

Karyopharm Therapeutics Inc.
Form 10-Q
May 10, 2018
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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 March 31, 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: 001-36167

Karyopharm Therapeutics Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

26-3931704
(I.R.S. Employer
Identification Number)

85 Wells Avenue, 2nd Floor

Newton, MA
(Address of principal executive offices)

02459
(Zip Code)

(617) 658-0600

(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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth 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

As of May 4, 2018, there were 49,849,972 shares of Common Stock, \$0.0001 par value per share, outstanding.

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements (Unaudited).
Karyopharm Therapeutics Inc.****CONDENSED CONSOLIDATED BALANCE SHEETS****(unaudited)****(in thousands, except share and per share amounts)**

	March 31, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 37,499	\$ 68,997
Short-term investments	93,418	77,472
Prepaid expenses and other current assets	2,396	1,754
Restricted cash		200
Total current assets	133,313	148,423
Property and equipment, net	2,454	2,185
Long-term investments	10,314	29,396
Restricted cash	292	290
Total assets	\$ 146,373	\$ 180,294
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	\$ 4,949	\$ 5,665
Accrued expenses	21,545	21,445
Deferred revenue	19,729	21,921
Deferred rent	178	303
Other current liabilities	333	133
Total current liabilities	46,734	49,467
Deferred revenue, net of current portion	2,192	
Deferred rent, net of current portion	1,918	1,363
Total liabilities	50,844	50,830
Stockholders equity:		
Preferred stock, \$0.0001 par value; 5,000,000 shares authorized; none issued and outstanding		
	5	5

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Common stock, \$0.0001 par value; 100,000,000 shares authorized; 49,670,328 and 49,533,150 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively		
Additional paid-in capital	629,610	625,017
Accumulated other comprehensive loss	(286)	(217)
Accumulated deficit	(533,800)	(495,341)
Total stockholders' equity	95,529	129,464
Total liabilities and stockholders' equity	\$ 146,373	\$ 180,294

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Karyopharm Therapeutics Inc.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(unaudited)****(in thousands, except share and per share amounts)**

	Three Months Ended, March 31,	
	2018	2017
License and other revenue	\$ 10,000	\$ 68
Operating expenses:		
Research and development	41,321	24,083
General and administrative	7,621	6,264
Total operating expenses	48,942	30,347
Loss from operations	(38,942)	(30,279)
Other income (expense):		
Interest income	509	400
Other expense	(14)	(15)
Total other income, net	495	385
Loss before income taxes	(38,447)	(29,894)
Provision for income taxes	(12)	(23)
Net loss	\$ (38,459)	\$ (29,917)
Net loss per share basic and diluted	\$ (0.78)	\$ (0.71)
Weighted-average number of common shares outstanding used in net loss per share basic and diluted	49,602,809	41,894,796

See accompanying notes to condensed consolidated financial statements.

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Karyopharm Therapeutics Inc.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(unaudited)

(in thousands)

	Three Months Ended March 31,	
	2018	2017
Net loss	\$ (38,459)	\$ (29,917)
Comprehensive income (loss)		
Unrealized gain (loss) on investments	(108)	59
Foreign currency translation adjustments	39	11
Comprehensive loss	\$ (38,528)	\$ (29,847)

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Karyopharm Therapeutics Inc.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)****(in thousands)**

	Three Months Ended March 31,	
	2018	2017
Operating activities		
Net loss	\$ (38,459)	\$ (29,917)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	169	183
Net amortization of premiums and discounts on investments	160	267
Stock-based compensation expense	4,164	5,909
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	(638)	(61)
Accounts payable	(773)	(522)
Accrued expenses and other liabilities	295	(498)
Deferred rent	430	(69)
Net cash used in operating activities	(34,652)	(24,708)
Investing activities		
Purchases of property and equipment	(382)	
Proceeds from maturities of investments	27,602	25,624
Purchases of investments	(24,736)	(25,075)
Net cash provided by investing activities	2,484	549
Financing activities		
Proceeds from the exercise of stock options	429	57
Net cash provided by financing activities	429	57
Effect of exchange rate on cash	43	16
Net decrease in cash and cash equivalents	(31,696)	(24,086)
Cash, cash equivalents and restricted cash at beginning of period	69,487	50,142
Cash, cash equivalents and restricted cash at end of period	\$ 37,791	\$ 26,056
Supplemental disclosure of non-cash activities		
Purchases of property and equipment included in accounts payable	\$ 56	\$
Deferred financing costs included in accounts payable	\$	\$ 15

See accompanying notes to condensed consolidated financial statements.

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Karyopharm Therapeutics Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands except share and per share data)

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Karyopharm Therapeutics Inc., a Delaware corporation (the Company), have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial reporting and as required by Regulation S-X, Rule 10-01. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (including those which are normal and recurring) considered necessary for a fair presentation of the interim financial information have been included. When preparing financial statements in conformity with GAAP, the Company must make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the date of the financial statements. Actual results could differ from those estimates. Additionally, operating results for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2018. For further information, refer to the financial statements and footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 as filed with the Securities and Exchange Commission (SEC) on March 15, 2018.

Basis of Consolidation

The condensed consolidated financial statements at March 31, 2018 include the accounts of (i) the Company, (ii) Karyopharm Securities Corp. (a wholly-owned Massachusetts corporation of the Company incorporated in December 2013), (iii) Karyopharm Europe GmbH (a wholly-owned German Limited Liability Company formed in August 2014) and (iv) Karyopharm Therapeutics (Bermuda) Ltd. (a wholly-owned Bermuda subsidiary of the Company formed in March 2015). All intercompany balances and transactions have been eliminated in consolidation.

Revenue Recognition

The Company adopted ASU 2014-09, *Revenue from Contracts with Customers* (ASC 606), as well as subsequent amendments, which were codified in ASC 606, on January 1, 2018, using the modified retrospective method for all contracts not completed as of the date of adoption. The reported results for the quarter ended March 31, 2018 reflect the application of ASC 606 while the reported results for 2017 were prepared under the guidance of ASC 605, *Revenue Recognition* (ASC 605), which is also referred to herein as legacy GAAP or the previous guidance. The adoption of ASC 606 did not have a material impact on the Company's consolidated financial position, results of operations, stockholder's equity or cash flows as of the adoption date, as no transition adjustment for any of the Company's contracts with customers was required.

ASC 606 applies to all contracts with customers, except for contracts that are within the scope of other standards, such as leases, insurance, collaboration arrangements and financial instruments. Under ASC 606, an entity recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of ASC 606, the entity performs the following five steps:

(i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. At contract inception, once the contract is determined to be within the scope of ASC 606, the Company assesses the goods or services promised within each contract and determines those that are performance obligations, and assesses whether each promised good or service is distinct. The Company then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

The Company generates revenue from license or similar agreements with pharmaceutical companies for the development and commercialization of certain of its product candidates. Such agreements may include the transfer of intellectual property rights in the form of licenses, transfer of technological know-how, delivery of drug substances, research and development services, and participation on certain committees with the counterparty. Payments made by the customers may include non-refundable upfront fees, payments upon the exercise of customer options, payments based upon the achievement of defined milestones, and royalties on sales of product candidates if they are successfully approved and commercialized.

If the license to the Company's intellectual property is determined to be distinct from the other performance obligations identified in the arrangement, the Company recognizes the transaction price allocated to the license as revenue upon transfer of control of the license. The Company evaluates all other promised goods or services in the agreement to determine if they are distinct. If they are not distinct, they are combined with other promised goods or services to create a bundle of promised goods or services that is

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distinct. Optional future services where any additional consideration paid to the Company reflects their standalone selling prices do not provide the customer with a material right and, therefore, are not considered performance obligations. If optional future services are priced in a manner which provides the customer with a significant or incremental discount, they are material rights, and are accounted for as performance obligations.

The Company utilizes judgment to determine the transaction price. In connection therewith, the Company evaluates contingent milestones at contract inception to estimate the amount which is not probable of a material reversal to include in the transaction price using the most likely amount method. Milestone payments that are not within the control of the Company, such as regulatory approvals, are not considered probable of being achieved until those approvals are received and therefore the variable consideration is constrained. The transaction price is then allocated to each performance obligation on a relative stand-alone selling price basis, for which the Company recognizes revenue as or when the performance obligations under the contract are satisfied. At the end of each reporting period, the Company re-evaluates the probability of achieving development milestone payments which may not be subject to a material reversal and, if necessary, adjusts its estimate of the overall transaction price. Any such adjustments are recorded on a cumulative catch-up basis, which would affect license and other revenue, as well as earnings, in the period of adjustment.

The Company then determines whether the performance obligations or combined performance obligations are satisfied over time or at a point in time and, if over time, the appropriate method of measuring progress for purposes of recognizing revenue from non-refundable, upfront fees. The Company evaluates the measure of progress, as applicable, each reporting period and, if necessary, adjusts the measure of performance and related revenue recognition.

When consideration is received, or such consideration is unconditionally due, from a customer prior to transferring goods or services to the customer under the terms of a contract, a contract liability is recorded within deferred revenue. Contract liabilities within deferred revenue are recognized as revenue after control of the goods or services is transferred to the customer and all revenue recognition criteria have been met.

For arrangements that include sales-based royalties, including sales-based milestone payments, and the license is deemed to be the predominant item to which the royalties relate, the Company recognizes revenue at the later of when the related sales occur or when the performance obligation to which some or all of the royalty has been allocated has been satisfied (or partially satisfied).

