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Spartan Race Inc.

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Over the seven years since its founding in 2010, Spartan Race grew to be the world's most popular obstacle course race provider. In 2012 and 2016, the company raised a total of $15 million through two separate private equity investments.[1] In 2017, however, Spartan Founder and CEO Joe De Sena was contemplating the possibility of an initial public offering. One question that he had was what impact, if any, the new accounting standard on revenue recognition would have on Spartan's financial statements.[2] Well aware of the importance of demonstrating robust prospects for revenue growth to investors, De Sena scheduled a meeting with Spartan's Director of Financial Planning Andy Boudreau and Controller Zac Biesiada to discuss the matter further.

Obstacle Course Racing Industry

Unlike other extreme fitness activities such as marathons or triathlons, obstacle course racing (OCR) requires participants to navigate a series of obstacles such as rope climbs, log carries, monkey bars, mud crawls, and fire jumps. Experiencing a boom in popularity beginning around 2010, OCR has been called the fastest growing sport in history. In 2015, an estimated 4.5 million people in the United States finished an obstacle course race.[3] This participation level, however, represented much smaller year-over-year growth than just a few years earlier, and some race organizers discontinued operations due to lack of demand.[4]

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[1] Spartan Race Inc. Form D, Notice of Exempt Offering of Securities, August 20, 2012, and Spartan Race Inc. Form D, Notice of Exempt Offering of Securities, April 19, 2016.

[2] The adoption date for the new accounting standard is December 15, 2017 for public companies and December 15, 2019 for non-public companies.

[3] A.J. Perez, "Obstacle Races Going Mainstream, More Popular than Marathons," *USA Today*, November 2, 2015.

[4] Rachel Bachman and Kevin Helliker, "Obstacle Racing Finds Itself Stuck in the Mud," *The Wall Street Journal*, May 11, 2016.

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As of 2017, in addition to Spartan, Warrior Dash, Rugged Maniac, and Tough Mudder were popular obstacle course race organizers. Rugged Maniac and Warrior Dash offered beginner-friendly 5K race lengths and emphasized the fun aspect of their events. Tough Mudder had the reputation as the most extreme race with obstacles that could only be completed with the help of others. Spartan offered races of varying lengths and focused on competition by timing all participants, creating obstacles that rewarded individual athleticism, and imposing a 30 burpee penalty for any failed obstacle.[5]

Company Background

Headquartered in Boston, Massachusetts, Spartan was founded in 2010 by Joe De Sena. After having competed in dozens of Ironman triathlons and ultra-events (100+ miles), De Sena, along with some friends, decided to create a 24-hour race called "The Death Race."[6] Since the idea of a 24-hour race appealed to only a limited customer base, De Sena envisioned a more accessible but still difficult race for the masses, and Spartan was born. By offering races ranging from three to 26+ miles, Spartan's purpose was to get people off their couches and challenge them both physically and mentally. "Spartan gives people that opportunity to go up against the odds, push to the brink, get dirty and define themselves," commented De Sena on the company's philosophy.[7]

In 2016, Spartan claimed one million global participants at roughly 130 events across 25+ countries.[8] Although race fees continued to make up the majority of revenues, the company had begun to enter into sponsorship agreements to diversify its revenue base. Most notably, in 2013, Reebok and Spartan entered into a multi-year partnership in which the sportswear giant would become Spartan's title sponsor and official apparel, footwear, and accessories supplier.[9] In a 2014 broadcasting agreement, NBC Sports Group agreed to air some of Spartan's races on television.[10] This alliance also resulted in the "Spartan: Ultimate Team Challenge" TV show, first aired in 2016 and produced by the same production company that created the "American Ninja Warrior" TV show.[11] In 2017, pushing to evolve beyond just a race into a lifestyle brand, Spartan partnered with Daily Burn, a leading streaming fitness service, to offer the six-week Daily Burn Spartan program, allowing people to train like a Spartan anytime or anywhere.[12]

[5] A burpee, also known as a squat thrust, is a full body exercise used in strength training and as an aerobic exercise.

[6] Erik Hedegaard, "Joe Hardcore: The Spartan Race Founder Tells All," *Men's Journal*, June 24, 2014.

[7] Joseph De Sena, "Why I left Wall Street for...EXTREME Racing," *CNBC*, June 17, 2015, http://www.cnbc.com/2015/06/17/why-i-left-wall-street-to-start-spartan-race-commentary.html (accessed June 2017).

[8] Company statistics.

[9] "Reebok and Spartan Race Announce Groundbreaking Global Partnership," *Business Wire*, January 17, 2013.

[10] "NBC Sport Ventures Announces Strategic Alliance with Spartan Race," *NBC Sports Group* press release, July 14, 2014, http://nbcsportsgrouppressbox.com/2014/07/14/nbc-sports-ventures-announces-strategic-alliance-with-spartan-race/ (accessed June 2017).

[11] "'The Night Shift' and 'Spartan: Ultimate Team Challenge' Set June Debuts," *NBC Universal* press release, April 1, 2016, http://www.nbcunivesal.com/press-release/'-night-shift'-and-'spartan-ultimate-team-challenge'-set-june-debuts (accessed June 2017).

[12] "Daily Burn and Spartan Race Team Up to Offer On-Demand Obstacle Race Training Program," *PR Newsire*, January 18, 2017.

