

# NAUTILUS, INC.

## FORM 10-K (Annual Report)

Filed 02/27/17 for the Period Ending 12/31/16

|             |  |
|-------------|--|
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| Telephone   | 360-859-2900   |
| CIK         | 0001078207   |
| Symbol      | NLS  |
| SIC Code    | 3949 - Sporting and Athletic Goods, Not Elsewhere Classified |
| Industry    | Personal Products  |
| Sector      | Consumer Non-Cyclicals                                       |
| Fiscal Year | 12/31  |

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2016

OR

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

FOR THE TRANSITION PERIOD FROM TO

Commission file number: 001-31321

NAUTILUS, INC.

(Exact name of Registrant as specified in its charter)

Washington

(State or other jurisdiction of  
incorporation or organization)

94-3002667

(I.R.S. Employer  
Identification No.)

17750 S.E. 6th Way

Vancouver, Washington 98683

(Address of principal executive offices, including zip code)

(360) 859-2900

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| <u>Title of each class</u> | <u>Name of each exchange on which registered</u> |
|----------------------------|--|
| Common Stock, no par value | New York Stock Exchange                          |

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the last sales price (\$ 17.84 ) as reported on the New York Stock Exchange as of the last business day of the registrant's most recently completed second fiscal quarter ( June 30, 2016 ) was \$541,556,142 .

The number of shares outstanding of the registrant's common stock as of February 24, 2017 was 30,700,791 shares.

**Documents Incorporated by Reference**

The registrant has incorporated by reference into Part III of this Form 10-K portions of its Proxy Statement for its 2017 Annual Meeting of Shareholders.

NAUTILUS, INC.  
2016 FORM 10-K ANNUAL REPORT

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## PART I

### *Forward-Looking Statements*

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "plan," "expect," "aim," "believe," "project," "intend," "estimate," "will," "should," "could," and other terms of similar meaning typically identify forward-looking statements. The forward-looking statements in this report include, without limitation: our prospects, resources or capabilities; current or future financial trends; future operating results; future plans for introduction of new products; anticipated demand for our new and existing products; anticipated benefits of the acquisition of Octane Fitness; maintenance of appropriate inventory levels; growth in revenues and profits; leverage of operating expenses; future revenues from licenses of our intellectual property; results of increased media investment in the Direct segment; continued improvement in operating margins; expectations for increased research and development expenses; anticipated capital expenditures; fluctuations in net sales due to seasonality; and our ability to continue to fund our operating and capital needs for the following twelve-month period. Forward-looking statements also include any statements related to our expectations regarding future business and financial performance or conditions, anticipated sales growth across markets, distribution channels and product categories, expenses and gross margins, profits or losses, losses from discontinued operations, settlements of warranty obligations, the anticipated outcome of litigation to which we are a party, new product introductions, financing and working capital requirements and resources. These forward-looking statements, and others we make from time-to-time, are subject to a number of risks and uncertainties. Many factors could cause actual results to differ materially from those projected in forward-looking statements, including the risks described in Part I, Item 1A of this report and in other reports we file with the Securities and Exchange Commission. We do not undertake any duty to update forward-looking statements after the date they are made or conform them to actual results or to changes in circumstances or expectations.

### **Item 1. Business**

#### **OVERVIEW**

Founded in 1986, Nautilus, Inc. and subsidiaries (collectively, "Nautilus" or the "Company") is a consumer fitness products company headquartered in Vancouver, Washington and incorporated in the State of Washington in January 1993. We are committed to providing innovative, quality solutions to help people achieve their fitness goals through a fit and healthy lifestyle. Our principal business activities include designing, developing, sourcing and marketing high-quality cardio and strength fitness products and related accessories for consumer use, primarily in the U.S. and Canada, but also in international markets outside North America. Our products are sold under some of the most-recognized brand names in the fitness industry: Nautilus<sup>®</sup>, Bowflex<sup>®</sup>, Octane Fitness<sup>®</sup>, Schwinn<sup>®</sup> and Universal<sup>®</sup>.

We market our products through two distinct distribution channels, Direct and Retail, which we consider to be separate business segments. Our *Direct* business offers products directly to consumers through television advertising, catalogs and the Internet. Our *Retail* business offers our products through a network of independent companies to reach consumers in both the home use as well as commercial use markets in the U.S. and internationally. We also derive a portion of our revenue from the licensing of our brands and intellectual property.