2. Recent Accounting Pronouncements

Recently Adopted Accounting Standards

As detailed above, the Company adopted ASC 606 on January 1, 2018. Under the modified retrospective transition method, the Company applied ASC 606 to all contracts within scope as of January 1, 2018. Under the practical expedient concerning contract modifications contained in the transitional provisions of ASC 606, the Company has not retrospectively restated its contracts for modifications prior to the earliest period presented, and instead has reflected the aggregate effect of all modifications when identifying the satisfied and unsatisfied performance obligations, determining the transaction price and allocating the transaction price. Qualitatively, the effect of applying this practical expedient is not material to the periods presented in the consolidated financial statements. As more fully discussed in Note 3, Asset Purchase and License Agreements, only the Company's arrangement with Ono Pharmaceutical Co., Ltd. was determined to have unsatisfied performance obligations as of the adoption date. However, the pattern of revenue recognition was not affected and, therefore, no transition adjustment was recorded to the opening balance of accumulated deficit on January 1, 2018. All other agreements subject to transition, which only

included the Company's arrangement with Anivive Lifesciences Inc., were unaffected by the adoption of ASC 606 in all periods presented in the consolidated financial statements through application of the modified retrospective transition method.

In August 2016, the FASB issued ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments* (ASU 2016-15). ASU 2016-15. This standard addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The Company adopted ASU 2016-05 effective January 1, 2018 and the adoption did not have a material impact on the Company's statements of cash flows.

In October 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-16, *Accounting for Income Taxes: Intra-Entity Asset Transfers of Assets Other than Inventory (Topic 740)*. Topic 740 eliminates the ability to defer the tax expense related to intra-entity asset transfers other than inventory. Under the new standard, entities should recognize the income tax consequences on an intra-entity transfer of an asset other than inventory when the transfer occurs. The Company adopted Topic 740 effective January 1, 2018 and the adoption did not have a material impact on the Company's financial position or results of operations.

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. The new standard requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-

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period total amounts shown on the statement of cash flows. The Company adopted this standard effective January 1, 2018 and reclassified restricted cash in the statements of cash flows to be included in the cash and cash equivalents balance. The standard resulted in the reclassification of \$292 and \$479 into the balance of cash, cash equivalents and restricted cash on the statement of cash flows for the periods ended March 31, 2018 and 2017, respectively.

In May 2017, the FASB issued ASU 2017-09, *Compensation-Stock Compensation (Topic 718)* (ASU 2017-09) *Scope of Modification Accounting*. ASU 2017-09 provides clarification on when modification accounting should be used for changes to the terms or conditions of a share-based payment award. This ASU does not change the accounting for modifications but clarifies that modification accounting guidance should only be applied if there is a change to the value, vesting conditions, or award classification and would not be required if the changes are considered non-substantive. The Company adopted this standard effective January 1, 2018 and the adoption did not have a material impact on the Company's consolidated financial statements.

Recently Issued Accounting Standards

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The new standard requires that all lessees recognize the assets and liabilities that arise from leases on the balance sheet and disclose qualitative and quantitative information about its leasing arrangements. The new standard will be effective for the Company on January 1, 2019. The Company is in process of evaluating this guidance and determining the potential impact on its consolidated financial statements; however, it anticipates that the new standard will result in the Company recording additional right of use assets and corresponding liabilities on its consolidated balance sheet.

3. Asset Purchase and License Agreements**Biogen Asset Purchase Agreement**

On January 24, 2018, the Company entered into an Asset Purchase Agreement (the APA) and Letter Agreement with Biogen MA Inc., a Massachusetts corporation and subsidiary of Biogen, Inc. (Biogen).

Under the terms of the APA and Letter Agreement, the Company sold Biogen exclusive worldwide rights to develop and commercialize the Company's oral Selective Inhibitor of Nuclear Export (SINE) compound KPT-350 and certain related assets with an initial focus in amyotrophic lateral sclerosis (ALS) (the Transfer of IP), and also granted Biogen: (i) an exclusive worldwide license under certain of the Company's intellectual property to manufacture or have manufactured KPT-350 (the Manufacturing License), (ii) a technology transfer package, consisting of information and the Company's know-how regarding the manufacture of KPT-350 (the Manufacturing Technology Transfer), (iii) a right, at Biogen's request, to have the Company provide transition assistance regarding manufacturing and other matters (the Transition Assistance), (iv) existing inventory of KPT-350 (the Inventory), (v) an initial supply of KPT-350 (the Initial Supply), and (vi) a right, at Biogen's request, to have the Company manufacture and supply the active pharmaceutical ingredient for an additional supply of KPT-350 (the Additional Supply). In consideration for these rights, the Company received an upfront payment of \$10,000, and is eligible to receive additional payments of up to \$142,000 based on the achievement by Biogen of future specified development milestones, and up to \$65,000 based on the achievement by Biogen of future specified commercial milestones. The Company will also be eligible to receive tiered royalty payments that reach low double-digits based on future net sales until the later of the tenth anniversary of the first commercial sale of the applicable product and the expiration of specified patent protection for the applicable product, determined on a country-by-country basis.

The Company and Biogen have made customary representations and warranties and agreed to customary covenants in the APA, including covenants requiring Biogen to use commercially reasonable efforts to develop KPT-350 in

specified neurological indications, including ALS, in any of the United States, United Kingdom, France, Spain, Germany or Italy. The APA will continue in effect until the expiration of all royalty obligations, provided that the APA may be terminated earlier by Biogen, subject to the requirements that Biogen (i) negotiate in good faith with the Company regarding an assignment or license back to the Company of the purchased assets and (ii) not transfer or license the purchased assets to a third party unless such third party assumes Biogen's obligations to the Company under the APA.

The Company assessed this arrangement in accordance with ASC 606 and concluded that the contract counterparty, Biogen, is a customer. The Company identified the following material promises in the arrangement: the Transfer of IP and the Manufacturing License. The Company also identified other immaterial promises under the contract that were not deemed performance obligations. The Company further determined other promises for Additional Supply and Transition Assistance represented customer options, which would create an obligation for the Company if exercised by Biogen. Since either no additional or immaterial consideration is owed to the Company by Biogen upon exercise of the customer options for Additional Supply and Transition Assistance, the Company determined both are offered at significant and incremental discounts. Accordingly, they were assessed as material rights and, therefore, separate performance obligations in the arrangement.

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The Company then determined the Transfer of IP and the Manufacturing License were not distinct from one another and must be combined as a performance obligation (the Combined Performance Obligation). This is because Biogen requires the Manufacturing License to derive benefit from the Transfer of IP. Based on these determinations, as well as the considerations noted above with respect to the material rights for Additional Supply and Transition Assistance, the Company identified three distinct performance obligations at the inception of the contract: (i) the Combined Performance Obligation, (ii) the material right for Additional Supply, and (iii) the material right for Transition Assistance.

The Company further determined that the up-front payment of \$10,000 constituted the entirety of the consideration to be included in the transaction price at contract inception, which was allocated to the performance obligations based on their relative stand-alone selling prices. In connection therewith, the Company estimated the stand-alone selling price of the (i) Combined Performance Obligation, (ii) material right for Additional Supply, and (iii) material right for Transition Assistance, and determined the stand-alone selling price of the material rights for Additional Supply and Transition Assistance were insignificant based on various quantitative and qualitative considerations. Accordingly, the Company further determined the allocation of the transaction price to the material rights for Additional Supply and Transition Assistance was insignificant. Based on the estimates of the stand-alone selling prices for each of the performance obligations, the Company determined that substantially all the \$10,000 transaction price should be allocated to the Combined Performance Obligation. The Company believes that a change in the assumptions used to determine its best estimate of the stand-alone selling prices for the identified performance obligations would not have a significant effect on the allocation of the underlying transaction price to the performance obligations.

Upon execution of the Biogen Agreement, the transaction price included only the \$10,000 up-front payment owed to the Company. The Company may receive further payments upon the achievement of certain regulatory and sales milestones, as detailed above, as well as tiered royalty payments that reach low double-digits based on future net sales. The future regulatory milestones, which represent variable consideration, were evaluated under the most likely amount method, and were not included in the transaction price, because the amounts are fully constrained as of March 31, 2018. As part of its evaluation of the constraint, the Company considered numerous factors, including that receipt of such milestones is outside the control of the Company. Separately, any consideration related to sales-based milestones, as well as royalties on net sales upon commercialization by Biogen, will be recognized when the related sales occur, as they were determined to relate predominantly to the intellectual property and, therefore, have also been excluded from the transaction price in accordance with the sales-based royalty exception, as well as the Company's accounting policy. The Company will re-evaluate the transaction price in each reporting period, as uncertain events are resolved, or as other changes in circumstances occur.

During the quarter ended March 31, 2018, the Company recognized \$10,000 of revenue, as it had satisfied its promises under the Combined Performance Obligation by transferring the underlying promised goods at a point in time during the quarter ended March 31, 2018.

Ono License Agreement

Effective October 11, 2017 (the Effective Date), the Company entered into a license agreement (the License Agreement) with Ono Pharmaceutical Co., Ltd., a corporation organized and existing under the laws of Japan (Ono), pursuant to which the Company granted Ono exclusive rights to develop and commercialize, at its own cost, selinexor (KPT-330), the Company's lead, novel, oral SINE compound, as well as eltanexor (KPT-8602), the Company's second-generation oral SINE compound, for the diagnosis, treatment and/or prevention of all human oncology indications (the Field) in Japan, Republic of Korea, Republic of China (Taiwan) and Hong Kong, as well as in the ten Southeast Asian countries currently comprising the Association of Southeast Asian Nations (the Ono Territory) (the Exclusive License). Pursuant to the terms of the License Agreement, the Company received an upfront payment of

¥2.5 billion (US\$21,916 on the date received), and could receive up to ¥10.15 billion (approximately US\$90,500 at the exchange rate as of the Effective Date) in milestone payments if certain development goals are achieved and up to ¥9.0 billion (approximately US\$80,200 at the exchange rate as of the Effective Date) in milestone payments if certain sales milestones are achieved, as well as a low double-digit royalty based on future net sales of selinexor and eltanexor in the Ono Territory. In addition, upon Ono's election and the parties' full execution of a manufacturing technology transfer plan and satisfaction of other specified conditions (the Manufacturing Election), the Company will grant to Ono non-exclusive rights to manufacture selinexor, eltanexor and products containing such compounds in or outside of the Ono Territory solely for development and commercialization in the Field in the Ono Territory.

