2010 is as follows:

	RSUs (in thousands)	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Balance, January 3, 2010	12	\$ 21.22		
Granted	1	49.49		
Vested	(6)	21.22		
Cancelled				
Balance, July 4, 2010	7	\$ 25.18	0.84	\$ 323
Vested and expected to vest at July 4, 2010	7	\$ 25.18	0.84	\$ 323

The aggregate intrinsic value in the tables above is before applicable income taxes and represents the amount recipients would have received if all options had been exercised or restricted stock units had been converted on the last business day of the period indicated, based on the Company's closing stock price.

The total intrinsic value of options exercised during the year to date ended July 4, 2010 was \$8.8 million. During the year to date ended July 4, 2010, the total fair value of options vested was \$4.1 million. As of July 4, 2010, the Company had total unrecognized compensation costs related to unvested stock options and restricted stock units of \$12.4 million, before income taxes. The Company expects to recognize this cost over a weighted average period of

2.6 years for its options and 1.1 years for its restricted stock units.

Table of Contents**Blue Nile, Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****Note 3. Inventories**

Inventories are stated at cost and consist of the following (in thousands):

	July 4, 2010	January 3, 2010
Loose diamonds	\$ 841	\$ 297
Fine jewelry, watches and other	17,625	19,137
	\$ 18,466	\$ 19,434

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 shares issuable upon assumed exercise of outstanding stock options and conversion of unvested restricted stock units, except when the effect of their inclusion would be antidilutive.

The following tables set forth the computation of basic and diluted net income per share (in thousands, except per share data):

Quarter ended		Year to date ended	
July 4, 2010	July 5, 2009	July 4, 2010	July 5, 2009