#### **BUSINESS STRATEGY**

We are focused on developing and marketing consumer fitness equipment and related products to help people enjoy healthier lives. Our products are targeted to meet the needs of a broad range of consumers, including fitness enthusiasts and individuals who are seeking the benefits of regular exercise. We have diversified our business by expanding our portfolio of high quality fitness equipment into multiple product lines utilizing our well-recognized brand names. We are focused on consumer markets and specialty and commercial distribution channels, and view the continual innovation of our product offerings as a key aspect of our business strategy. We regularly refresh our existing product lines with new technologies and finishes, and focus significant effort and resources on the development or acquisition of innovative new fitness products for introduction to the marketplace at periodic intervals.

Our strategies incorporate the individual characteristics of our Direct and Retail businesses. Our Direct business focuses on: (i) the development of, or acquisition of rights to, unique products; (ii) the application of creative, cost-effective ways to communicate the benefits of their use; and (iii) making various payment options available to our customers. We are particularly attentive to Direct business metrics that provide feedback regarding the effectiveness of our media marketing programs and attractiveness of third-party consumer financing programs.

In our Retail business, we strive to develop long-term relationships with key retailers of sports or fitness equipment. The primary objectives of our Retail business are (i) to offer a selection of innovative, unique products at key price-points to capture market share; and (ii) to utilize the strength of our brands and long-standing customer relationships to secure more floor space with our Retail customers for our products, as well as support efforts to gain share in multi-user environments.

Our long-term strategy involves:

- Creatively marketing our equipment, both directly to consumers and through our Retail customers, while leveraging our well-known brand names;
- Enhancing our product lines by designing fitness equipment that meets or exceeds the high expectations of our customers;
- Utilizing our strengths in product engineering to reduce product costs;
- Continuing our investment in research and development activities aimed at acquiring or creating new technologies;
- Increasing our international Retail sales and distribution; and
- Maximizing available royalty revenues from the licensing of our brands and intellectual property.

## PRODUCTS

We market quality cardiovascular and strength fitness products that cover a broad range of price points and features. Our products are designed for home use and multi-user environments by individuals with varying exercise needs. From the person who works out occasionally to the serious athlete, we have products that will help them achieve their fitness objectives.

- **Nautilus**® is our corporate umbrella brand and is also used to differentiate certain specialized cardio, treadmills, ellipticals and bike products.
- Our **Bowflex**® brand represents a highly-regarded line of fitness equipment comprised of both cardio and strength products, including the Max Trainer® and TreadClimber® specialized cardio machines, PowerRod® and Revolution® home gyms and SelectTech® dumbbells.
- Our **Octane Fitness**® brand is known for its innovation around low-impact cardio products, including the perfection of the traditional elliptical machine, along with the creation of new categories of exercise, including the xRide® recumbent elliptical, the LateralX® elliptical, and the Zero Runner®.
- Our **Schwinn**® brand is known for its popular line of exercise bikes, including the Airdyne®, as well as Schwinn-branded treadmills and ellipticals.
- Our **Universal**® brand, one of the oldest and most recognized names in the fitness industry, currently offers a line of kettlebell weights and weight benches along with a recently launched cardio line.

We generally differentiate the product models offered in our Direct and Retail sales channels. Currently, our Max Trainer® and TreadClimber® product lines are offered for sale primarily through our Direct sales channel.

Approximately 85% of our revenue in 2016 was derived from sales of consumer cardio products. While we continue to be a leader in the consumer strength product category, we believe the much larger market for cardio products offers us greater opportunity for growth.

## BUSINESS SEGMENTS AND GEOGRAPHIC INFORMATION

We conduct our business in two segments, Direct and Retail. For further information regarding our segments and geographic information, see Note 20, *Segment and Enterprise-Wide Information*, to our consolidated financial statements in Part II, Item 8 of this report.

## SALES AND MARKETING

### *Direct*

In our Direct business, we market and sell our products, principally Bowflex® cardio and strength products, directly to consumers. While we are, and plan to continue to be, a large direct marketer of strength products in the U.S., our advertising emphasis has shifted toward cardio products, especially the Max Trainer® and TreadClimber®, as cardio products represent the largest component of the fitness equipment market and a majority of our business. Sales of cardio products represented 93% of our Direct channel revenues in 2016, compared to 93% in 2015 and 91% in 2014.