As part of the License Agreement, Ono will also have the right to participate in global clinical studies of selinexor and eltanexor, and will bear the cost and expense for patients enrolled in clinical studies in the Ono Territory. Ono is responsible for seeking regulatory and marketing approvals for selinexor and eltanexor in the Ono Territory, as well as any development of the products specifically necessary to obtain such approvals. Ono is also responsible for the commercialization of products containing selinexor or eltanexor in the Field in the Ono Territory at its own cost and expense.

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Subject to Ono's Manufacturing Election, the Company will furnish clinical supplies of drug substance to Ono for use in Ono's development efforts pursuant to a clinical supply agreement to be entered into by the Company and Ono, and Ono may elect to have the Company provide commercial supplies of drug product to Ono pursuant to a commercial supply agreement to be entered into by the Company and Ono, in each case the costs of which will be borne by Ono.

The License Agreement will continue in effect on a product-by-product, country-by-country basis until the later of the tenth anniversary of the first commercial sale of the applicable product in such country or the expiration of specified patent protection and regulatory exclusivity periods for the applicable product in such country. However, the License Agreement may be terminated earlier by (i) either party for breach of the License Agreement by the other party or in the event of the insolvency or bankruptcy of the other party, (ii) Ono on a product-by-product basis for certain safety reasons or on a product-by-product, country-by-country basis for any reason with 180 days' prior notice or (iii) the Company in the event Ono challenges or assists with a challenge to certain of the Company's patent rights.

The Company assessed this arrangement in accordance with ASC 606 and concluded that the contract counterparty, Ono, is a customer. The Company identified the following material promises under the contract: (i) Exclusive Licenses for selinexor and eltanexor, (ii) Initial Data Transfer for selinexor and eltanexor, which consisted of regulatory data compiled by the Company for the licensed compounds and products as of the Effective Date, (iii) Initial Clinical Supply for selinexor, which consisted of units of clinical supply for Ono to conduct its Phase I Trial, and (iv) an obligation to stand-ready to provide Initial Clinical Supply for eltanexor. The Company also identified several immaterial promises under the contract relating to information exchanges, and participation on operating committees and other working groups. Separately, the Company also identified certain customer options that would create an obligation for the Company if exercised by Ono, including the (i) Additional Data Transfer for selinexor and eltanexor, which would consist of the transfer of additional regulatory data compiled by the Company for the licensed compounds and products after the Effective Date, (ii) Additional Clinical Supply and Related Substance Supply for selinexor and eltanexor, which would consist of supplying Ono with units and substance of selinexor and eltanexor incremental to the Initial Clinical Supply for selinexor and the obligation to stand-ready to provide Initial Clinical Supply for eltanexor, as noted above, (iii) Manufacturing Technology Transfer and License for selinexor and eltanexor under Ono's Manufacturing Election, as detailed above, and (iv) Option for Backup Compound, which represents Ono's option to select a replacement compound in the event it elects to discontinue to development of either of the licensed compounds. Collectively, these options are referred to herein as the Transfer Option. The Transfer Options individually represent material rights, as they were offered at a significant and incremental discount. Therefore, they were further assessed as performance obligations under the

Three Months Ended

March 31,

March 31,

2016

2015

(unaudited)

Net sales

\$

48,789

\$

53,890

Cost of sales

34,658

37,453

Gross profit

14,131

16,437

Selling, general, and administrative expense

10,913

11,417

Intangibles amortization

1,726

1,903

Income from operations

1,492

3,117

Interest expense, net

(2,872)

(2,454)

Litigation proceeds

10,050

-

Other expense, net

(64)

(60)

Income before taxes

8,606

603

Income tax expense

3,328

220

Net income

\$

5,278

\$

383

Less net income attributable to participating securities

70

5

Net income attributable to common shareholders

\$

5,208

\$

378

Weighted average number of common shares outstanding:

Basic

22,417,337

22,247,802

Diluted

22,417,337

22,269,022

Earnings per common share:

Basic

\$

0.23

\$

0.02

Diluted

\$

0.23

\$

0.01

Cash dividends declared and paid per share

\$

0.24

\$

0.22

Comprehensive income (loss)

\$

4,204

\$

(271)

See the accompanying notes to consolidated financial statements.

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Douglas Dynamics, Inc.

Consolidated Statements of Cash Flows

(In thousands)

	Three Months Ended March 31, 2016 (unaudited)	March 31, 2015
Operating activities		
Net income	\$ 5,278	\$ 383
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,109	3,055
Inventory step up of acquired business included in cost of sales	-	1,956
Amortization of deferred financing costs and debt discount	183	167
Stock-based compensation	1,213	1,124
Provision for losses on accounts receivable	(9)	58
Deferred income taxes	642	2,228
Earnout liability	66	232
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	38,751	36,953
Inventories	(22,145)	(24,661)

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Prepaid refundable income taxes and other assets	3,432	(3,809)
Accounts payable	(4,305)	499
Accrued expenses and other current liabilities	(8,640)	(6,002)
Benefit obligations and other long-term liabilities	976	(857)
Net cash provided by operating activities	18,551	11,326
Investing activities		
Capital expenditures	(1,165)	(1,254)
Acquisition of business	-	(7,931)
Net cash used in investing activities	(1,165)	(9,185)
Financing activities		
Shares withheld on restricted stock vesting paid for employees' taxes	-	(27)
Dividends paid	(5,361)	(5,034)
Repayment of long-term debt	(475)	(475)
Net cash used in financing activities	(5,836)	(5,536)
Change in cash and cash equivalents	11,550	(3,395)
Cash and cash equivalents at beginning of period	36,844	24,195
Cash and cash equivalents at end of period	\$ 48,394	\$ 20,800

See the accompanying notes to consolidated financial statements.

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Douglas Dynamics, Inc.

Notes to Unaudited Consolidated Financial Statements

(in thousands except share and per share data)

1. Basis of presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for fiscal year-end financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. For further information, refer to the financial statements and related footnotes included in our 2015 Form 10-K (Commission File No. 001-34728) filed with the Securities and Exchange Commission on March 8, 2016.

We operate as a single business segment.

Certain reclassifications have been made to the prior period financial statements to conform to the 2016 presentation. In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-03, Simplifying the Presentation of Debt Issuance Costs. This ASU requires an entity to present such costs on the balance sheet as a direct deduction from the related debt liability rather than as an asset. The Company adopted ASU No. 2015-03 during the quarter ended March 31, 2016 and applied it retrospectively. The adoption resulted in the reclassification of debt issuance costs from Deferred Financing Costs to Long-term Debt on the balance sheet of \$2,222 and \$2,337 as of March 31, 2016 and December 31, 2015, respectively.

Interim Consolidated Financial Information

The accompanying consolidated balance sheet as of March 31, 2016 and the consolidated statements of operations and comprehensive income for the three months ended March 31, 2016 and 2015 and cash flows for the three months ended March 31, 2016 and 2015 have been prepared by the Company and have not been audited.

The Company is a counterparty to interest-rate swap agreements to hedge against the potential impact on earnings from increases in market interest rates. The Company entered into three interest rate swap agreements during the first quarter of 2015 with notional amounts of \$45,000, \$90,000 and \$135,000 effective for the periods December 31, 2015

through March 29, 2018, March 29, 2018 through March 31, 2020 and March 31, 2020 through June 30, 2021, respectively. Under the interest rate swap agreement, effective as of December 31, 2015 the Company will either receive or make payments on a monthly basis based on the differential between 6.105% and London Interbank Offered Rate (“LIBOR”) plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap agreement, effective as of March 29, 2018 the Company will either receive or make payments on a monthly basis based on the differential between 6.916% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap agreement effective as of March 31, 2020 the Company will either receive or make payments on a monthly basis based on the differential between 7.168% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). The negative fair value of the interest rate swap, net of tax, of (\$2,104) at March 31, 2016 is included in Accumulated other comprehensive loss on the Consolidated Balance Sheet. This fair value was determined using Level 2 inputs as defined in Accounting Standards Codification Topic (“ASC”) 820. Additionally, other comprehensive income includes the net income of the Company plus the Company’s adjustments for its defined benefit retirement plans based on the measurement date as of the Company’s year-end. For further disclosure, refer to Note 13 to the Unaudited Consolidated Financial Statements.

The Company’s business is seasonal and consequently its results of operations and financial condition vary from quarter-to-quarter. Because of this seasonality, the Company’s results of operations for any quarter may not be indicative of results of operations that may be achieved for a subsequent quarter or the full year, and may not be similar to results of operations experienced in prior years. The Company attempts to manage the seasonal impact of snowfall on its revenues in part through its pre-season sales program. This pre-season sales program encourages the Company’s distributors to re-stock their inventory during the second and third quarters in anticipation of the peak fourth quarter retail sales period by offering favorable pre-season pricing and payment

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deferral until the fourth quarter. Thus, the Company tends to generate its greatest volume of sales during the second and third quarters. By contrast, its revenue and operating results tend to be lowest during the first quarter, as management believes the Company's end-users prefer to wait until the beginning of a snow season to purchase new equipment and as the Company's distributors sell off inventory and wait for the pre-season sales incentive period to re-stock inventory. Fourth quarter sales vary from year-to-year as they are primarily driven by the level, timing and location of snowfall during the quarter. This is because most of the Company's fourth quarter sales and shipments consist of re-orders by distributors seeking to restock inventory to meet immediate customer needs caused by snowfall during the winter months.

The Company relies on a combination of patents, trade secrets and trademarks to protect certain of the proprietary aspects of its business and technology. In the three months ended March 31, 2016, the Company received a settlement resulting from an ongoing lawsuit with one of its competitors. Previously under the same lawsuit the competitor was required to stop using the Company's intellectual property. Under the settlement agreement the Company received \$10,050 as part of defending its intellectual property. The proceeds of the lawsuit are included on the Consolidated Statements of Operations and Comprehensive Income as Litigation proceeds.