De Sena's ultimate dream for Spartan and OCR would be to see the sport in the Olympics. "The sport is growing at an exponential pace, and I believe there isn't another sport out there that captures the true spirit and appreciation of athleticism of the Olympic Games in the same way obstacle racing does. Every day we hear and experience stories of resilience at obstacle races around the world — reminiscent of stories we see during each Olympic Games when international heroes emerge on the largest stage of all," explained De Sena.[13]

New Revenue Recognition Standard

One of the important determinants of a successful startup is to demonstrate to investors that the company can sustain its revenue growth. As the new accounting standard's adoption date approached, Boudreau and Biesiada questioned whether it would materially affect Spartan's revenue recognition. The new accounting standard provides for a five-step process to determine when revenue should be recognized.[14] These steps are as follows:

1. Determine whether there is a contract.
2. Determine the performance obligation(s) under the contract.
3. Determine the transaction price.
4. Allocate the transaction price across multiple performance obligations (if applicable).
5. Recognize revenue when performance obligation(s) is/are satisfied.

Determine whether there is a contract. The new accounting standard does not require Spartan to use written contracts when selling products and services, but it does require the transacting parties to have committed to a transaction. To qualify as a contract, there must be agreement between both parties regarding what is being exchanged, and there must be specific, but not necessarily fixed, payment terms. The contract must also have commercial substance, meaning that the risk, timing, or amount of the seller's future cash flows is expected to change as a result of the contract. Payment in cash is not required. For example, it could be the case that payment comes in the form of products and services from one of Spartan's strategic partners. Lastly, in order to recognize revenue, collection of the payment must be probable.

Determine the performance obligation(s) under the contract. Spartan has to identify whether a transaction is comprised of a single performance obligation or constitutes a bundle of multiple performance obligations. A performance obligation is a promise provided by a company to its customers to deliver a product or service. If Spartan's customers can benefit from an individual product or service on its own or with readily available resources, the item is considered a performance obligation

[13] Mark J. Burns, "Spartan Race CEO Discusses Brand Evolution, Overcoming Adversity and Obstacle Racing in the Olympics," *Forbes,* August 6, 2015.

[14] For a concise sysnopsis of the new accoutning standard, see http://www.journalofaccountancy.com/newsletters/2016/mar/revenue-recognition-standard-in-plain-english.html (accessed June 2017).

(e.g., a t-shirt). Otherwise, the item is bundled with other items to form a performance obligation (e.g., a drink in a cup).

Determine the transaction price. When determining the transaction price, Spartan has to consider whether any aspect of a transaction may affect the payment that it will ultimately collect (e.g., discounts, rebates, or refunds). If there are variable components of the transaction, such as discounts, Spartan would need to use historical data to estimate these effects at the time of the transaction. In addition, if there is a significant delay in receiving payment, Spartan would need to include a time value of money discount estimate in the transaction price. If a customer does not pay in cash, the products or services being received should be measured at fair value.

Allocate the transaction price across multiple performance obligations (if applicable). If there are multiple performance obligations to a transaction, Spartan would need to allocate the transaction price across these obligations. Variable components related to specific performance obligations should be applied against only those obligations' transaction prices. Alternatively, if a variable component is generic, it should be allocated proportionately across all performance obligations of the transaction.

Recognize revenue when performance obligation(s) is/are satisfied. Spartan can only recognize revenue once a performance obligation is satisfied. The key to determining when a performance obligation has been satisfied for products is whether the customer controls the good. The determining factor for services is whether the service has been completed. If the service occurs over a period of time, revenue is recognized over time.

Different Ways Spartan Generates Revenue

As he was about to meet with Boudreau and Biesiada, De Sena could not help but think that Spartan had developed numerous revenue streams despite being a relatively young company. For example:

Walk-up single race entry. Space permitting, Spartan sells single entries on race days for prices generally ranging from $100 to $200 depending on race length. Anyone who works a shift as a volunteer at a race venue receives a complimentary entry.

Advance purchase single race entry. Approximately one year ahead of time, a race goes on sale at www.spartan.com with prices generally ranging from $100 to $200 depending on race length. Prices for the race increase as the race date approaches. There are no refunds, but participants can defer to a future race for a $25 transfer fee as long as they notify Spartan prior to race day.

Annual race pass. Annual passes, which can cost upwards of $1,000, entitle the holder to run as many races as possible in the Continental United States and Hawaii during one calendar year. The passes are non-refundable and non-transferable.

Merchandise. Spartan sells merchandise, such as t-shirts, caps, and shorts, at races as well as online. Full refunds are allowed on clothing as long as the return is made in good condition within 31 days with the original receipt.

Sponsorship agreements. Spartan has many sponsors, including Clif bars, FitAID sport drinks, and Yokohama tires. While the details of sponsorship agreements vary, they generally involve payments to Spartan over a specified time period in exchange for recognition on the Spartan website as well as product placement at races.

SGX training certification. Spartan offers various live workshops and online programs to certify individuals to teach Spartan group training classes. In addition to receiving discounts on races and merchandise, SGX-certified trainers are listed on the Spartan website's "Spartan Coach Finder." Certification is subject to annual renewal for a nominal fee. Trainers must also submit evidence of eight continuing education credits from Spartan or elsewhere.

International races. International races are organized by local licensees, which pay Spartan royalties based on a percentage of their revenues. In addition, licensees might also purchase obstacles, merchandise, or race day logistical services from Spartan as needed. Licenses tend to be multi-year contracts.

De Sena was curious how Spartan's varied revenue generating activities would be treated under the new accounting standard, specifically how the amount and timing of revenue should be reported. He was eager to hear what Boudreau and Biesiada had to say on the subject.