2.Fair Value

Fair value is the price at which an asset could be exchanged in a current transaction between knowledgeable, willing parties. A liability's fair value is defined as the amount that would be paid to transfer the liability to a new obligor, not the amount that would be paid to settle the liability with the creditor. Fair value measurements are categorized into one of three levels based on the lowest level of significant input used: Level 1 (unadjusted quoted prices in active markets); Level 2 (observable market inputs available at the measurement date, other than quoted prices included in Level 1); and Level 3 (unobservable inputs that cannot be corroborated by observable market data).

The following table presents financial assets and liabilities measured at fair value on a recurring basis and discloses the fair value of long-term debt:

	Fair Value at March 31, 2016	Fair Value at December 31, 2015
Assets:		
Other long-term assets (a)	\$ 3,264	\$ 2,500
Total Assets	\$ 3,264	\$ 2,500
Liabilities:		
Interest rate swaps (b)	\$ 3,381	\$ 1,501
Long term debt (c)	186,529	185,540
Earnout - TrynEx (d)	-	1,606
Earnout - Henderson (e)	709	761
Total Liabilities	\$ 190,619	\$ 189,408

(a) Included in other assets is the cash surrender value of insurance policies on various individuals that are associated with the Company. The carrying amounts of these insurance policies approximates their fair value.

(b) Valuation models are calibrated to initial trade price. Subsequent valuations are based on observable inputs to the valuation model (e.g. interest rates and credit spreads). Model inputs are changed only when corroborated by market data. A credit risk adjustment is made on each swap using observable market credit spreads. Thus, inputs used to determine fair value of the interest rate swap are Level 2 inputs. Interest rate swaps of \$379 and \$3,002 at March 31,

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2016 are included in Accrued expenses and other current liabilities and Other long-term liabilities, respectively. Interest rate swaps of \$286 and \$1,215 at December 31, 2015 are included in Accrued expenses and other current liabilities and Other long-term liabilities, respectively.

(c) The fair value of the Company's long-term debt, including current maturities, is estimated using discounted cash flows based on the Company's current incremental borrowing rates for similar types of borrowing arrangements, which is a Level 2 input for all periods presented. Meanwhile, long-term debt is recorded at carrying amount, net of discount and deferred debt issuance costs, as disclosed on the face of the balance sheet.

(d) Included in accrued expenses and other current liabilities in the amount of \$0 and \$2,032 at March 31, 2016 and March 31, 2015, respectively, is an obligation for a portion of the potential earn out incurred in conjunction with the acquisition of substantially all of the assets of TrynEx, Inc. ("TrynEx"). The carrying amount of the earn out approximates its fair value. Fair value is based upon Level 3 inputs of a monte carlo simulation analysis using key inputs of forecasted future sales and financial performance as well as a growth rate reduced by the market required rate of return. See reconciliation of liability included below:

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Beginning Balance	\$ 1,606	\$ 1,987
Additions	—	—
Adjustments to fair value	—	313
Payment to former owners	(1,606)	(268)
Ending balance	\$ -	\$ 2,032

(e) Included in accrued expenses and other current liabilities and other long term liabilities in the amounts of \$267 and \$442, respectively, at March 31, 2016 is the fair value of an obligation for a portion of the potential earn out acquired in conjunction with the acquisition of Henderson Enterprise Group, Inc. ("Henderson"). Included in accrued expenses and other current liabilities and other long term liabilities in the amounts of \$193 and \$442, respectively, at March 31, 2015 is the fair value of an obligation for a portion of the potential earn out acquired in

conjunction with the acquisition of Henderson. Fair value is based upon Level 3 discounted cash flow analysis using key inputs of forecasted future sales as well as a growth rate reduced by the market required rate of return. See reconciliation of liability included below:

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Beginning Balance	\$ 761	\$ 600
Additions	—	—
Adjustments to fair value	—	96
Payment to former owners	(52)	(61)
Ending balance	\$ 709	\$ 635

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3. Inventories

Inventories consist of the following:

	March 31, 2016	December 31, 2015
Finished goods and work-in-process	\$ 63,901	\$ 40,984
Raw material and supplies	9,828	10,600
	\$ 73,729	\$ 51,584

4. Property, plant and equipment

Property, plant and equipment are summarized as follows:

	March 31, 2016	December 31, 2015
Land	\$ 1,500	\$ 1,500
Land improvements	3,010	3,010
Leasehold Improvements	859	859
Buildings	24,481	24,476
Machinery and equipment	36,777	35,628
Furniture and fixtures	11,663	11,657
Mobile equipment and other	2,430	2,255
Construction-in-process	1,752	2,155
Total property, plant and equipment	82,472	81,540
Less accumulated depreciation	(40,054)	(38,904)
Net property, plant and equipment	\$ 42,418	\$ 42,636

5. Long-Term Debt

Long-term debt is summarized below:

	March 31, 2016	December 31, 2015
Term Loan, net of debt discount of \$1,561 and \$1,629 at March 31, 2016 and December 31, 2015, respectively	\$ 186,065	\$ 186,472

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Less current maturities	1,629	1,629
Long term debt before deferred financing costs	184,436	184,843
Deferred financing costs, net	2,222	2,337
Long term debt, net	\$ 182,214	\$ 182,506

The Company's senior credit facilities consist of a \$190,000 term loan facility and a \$100,000 revolving credit facility with a group of banks, of which \$10,000 will be available in the form of letters of credit

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and \$5,000 will be available for the issuance of short-term swing line loans. The agreement for the term loan (the “Term Loan Credit Agreement”) provides for a senior secured term loan facility in the aggregate principal amount of \$190,000 and generally bears interest (at the Company’s election) at either (i) 3.25% per annum plus the greatest of (a) the Prime Rate (as defined in the Term Loan Credit Agreement) in effect on such day, (b) the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers plus 0.50% and (c) 1.00% plus the greater of (1) the LIBOR for a one month interest period multiplied by the Statutory Reserve Rate (as defined in the Term Loan Credit Agreement) and (2) 1.00% or (ii) 4.25% per annum plus the greater of (a) the LIBOR for the applicable interest period multiplied by the Statutory Reserve Rate and (b) 1.00%. The Term Loan Credit Agreement also allows the Company to request the establishment of one or more additional term loan commitments in an aggregate amount not in excess of \$80,000 subject to specified terms and conditions, which amount may be further increased so long as the First Lien Debt Ratio (as defined in the Term Loan Credit Agreement) is not greater than 3.25 to 1.00.

The revolving credit facility (the “Revolving Credit Agreement”) provides that the Company has the option to select whether borrowings will bear interest at either (i) a margin ranging from 1.50% to 2.00% per annum, depending on the utilization of the facility, plus the LIBOR for the applicable interest period multiplied by the Statutory Reserve Rate (as defined by the Revolving Credit Agreement) or (ii) a margin ranging from 0.50% to 1.00% per annum, depending on the utilization of the facility, plus the greatest of (a) the Prime Rate (as defined in the Revolving Credit Agreement) in effect on such day, (b) the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers plus 0.50% and (c) the LIBOR for a one month interest period multiplied by the Statutory Reserve Rate plus 1%. The maturity date for the Revolving Credit Agreement is December 31, 2019, and the Company’s term loan amortizes in nominal amounts quarterly with the balance payable on December 31, 2021.

The term loan was issued at a \$1,900 discount which is being amortized over the term of the term loan.

At March 31, 2016, the Company had no outstanding borrowings on the Revolving Credit Agreement and remaining borrowing availability of \$97,776. There were no outstanding borrowings on the Revolving – Credit Agreement at December 31, 2015.

The Company’s senior credit facilities include certain negative and operating covenants, including restrictions on its ability to pay dividends, and other customary covenants, representations and warranties and events of default. The senior credit facilities entered into and recorded by the Company’s subsidiaries significantly restrict its subsidiaries from paying dividends and otherwise transferring assets to Douglas Dynamics, Inc. The terms of the Revolving Credit Agreement specifically restrict subsidiaries from paying dividends if a minimum availability under the Revolving Credit Agreement is not maintained, and both senior credit facilities restrict subsidiaries from paying dividends above certain levels or at all if an event of default has occurred. These restrictions would affect the Company indirectly since the Company relies principally on distributions from its subsidiaries to have funds available for the payment of dividends. In addition, the Revolving Credit Agreement includes a requirement that, subject to certain exceptions, capital expenditures may not exceed \$12,500 in any calendar year (plus the unused portion of permitted capital expenditures from the preceding year subject to a \$12,500 cap and a separate one-time \$15,000 capital

expenditures to be used for the consolidation of facilities and costs associated with the acquiring and/or development and construction of one new manufacturing facility) and, if certain minimum availability under the Revolving Credit Agreement is not maintained, that the Company comply with a monthly minimum fixed charge coverage ratio test of 1.0:1.0. Compliance with the fixed charge coverage ratio test is subject to certain cure rights under the Revolving Credit Agreement. At March 31, 2016, the Company was in compliance with the respective covenants. The credit facilities are collateralized by substantially all assets of the Company.

In accordance with the senior credit facilities, the Company is required to make additional principal prepayments over the above scheduled payments under certain conditions. This includes, in the case of the term loan facility, 100% of the net cash proceeds of certain asset sales, certain insurance or condemnation events, certain debt issuances, and, within 150 days of the end of the fiscal year, 50% of excess cash flow, as defined, including a deduction for certain distributions (which percentage is reduced to 0% upon the achievement of certain leverage ratio thresholds), for any fiscal year. Excess cash flow is defined in the senior credit facilities as consolidated adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) plus a working

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capital adjustment less the sum of repayments of debt and capital expenditures subject to certain adjustments, interest and taxes paid in cash, management fees and certain restricted payments (including dividends or distributions). Working capital adjustment is defined in the senior credit facilities as the change in working capital, defined as current assets excluding cash and cash equivalents less current liabilities excluding current portion of long term debt. As of March 31, 2016, the Company was not required to make an excess cash flow payment.

The Company entered into interest rate swap agreements on February 20, 2015 to reduce its exposure to interest rate volatility. The three interest rate swap agreements have notional amounts of \$45,000, \$90,000 and \$135,000 effective for the periods December 31, 2015 through March 29, 2018, March 29, 2018 through March 31, 2020 and March 31, 2020 through June 30, 2021, respectively. The interest rate swaps' negative fair value at March 31, 2016 was \$3,381, of which \$379 and \$3,002 are included in accrued expenses and other current liabilities and Other long-term liabilities on the Consolidated Balance Sheet, respectively. Meanwhile, the interest rate swaps' negative fair value at March 31, 2015 was \$1,293, of which \$88 and \$1,205 are included in Accrued expenses and Other current liabilities and Other long-term liabilities on the Consolidated Balance Sheet, respectively. The Company has counterparty credit risk resulting from the interest rate swap, which it monitors on an on-going basis. This risk lies with one global financial institution. Under the interest rate swap agreement, effective as of December 31, 2015, the Company will either receive or make payments on a monthly basis based on the differential between 6.105% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap agreement, effective as of March 29, 2018, the Company will either receive or make payments on a monthly basis based on the differential between 6.916% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap agreement, effective as of March 31, 2020, the Company will either receive or make payments on a monthly basis based on the differential between 7.168% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%).

6. Accrued Expenses and Other Current Liabilities

Accrued expenses and other liabilities are summarized as follows:

	March 31, 2016	December 31, 2015
Payroll and related costs	\$ 4,063	\$ 8,927
Employee benefits	4,265	4,113

Accrued warranty	5,504	7,423
Other	3,077	5,086
	\$ 16,909	\$ 25,549

7. Warranty Liability

The Company accrues for estimated warranty costs as sales are recognized and periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. The Company's warranties generally provide, with respect to its snow and ice control equipment, that all material and workmanship will be free from defect for a period of two years after the date of purchase by the end-user, and with respect to its parts and accessories purchased separately, that such parts and accessories will be free from defect for a period of one year after the date of purchase by the end-user. Certain snowplows only provide for a one year warranty. The Company determines the amount of the estimated warranty costs (and its corresponding warranty reserve) based on the Company's prior five years of warranty history utilizing a formula driven by historical warranty expense and applying management's judgment. The Company adjusts its historical warranty costs to take into account unique factors such as the introduction of new products into the marketplace that do not provide a historical warranty record to assess. The warranty reserve is \$6,504 at March 31, 2016 of which \$1,000 is included in Other long term liabilities and \$5,504 is included in Accrued expenses and other current liabilities in the accompanying

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consolidated balance sheet. Meanwhile at December 31, 2015 \$7,423 is included in accrued expenses and other current liabilities in the accompanying Consolidated Balance Sheet.

The following is a rollforward of the Company's warranty liability:

	Three Months Ended	
	March	March
	31,	31,
	2016	2015
Balance at the beginning of the period	\$ 7,423	\$ 6,279
Warranty provision	471	648
Claims paid/settlements	(1,390)	(1,739)
Balance at the end of the period	\$ 6,504	\$ 5,188

8.Employee Retirement Plans

The components of net periodic pension cost consist of the following:

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Three Months
 Ended
 March March
 31, 31,
 2016 2015

Component of net periodic pension cost:

Service cost	\$ 80	\$ 64
Interest cost	410	372
Expected return on plan assets	(456)	(407)
Amortization of net loss	181	255
Net periodic pension cost	\$ 215	\$ 284

The Company estimates its total required minimum contributions to its pension plans in 2016 will be \$967. During the first quarter of 2016, the Company made \$193 of cash contributions to the pension plans versus \$226 through the same period in 2015.

Components of net periodic other postretirement benefit cost consist of the following:

Three Months
 Ended
 March March
 31, 31,
 2016 2015

Component of periodic other postretirement benefit cost:

Service cost	\$ 53	\$ 57
Interest cost	70	64
Amortization of net gain	(32)	(17)
Net periodic other postretirement benefit cost	\$ 91	\$ 104

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9.Earnings per Share

Basic earnings per share of common stock is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share of common stock is computed by dividing net income by the weighted average number of common shares and common stock equivalents related to the assumed exercise of stock options, using the two-class method. Stock options for which the exercise price exceeds the average fair value have an anti-dilutive effect on earnings per share and are excluded from the calculation.

As restricted shares and restricted stock units both participate in dividends, in accordance with ASC 260, the Company has calculated earnings per share pursuant to the two-class method, which is an earnings allocation formula that determines earnings per share for common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings (distributed and undistributed) are allocated to common shares and participating securities based on their respective rights to receive dividends.

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	Three Months Ended	
	March 31, 2016	March 31, 2015
Basic earnings per common share		
Net income	\$ 5,278	\$ 383
Less income allocated to participating securities	70	5
Net income allocated to common shareholders	\$ 5,208	\$ 378
Weighted average common shares outstanding	22,417,337	22,247,802
	\$ 0.23	\$ 0.02
Earnings per common share assuming dilution		
Net income	\$ 5,278	\$ 383
Less income allocated to participating securities	70	5
Net income allocated to common shareholders	\$ 5,208	\$ 378
Weighted average common shares outstanding	22,417,337	22,247,802
Incremental shares applicable to stock based compensation	-	21,220
Weighted average common shares assuming dilution	22,417,337	22,269,022
	\$ 0.23	\$ 0.01

10.Employee Stock Plans

2010 Stock Incentive Plan

In May 2010, the Company's Board of Directors and stockholders adopted the 2010 Stock Incentive Plan (the "2010 Plan"). The Company's Board of Directors approved an amendment and restatement of the 2010 Plan on March 5, 2014, contingent on stockholder approval of the performance goals under the 2010 Plan, and the amendment and restatement became effective upon stockholder approval of the performance goals at the 2014 annual meeting of stockholders held on April 30, 2014. The 2010 Plan provides for the issuance of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock awards and restricted stock units ("RSUs"), any of which may be performance-based, and for incentive bonuses, which may be paid in cash or stock or a combination of both, to eligible employees, officers, non-employee directors and other service providers to the Company and its subsidiaries. A maximum of 2,130,000 shares of common stock may be issued pursuant to all awards under the 2010 Plan.

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Restricted Stock Awards

A summary of restricted stock activity for the three months ended March 31, 2016 is as follows:

	Shares	Weighted Average Grant Date Fair value	Weighted Average Remaining Contractual Term
Unvested at December 31, 2015	14,701	\$ 14.78	0.01 years
Granted	-	-	-
Vested	(14,701)	\$ 14.78	
Cancelled and forfeited	—	—	
Unvested at March 31, 2016	-	\$ -	- years
Expected to vest in the future at March 31, 2016	-	\$ -	- years

The fair value of the Company's restricted stock awards is the closing stock price on the date of grant. The Company recognized \$0 and \$165 of compensation expense related to restricted stock awards granted for the three months ended March 31, 2016 and March 31, 2015, respectively. In the year ending December 31, 2013, the company transitioned from granting restricted stock awards to granting RSUs. The 14,701 restricted stock awards that vested in the three month period ended March 31, 2016 were the final tranche of restricted stock awards granted prior to the transition to RSUs.

Performance Share Unit Awards

The Company granted performance share units as performance based awards under the 2010 Plan in the first quarter of 2016 that are subject to performance conditions. Upon meeting the prescribed performance conditions, in the first quarter of the year subsequent to grant, employees will be issued RSUs, a portion of which will be subject to vesting

over the two years following the end of the performance period. In accordance with ASC 718, such awards are being expensed over the vesting period from the date of grant through the requisite service period, based upon the most probable outcome. The fair value per share of the awards is the closing stock price on the date of grant, which was \$19.88. The Company recognized \$127 and \$127 of compensation expense related to the awards in the three months ended March 31, 2016 and March 31, 2015, respectively. The unrecognized compensation expense calculated under the fair value method for shares that were, as of March 31, 2016, expected to be earned through the requisite service period was approximately \$1,430 and is expected to be recognized through 2019.

Restricted Stock Unit Awards

RSUs are granted to both non-employee directors and management. RSUs carry dividend equivalent rights but do not carry voting rights. Each RSU represents the right to receive one share of the Company's common stock and is subject to time based vesting restrictions. Participants are not required to pay any consideration to the Company at either the time of grant of a RSU or upon vesting.

RSUs issued to management include a retirement provision under which members of management who either (1) are age 65 or older or (2) have at least ten years of service and are at least age 55 will continue to vest in unvested RSUs upon retirement. As the retirement provision does not qualify as a substantive service condition, the Company incurred \$528 and \$303 in additional expense in the first quarter of 2016 and 2015, respectively, for employees who meet the thresholds of the retirement provision. In 2013, the Company's nominating and governance committee approved a retirement provision for the RSUs issued to non-employee directors that accelerates the vesting of such RSUs upon retirement. Such awards are fully expensed immediately upon grant in accordance with ASC 718, as the retirement provision eliminates substantive service conditions associated with the awards.

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A summary of RSU activity for the three months ended March 31, 2016 is as follows:

	Shares	Weighted Average Grant Date Fair value	Weighted Average Remaining Contractual Term
Unvested at December 31, 2015	48,665	\$ 17.33	1.00 years
Granted	131,765	\$ 21.37	0.57 years
Vested	(131,638)	\$ 20.27	
Cancelled and forfeited	-	\$ -	
Unvested at March 31, 2016	48,792	\$ 20.30	1.74 years
Expected to vest in the future at March 31, 2016	47,035	\$ 20.30	1.74 years

The Company recognized \$742 and \$832 of compensation expense related to the RSU awards in the three months ended March 31, 2016 and March 31, 2015, respectively. The unrecognized compensation expense, net of expected forfeitures, calculated under the fair value method for shares that were, as of March 31, 2016, expected to be earned through the requisite service period was approximately \$829 and is expected to be recognized through 2019.

Vested director RSUs are “settled” by the delivery to the participant or a designated brokerage firm of one share of common stock per vested RSU as soon as reasonably practicable following a termination of service of the participant that constitutes a separation from service, and in all events no later than the end of the calendar year in which such termination of service occurs or, if later, two and one-half months after such termination of service. Vested management RSUs are “settled” by the delivery to the participant or a designated brokerage firm of one share of common stock per vested RSU as soon as reasonably practicable following vesting.

11. Commitments and Contingencies

In the ordinary course of business, the Company is engaged in various litigation including product liability and intellectual property disputes. However, the Company does not believe that any pending litigation will have a material adverse effect on its consolidated financial position. In addition, the Company is not currently a party to any environmental-related claims or legal matters.

12. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The largest item affecting deferred taxes is the difference between book and tax amortization of goodwill and other intangibles amortization. The Company's effective tax rate was 38.7% and 36.5% for the three months ended March 31, 2016 and 2015, respectively. The effective tax rate for the three months ended March 31, 2016 is higher than the corresponding period in 2015 due to state tax expense adjustments resulting from changes in apportionment.

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13.Changes in Accumulated Other Comprehensive Loss by Component

Changes to accumulated other comprehensive loss by component for the three months ended March 31, 2016 are as follows:

	Unrealized Net Loss on Interest Rate Swap	Retiree Health Benefit Obligation	Pension Obligation	Total
Balance at December 31, 2015	\$ (937)	\$ 1,048	\$ (6,294)	\$ (6,183)
Other comprehensive loss before reclassifications	(1,227)	—	—	(1,227)
Amounts reclassified from accumulated other comprehensive loss: (1)	60	(20)	113	153
Balance at March 31, 2016	\$ (2,104)	\$ 1,028	\$ (6,181)	\$ (7,257)
(1) Amounts reclassified from accumulated other comprehensive loss:				
Amortization of Other Postretirement Benefit items:				
Actuarial gains (a)	(32)			
Tax expense	12			
Reclassification net of tax	\$ (20)			
Amortization of pension items:				
Actuarial losses (a)	181			
Tax benefit	(68)			
Reclassification net of tax	\$ 113			
Realized losses on interest rate swaps reclassified to interest expense	97			
Tax benefit	(37)			
Reclassification net of tax	\$ 60			

(a) These components are included in the computation of benefit plan costs in Note 8.

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Changes to accumulated other comprehensive loss by component for the three months ended March 31, 2015 are as follows:

	Unrealized Net Loss on Interest Rate Swap	Retiree Health Benefit Obligation	Pension Obligation	Total
Balance at December 31, 2014	\$ -	\$ 807	\$ (6,835)	\$ (6,028)
Other comprehensive loss before reclassifications	(802)	-	-	(802)
Amounts reclassified from accumulated other comprehensive loss: (1)	-	(11)	159	148
Balance at March 31, 2015	\$ (802)	\$ 796	\$ (6,676)	\$ (6,682)
(1) Amounts reclassified from accumulated other comprehensive loss:				
Amortization of Other Postretirement Benefit items:				
Actuarial gains (a)	(17)			
Tax expense	6			
Reclassification net of tax	\$ (11)			
Amortization of pension items:				
Actuarial losses (a)	255			
Tax benefit	(96)			
Reclassification net of tax	\$ 159			

(a) These components are included in the computation of benefit plan costs in Note 8.

14. Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02 Leases: Amendments to the FASB Accounting Standards Codification. ASU 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 will be effective for the Company beginning on January 1, 2019. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The Company is currently evaluating the expected impact of this standard.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes which are included in Item 1 of this Quarterly Report on Form 10-Q, as well as the information contained in our Form 10-K (Commission File No. 001-34728) filed with the Securities and Exchange Commission.

In this Quarterly Report on Form 10-Q, unless the context indicates otherwise: "Douglas Dynamics," the "Company," "we," "our," or "us" refer to Douglas Dynamics, Inc.

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Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These statements include information relating to future events, product demand, the payment of dividends, future financial performance, strategies, expectations, competitive environment, regulation and availability of financial resources. These statements are often identified by use of words such as “anticipate,” “believe,” “intend,” “estimate,” “expect,” “continue,” “should,” “could,” “may,” “project,” “predict,” “will” and similar expressions and include references to assumptions and relate to our future prospects, developments and business strategies. Such statements involve known and unknown risks, uncertainties and other factors that could cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to: (i) weather conditions, particularly lack of or reduced levels of snowfall and the timing of such snowfall; (ii) a significant decline in economic conditions; (iii) our inability to maintain good relationships with our distributors; (iv) lack of available or favorable financing options for our end-users or distributors; (v) increases in the price of steel or other materials necessary for the production of our products that cannot be passed on to our distributors; (vi) increases in the price of fuel; (vii) the inability of our suppliers to meet our volume or quality requirements; (viii) inaccuracies in our estimates of future demand for our products; (ix) our inability to protect or continue to build our intellectual property portfolio; (x) the effects of laws and regulations and their interpretations on our business and financial condition; (xi) our inability to develop new products or improve upon existing products in response to end-user needs; (xii) losses due to lawsuits arising out of personal injuries associated with our products; (xiii) factors that could impact the future declaration and payment of dividends; (xiv) our inability to compete effectively against competition; and (xv) our inability to achieve the projected financial performance with the assets of TrynEx, which we acquired in 2013, or the business of Henderson, which we acquired in 2014 and unexpected costs or liabilities related to such acquisitions, as well as those discussed in the sections entitled “Risk Factors” in Part II, Item 1A of this Quarterly Report on Form 10-Q, if any, or in our most recent Annual Report on Form 10-K. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. In addition, the forward-looking statements in this Quarterly Report on Form 10-Q speak only as of the date hereof and we undertake no obligation, except as required by law, to update or release any revisions to any forward-looking statement, even if new information becomes available in the future.

Results of Operations

Overview

The following table sets forth, for the three months ended March 31, 2016 and 2015, the consolidated statements of operations of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the table below and throughout this “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” consolidated statements of operations data for the three months ended March 31, 2016 and 2015 have been derived from our unaudited consolidated financial statements. The information

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contained in the table below should be read in conjunction with our unaudited consolidated financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q.

	Three Months Ended	
	March	March
	31,	31,
	2016	2015
	(unaudited)	
	(in thousands)	
Net sales	\$ 48,789	\$ 53,890
Cost of sales	34,658	37,453
Gross profit	14,131	16,437
Selling, general, and administrative expense	10,913	11,417
Intangibles amortization	1,726	1,903
Income from operations	1,492	3,117
Interest expense, net	(2,872)	(2,454)
Litigation proceeds	10,050	-
Other expense, net	(64)	(60)
Income before taxes	8,606	603
Income tax expense	3,328	220
Net income	\$ 5,278	\$ 383

The following table sets forth for the three months ended March 31, 2016 and 2015, the percentage of certain items in our consolidated statement of operations, relative to net sales:

	Three Months Ended		
	March 31,	March 31,	
	2016	2015	
	(unaudited)		
Net sales	100.0	% 100.0	%
Cost of sales	71.0	% 69.5	%

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Gross profit	29.0	% 30.5	%
Selling, general, and administrative expense	22.4	% 21.2	%
Intangibles amortization	3.5	% 3.5	%
Income from operations	3.1	% 5.8	%
Interest expense, net	(5.9)	% (4.6)	%
Litigation proceeds	20.6	% -	%
Other expense, net	(0.0)	% (0.0)	%
Income before taxes	17.8	% 1.2	%
Income tax expense	6.8	% 0.4	%
Net income	11.0	% 0.8	%

Net Sales

Net sales were \$48.8 million for the three months ended March 31, 2016 compared to \$53.9 million in the three months ended March 31, 2015, a decrease of \$5.1 million, or 9.5%. The decrease in net sales stems from lower shipments of plows as well as parts and accessories in the commercial snow and ice business when compared to the prior year period. Specifically, due to below average levels of snowfall in the snow season ending March 31, 2016, overall sales of snow and ice control equipment decreased for the three months ended March 31, 2016 by 2.2%

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compared to the corresponding period in 2015. In addition, due to the below average levels of snowfall, parts and accessories sales decreased by 30.2% for the three months ended March 31, 2016, compared to the corresponding period in 2015.

Cost of Sales

Cost of sales was \$34.7 million for the three months ended March 31, 2016 compared to \$37.5 million for the three months ended March 31, 2015, a decrease of \$2.8 million, or 7.5%. The decrease in cost of sales for the three months ended March 31, 2016 compared to the corresponding period in 2015 was driven by the decrease in both equipment unit shipments and parts and accessory sales primarily attributable to below average snowfall in the snow season ending March 31, 2016 as discussed above under “—Net Sales.” The Company experienced higher cost of sales as a percentage of sales of 71.0% for the three-month period ended March 31, 2016 compared to 69.5% for the three month period ended March 31, 2015. The increases in cost of sales as a percentage of sales was primarily due to higher cost of sales as a percentage of sales for Henderson products, which made up a larger portion of our total sales in the three months ended March 31, 2016 as compared to March 31, 2015. Henderson products typically are sold at lower margins than non-Henderson products. As a percentage of cost of sales, fixed and variable costs were approximately 23% and 77%, respectively, for the three months ended March 31, 2016 versus approximately 20% and 80%, respectively, for the three months ended March 31, 2015.

Gross Profit

Gross profit was \$14.1 million for the three months ended March 31, 2016 compared to \$16.4 million for the three months ended March 31, 2015, a decrease of \$2.3 million, or 14.0%. Gross profit decreased for the three month period due to decreased sales as discussed above under “-Net Sales”. As a percentage of net sales, gross profit decreased from 30.5% for the three months ended March 31, 2015 to 29.0% for the corresponding period in 2016. The reasons for the decrease in gross profit as a percentage of net sales are the same as those relating to the decrease in cost of sales as a percentage of sales discussed above under “—Cost of Sales.”

Selling, General and Administrative Expense

Selling, general and administrative expenses, including intangibles amortization, were \$12.6 million for the three months ended March 31, 2016, compared to the corresponding period in \$13.3 million for the three months ended March 31, 2015, a decrease of \$0.7 million, or 5.1%. The decrease compared to the corresponding period in 2015 was driven by decreased sales and marketing spending due to below average snowfall. In periods of below average snowfall, discretionary spending, namely sales and marketing expenses are reduced.

Interest Expense

Interest expense was \$2.9 million for the three months ended March 31, 2016 which was slightly higher than the \$2.5 million incurred in the same period in the prior year.

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Litigation Proceeds

Litigation proceeds were \$10.0 million for the three months ended March 31, 2016. The Company received a settlement related to the successful conclusion of a patent infringement lawsuit against Buyers Products Company in the three months ended March 31, 2016. Under the settlement agreement, the Company received a non-reoccurring payment of \$10.0 million. There were no litigation proceeds in the three months ended March 31, 2015.

Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The largest item affecting deferred taxes is the difference between book and tax amortization of goodwill and other intangibles amortization. The Company's effective tax rate was 38.7% and 36.5% for the three months ended March 31, 2016 and 2015, respectively. The effective tax rate for the three months ended March 31, 2016 is higher than the corresponding period in 2015 due to state tax expense adjustments resulting from changes in apportionment.

Net Income

Net income for the three months ended March 31, 2016 was \$5.3 million, including the litigation proceeds of \$10.0 million described above under "—Litigation Proceeds," compared to net income of \$0.4 million for the corresponding period in 2015, an increase in net income of \$4.9 million. The increase in net income for the three months ended March 31, 2016 was driven by the factors described above under "— Net Sales," "—Cost of Sales," " — Selling, General and Administrative Expense," and "—Litigation Proceeds". As a percentage of net sales, net income was 11.0% for the three months ended March 31, 2016 compared to 0.8% for the three months ended March 31, 2015.

Adjusted EBITDA

Adjusted EBITDA for the three months ended March 31, 2016 was \$6.3 million compared to \$9.6 million in the corresponding period in 2015, a decrease of \$3.3 million. For the three month period ended March 31, 2016 the decrease in Adjusted EBITDA is attributable to the decrease in unit sales of snow and ice control equipment and parts and accessories sales.

Free Cash Flow

Free cash flow for the three months ended March 31, 2016 was \$17.4 million compared to \$10.1 million in the corresponding period in 2015, an increase in cash provided of \$7.3 million. The increase in free cash flow is primarily a result of higher cash provided by operating activities of \$7.2 million, as discussed below under “Liquidity and Capital Resources.” Meanwhile, acquisitions of property and equipment decreased from \$1.3 million for the three months ended March 31, 2015 to \$1.2 million for the three months ended March 31, 2016.

Non-GAAP Financial Measures

This Quarterly Report on Form 10-Q contains financial information calculated other than in accordance with U.S. generally accepted accounting principles (“GAAP”).

These non-GAAP measures include:

- Free cash flow; and
- Adjusted EBITDA.

These non-GAAP disclosures should not be construed as an alternative to the reported results determined in accordance with GAAP.

Free cash flow is a non-GAAP financial measure which we define as net cash provided by (used in) operating activities less capital expenditures. Free cash flow should be evaluated in addition to, and not considered a substitute

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for, other financial measures such as net income and cash flow provided by operations. We believe that free cash flow represents our ability to generate additional cash flow from our business operations.

The following table reconciles net cash provided by operating activities, a GAAP measure, to free cash flow, a non-GAAP measure.

	Three Months Ended	
	March	March
	31,	31,
	2016	2015
	(In Thousands)	
Net cash provided by operating activities	\$ 18,551	\$ 11,326
Acquisition of property and equipment	(1,165)	(1,254)
Free cash flow	\$ 17,386	\$ 10,072

Adjusted EBITDA represents net income before interest, taxes, depreciation and amortization, as further adjusted for certain charges consisting of unrelated legal and consulting fees, stock-based compensation, litigation proceeds and certain purchase accounting expenses. We use, and we believe our investors benefit from the presentation of Adjusted EBITDA in evaluating our operating performance because it provides us and our investors with additional tools to compare our operating performance on a consistent basis by removing the impact of certain items that management believes do not directly reflect our core operations. In addition, we believe that Adjusted EBITDA is useful to investors and other external users of our consolidated financial statements in evaluating our operating performance as compared to that of other companies, because it allows them to measure a company's operating performance without regard to items such as interest expense, taxes, depreciation and amortization, which can vary substantially from company to company depending upon accounting methods and book value of assets and liabilities, capital structure and the method by which assets were acquired. Our management also uses Adjusted EBITDA for planning purposes, including the preparation of our annual operating budget and financial projections. Management also uses Adjusted EBITDA to evaluate our ability to make certain payments, including dividends, in compliance with our senior credit facilities, which is determined based on a calculation of "Consolidated Adjusted EBITDA" that is substantially similar to Adjusted EBITDA.

Adjusted EBITDA has limitations as an analytical tool. As a result, you should not consider it in isolation, or as a substitute for net income, operating income, cash flow from operating activities or any other measure of financial performance or liquidity presented in accordance with GAAP. Some of these limitations are:

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- Adjusted EBITDA does not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our indebtedness;
 - Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;
- Other companies, including other companies in our industry, may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure; and
- Adjusted EBITDA does not reflect tax obligations whether current or deferred.

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The following table presents a reconciliation of net income, the most comparable GAAP financial measure, to Adjusted EBITDA as well as the resulting calculation of Adjusted EBITDA for the three months ended March 31, 2016 and 2015:

	Three Months Ended	
	March 31, 2016	March 31, 2015
	(in thousands)	
Net income	\$ 5,278	\$ 383
Interest expense - net	2,872	2,454
Income tax expense	3,328	220
Depreciation expense	1,383	1,152
Amortization	1,726	1,903
EBITDA	14,587	6,112
Stock - based compensation expense	1,213	1,124
Litigation proceeds	(10,050)	-
Purchase accounting (1)	66	2,188
Other charges (2)	443	184
Adjusted EBITDA	\$ 6,259	\$ 9,608

(1) Reflects \$66 and \$136 in earnout compensation expense related to TrynEx in the three months ended March 31, 2016 and March 31, 2015, respectively. Reflects \$96 in earnout compensation expense related to Henderson in the three months ended March 31, 2015. Reflects \$1,956 in inventory step up related to Henderson included in cost of sales in the three months ended March 31, 2015.

(2) Reflects expenses of \$443 and \$184 for one time, unrelated legal and consulting fees for the three months ended March 31, 2016 and March 31, 2015, respectively.

Discussion of Critical Accounting Policies

For a discussion of our critical accounting policies, please see the disclosure included in our Form 10-K (Commission File No. 001-34728) filed with the Securities and Exchange Commission, under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operation — Critical Accounting Policies.”

New Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02 Leases: Amendments to the FASB Accounting Standards Codification. ASU 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 will be effective for us beginning on January 1, 2019. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. We are currently evaluating the expected impact of this standard.

Liquidity and Capital Resources

Our principal sources of cash have been and we expect will continue to be cash from operations and borrowings under our senior credit facilities.

Our primary uses of cash are to provide working capital, meet debt service requirements, finance capital expenditures, pay dividends under our dividend policy and support our growth, including through potential

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acquisitions, and for other general corporate purposes. For a description of the seasonality of our working capital rates see “—Seasonality and Year To Year Variability.”

Our Board of Directors has adopted a dividend policy that reflects an intention to distribute to our stockholders a regular quarterly cash dividend. The declaration and payment of these dividends to holders of our common stock is at the discretion of our Board of Directors and depends upon many factors, including our financial condition and earnings, legal requirements, taxes and other factors our Board of Directors may deem to be relevant. The terms of our indebtedness may also restrict us from paying cash dividends on our common stock under certain circumstances. As a result of this dividend policy, we may not have significant cash available to meet any large unanticipated liquidity requirements. As a result, we may not retain a sufficient amount of cash to fund our operations or to finance unanticipated capital expenditures or growth opportunities, including acquisitions. Our Board of Directors may, however, amend, revoke or suspend our dividend policy at any time and for any reason.

As of March 31, 2016, we had \$146.2 million of total liquidity, comprised of \$48.4 million in cash and cash equivalents and borrowing availability of \$97.8 million under our revolving credit facility, compared with total liquidity as of December 31, 2015 of approximately \$136.2 million, comprised of approximately \$36.8 million in cash and cash equivalents and borrowing availability of approximately \$99.4 million under our revolving credit facility. The increase in our total liquidity from December 31, 2015 is primarily due to litigation proceeds and the seasonality of our business slightly offset by our working capital needs. Borrowing availability under our revolving credit facility is governed by a borrowing base, the calculation of which includes cash on hand. Accordingly, use of cash on hand may also result in a reduction in the amount available for borrowing under our revolving credit facility. Furthermore, our revolving credit facility requires us to maintain at least \$10.5 million of borrowing availability and 15% of the aggregate revolving commitments at the time of determination. We expect that cash on hand and cash we generate from operations, as well as available credit under our senior credit facilities, will provide adequate funds for the purposes described above for at least the next 12 months.

The following table shows our cash and cash equivalents and inventories in thousands at March 31, 2016, December 31, 2015 and March 31, 2015.

	As of March 31, 2016	December 31, 2015	March 31, 2015
Cash and cash equivalents	\$ 48,394	\$ 36,844	\$ 20,800
Inventories	73,729	51,584	70,953

We had cash and cash equivalents of \$48.4 million at March 31, 2016 compared to cash and cash equivalents of \$36.8 million and \$20.8 million at December 31, 2015 and March 31, 2015, respectively. The table below sets forth a summary of the significant sources and uses of cash for the periods presented in thousands.

Cash Flows (in thousands)	Three Months Ended		Change	% Change	
	March 31, 2016	March 31, 2015			
Net cash provided by operating activities	\$ 18,551	\$ 11,326	\$ 7,225	63.8	%
Net cash used in investing activities	(1,165)	(9,185)	8,020	(87.3)	%
Net cash used in financing activities	(5,836)	(5,536)	(300)	5.4	%
Increase (Decrease) in cash	\$ 11,550	\$ (3,395)	\$ 14,945	440.2	%

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Net cash provided by operating activities increased \$7.2 million from the three months ended March 31, 2015 to the three months ended March 31, 2016. The increase in cash provided by operating activities was due to a \$1.3 million increase in net income adjusted for reconciling items and favorable changes in working capital of \$5.9 million.

Net cash used in investing activities decreased \$8.0 million for the three months ended March 31, 2016, compared to the corresponding period in 2015. This decrease was primarily due to the \$7.9 million in non-reoccurring cash payments that occurred in the three months ended March 31, 2015 related to the acquisition of Henderson.

Net cash used in financing activities increased \$0.3 million for the three months ended March 31, 2016 as compared to the corresponding period in 2015. The increase in cash used in financing activities was primarily a result of the 5.6% increase in dividends paid.

Contractual Obligations

There have been no material changes to our contractual obligations in the three months ended March 31, 2016.

Off-Balance Sheet Arrangements

We are not party to any off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

Seasonality and Year-to-Year Variability

Our business is seasonal and also varies from year-to-year. Consequently, our results of operations and financial condition vary from quarter-to-quarter and from year-to-year as well. In addition, because of this seasonality and variability, our results of operations for any quarter may not be indicative of results of operations that may be achieved for a subsequent quarter or the full year, and may not be similar to results of operations experienced in prior years. That being the case, while snowfall levels vary within a given year and from year-to-year, snowfall, and the corresponding replacement cycle of snow and ice control equipment, is relatively consistent over multi-year periods.

Sales of our products are significantly impacted by the level, timing and location of snowfall, with sales in any given year and region most heavily influenced by snowfall levels in the prior snow season (which we consider to begin in

October and end in March) in that region. This is due to the fact that end-user demand for our products is driven primarily by the condition of their snow and ice control equipment, and in the case of professional snowplowers, by their financial ability to purchase new or replacement snow and ice control equipment, both of which are significantly affected by snowfall levels. Heavy snowfall during a given winter causes usage of our products to increase, resulting in greater wear and tear to our products and a shortening of their life cycles, thereby creating a need for replacement snow and ice control equipment and related parts and accessories. In addition, when there is a heavy snowfall in a given winter, the increased income our professional snowplowers generate from their professional snowplow activities provides them with increased purchasing power to purchase replacement snow and ice control equipment prior to the following winter. To a lesser extent, sales of our products are influenced by the timing of snowfall in a given winter. Because an early snowfall can be viewed as a sign of a heavy upcoming snow season, our end-users may respond to an early snowfall by purchasing replacement snow and ice control equipment during the current season rather than delaying purchases until after the season is over when most purchases are typically made by end-users.

We attempt to manage the seasonal impact of snowfall on our revenues in part through our pre-season sales program, which involves actively soliciting and encouraging pre-season distributor orders in the second and third quarters by offering our distributors a combination of pricing, payment and freight incentives during this period. These pre-season sales incentives encourage our distributors to re-stock their inventory during the second and third quarters in anticipation of the peak fourth quarter retail sales period by offering pre-season pricing and payment deferral until the fourth quarter. As a result, we tend to generate our greatest volume of sales (an average of over two-thirds over the last ten years) during the second and third quarters, providing us with manufacturing visibility for the remainder of the year. By contrast, our revenue and operating results tend to be lowest during the first quarter, as management believes our end-users prefer to wait until the beginning of a snow season to purchase new equipment and as our distributors sell off inventory and wait for our pre-season sales incentive period to re-stock inventory. Fourth quarter sales vary from year-to-year as they are primarily driven by the level, timing and location of snowfall during the

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quarter. This is because most of our fourth quarter sales and shipments consist of re-orders by distributors seeking to restock inventory to meet immediate customer needs caused by snowfall during the winter months.

Because of the seasonality of our sales, we experience seasonality in our working capital needs as well. In the first quarter, we typically require capital as we are generally required to build our inventory in anticipation of our second and third quarter pre-season sales. During the second and third quarters, our working capital requirements rise as our accounts receivable increase as a result of the sale and shipment of products ordered through our pre-season sales program and we continue to build inventory. Working capital requirements peak towards the end of the third quarter and then begin to decline through the fourth quarter through a reduction in accounts receivable when we receive the majority of the payments for pre-season shipped products.

We also attempt to manage the impact of seasonality and year-to-year variability on our business costs through the effective management of our assets. Our asset management and profit focus strategies include:

- the employment of a highly variable cost structure facilitated by a core group of workers that we supplement with a temporary workforce as sales volumes dictate, which allows us to adjust costs on an as-needed basis in response to changing demand;
- our enterprise-wide lean concept, which allows us to adjust production levels up or down to meet demand;
- the pre-season order program described above, which incentivizes distributors to place orders prior to the retail selling season; and
- a vertically integrated business model.

These asset management and profit focus strategies, among other management tools, allow us to adjust fixed overhead and sales, general and administrative expenditures to account for the year-to-year variability of our sales volumes.

Additionally, although modest, our annual capital expenditure requirements can be temporarily reduced by up to approximately 40% in response to actual or anticipated decreases in sales volumes. If we are unsuccessful in our asset management initiatives, the seasonality and year-to-year variability effects on our business may be compounded and in turn our results of operations and financial condition may suffer.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We do not use financial instruments for speculative trading purposes, and do not hold any derivative financial instruments that could expose us to significant market risk. Our primary market risk exposures are changes in interest rates and steel price fluctuations.

Interest Rate Risk

We are exposed to market risk primarily from changes in interest rates. Our borrowings, including our term loan and any revolving borrowings under our senior credit facilities, are at variable rates of interest and expose us to interest rate risk. A portion of our interest rate risk associated with our term loan is mitigated through an interest rate swap as discussed in Note 5 to the Consolidated Financial Statements, above. In addition, the interest rate on any revolving borrowings is subject to an increase in the interest rate based on our average daily availability under our revolving credit facility.

As of March 31, 2016, we had outstanding borrowings under our term loan of \$186.1 million. A hypothetical interest rate change of 1%, 1.5% and 2% on our term loan would have changed interest incurred for the three months ended March 31, 2016 by \$0.1 million, \$0.4 million and \$0.6 million, respectively. We entered into three interest rate swap agreements with notional amounts of \$45.0 million, \$90.0 million and \$135.0 million effective for the periods December 31, 2015 through March 29, 2018, March 29, 2018 through March 31, 2020 and March 31, 2020 through June 30, 2021, respectively. We have counterparty credit risk resulting from the interest rate swap, which we monitor on an on-going basis. This risk lies with one global financial institution. Under the interest rate swap agreement, effective as of December 31, 2015, we will either receive or make payments on a monthly basis based on the differential between 6.105% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap agreement, effective as of March 29, 2018, we will either receive or make payments on a monthly basis based on the differential between 6.916% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap

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agreement, effective as of March 31, 2020, we will either receive or make payments on a monthly basis based on the differential between 7.168% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). As of March 31, 2016, we had no outstanding borrowings under our revolving credit facility.

Commodity Price Risk

In the normal course of business, we are exposed to market risk related to our purchase of steel, the primary commodity upon which our manufacturing depends. Our steel purchases as a percentage of revenue were 24.2% for the three months ended March 31, 2016, compared to 21.9% for the three months ended March 31, 2015. While steel is typically available from numerous suppliers, the price of steel is a commodity subject to fluctuations that apply across broad spectrums of the steel market. We do not use any derivative or hedging instruments to manage steel price risk. If the price of steel increases, our variable costs could also increase. While historically we have successfully mitigated these increased costs through the implementation of either permanent price increases and/or temporary invoice surcharges, in the future we may not be able to successfully mitigate these costs, which could cause our gross margins to decline. If our costs for steel were to increase by \$1.00 in a period where we are not able to pass any of this increase onto our distributors, our gross margins would decline by \$1.00 in the period in which such inventory was sold.

Item 4. Controls And Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this Quarterly Report our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure that the information required to be disclosed by us in such reports is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary course of business, we are engaged in various litigation primarily including product liability and intellectual property disputes. However, management does not believe that any current litigation is material to our operations or financial position. In addition, we are not currently party to any environmental-related claims or legal matters.

Item 1A. Risk Factors

There have been no significant changes in our risk factors from those described in our Annual Report on Form 10-K for the year ended December 31, 2015.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Unregistered Sales of Equity Securities

During the three months ended March 31, 2016, the Company sold no securities that were not registered under the Securities Act of 1933, as amended.

Dividend Payment Restrictions

The Company's senior credit facilities include certain restrictions on its ability to pay dividends. The senior credit facilities also restrict the Company's subsidiaries from paying dividends and otherwise transferring assets to Douglas Dynamics, Inc. For additional detail regarding these restrictions, see Note 5 to the notes to the consolidated financial statements.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

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Item 6.Exhibits

The following documents are filed as Exhibits to this Quarterly Report on Form 10-Q:

Exhibit Numbers	Description
10.1#*	Douglas Dynamics, Inc. Annual Incentive Plan.
10.2#*	Douglas Dynamics, Inc. Amended and Restated 2010 Stock Incentive Plan.
31.2*	Certification of the Company's Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101*	Financial statements from the quarterly report on Form 10-Q of Douglas Dynamics, Inc. for the quarter ended March 31, 2016, filed on May 10, 2016, formatted in XBRL: (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations and Comprehensive Income; (iii) the Consolidated Statements of Cash Flows; and (iv) the Notes to the Consolidated Financial Statements

#A management contract or compensatory plan or arrangement.

*Filed herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DOUGLAS DYNAMICS, INC.

By: /s/ ROBERT MCCORMICK
Robert McCormick
Executive Vice President and Chief Financial Officer
(Principal Financial Officer and Authorized Signatory)

Dated: May 10, 2016

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Exhibit Index to Form 10-Q for the Period Ended March 31, 2016

Exhibit

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