Our marketing efforts are based on an integrated combination of media and direct consumer contact. In addition to television advertising, which ranges in length from 30 seconds to as long as three minutes, we utilize Internet advertising, product websites, inquiry-response mailings, catalogs and inbound/outbound call centers. Marketing and media effectiveness is measured continuously based on sales inquiries generated, cost-per-lead, conversion rates, return on investment and other performance

metrics and we strive to optimize the efficiency of our marketing and media expenditures based on this data. Almost all of our Direct customer orders are received either on our Internet websites or through company-owned and third-party call centers.

In order to facilitate consumer purchases, we partner with several third-party credit providers. Credit approval rates are an important variable in the number of Direct products we sell in a given period. Combined consumer credit approvals by our primary and secondary U.S. third-party financing providers increased to 51% in 2016 from 48% in 2015 and 41% in 2014 . The year-over-year boost in approval rates for 2016 compared to 2015 was due to expansion of credit approval standards, primarily by our Tier 1 third-party credit provider. The expansion of approval standards was driven by strong performance of their Bowflex<sup>®</sup> credit portfolio. Also contributing, was our marketing and media strategy which has attracted customers with higher credit scores. Our marketing and media strategy was the primary driver of higher credit approval rates in 2015 compared to 2014 .

### ***Retail***

In our Retail business, we market and sell a comprehensive line of consumer fitness equipment under the Nautilus<sup>®</sup>, Octane Fitness<sup>®</sup>, Schwinn<sup>®</sup>, Universal<sup>®</sup> and Bowflex<sup>®</sup> brands. Our products are marketed through a network of retail companies, consisting of sporting goods stores, Internet retailers, large-format and warehouse stores, smaller specialty retailers, independent bike dealers, and to specialty commercial customers purchasing our products for multi-user environments.

We offer programs that provide price discounts to our Retail customers for ordering container-sized shipments or placing orders early enough in the season to allow for more efficient manufacturing by our Asian suppliers. These programs are designed to reduce our shipping and handling costs, with much of the savings being passed on to our customers. In addition, we often offer other types of sales incentives to our Retail customers, including volume discounts and various forms of rebates or allowances, which generally are intended to increase product exposure and availability for consumers, reduce transportation costs, and encourage marketing and promotion of our brands or specific products.

### **PRODUCT DESIGN AND INNOVATION**

Innovation is a vital part of our business, and we continue to expand and diversify our product offerings by leveraging our research and development capabilities. We constantly search for new technologies and innovations that will help us grow our business, either through higher sales or increased production efficiencies. To accomplish this objective, we seek out ideas and concepts both within our company and from outside inventors.

We rely on financial and engineering models to assist us in assessing the potential operational and economic impacts of adopting new technologies and innovations. If we determine that a third-party technology or innovation concept meets certain technical and financial criteria, we may enter into a licensing arrangement to utilize the technology or, in certain circumstances, purchase the technology for our own use. Our product design and engineering teams also invest considerable effort to improve product design and quality. As a consumer-driven company, we invest from time-to-time in qualitative and quantitative consumer research to help us assess new product concepts, optimal features and anticipated consumer adoption.

Our research and development expenses were \$13.9 million , \$9.9 million and \$7.2 million in 2016 , 2015 and 2014 , respectively, as we increased our investment in new product development resources and capabilities. We expect our research and development expenses to increase in 2017 as we continue to supplement our investment in new product development and engineering capabilities.

### **SEASONALITY**

We expect our revenue from fitness equipment products to vary seasonally. Sales are typically strongest in the first and fourth quarters, followed by the third quarter, and are generally weakest in the second quarter. We believe that consumers tend to be involved in outdoor activities during the spring and summer months, including outdoor exercise, which impacts sales of indoor fitness equipment. This seasonality can have a significant effect on our inventory levels, working capital needs and resource utilization.

### **MERCHANDISE SOURCING**

All of our products are produced by third-party manufacturers, and, in 2016 , our manufacturing partners were primarily located in Asia. Although multiple factories bid on and are able to produce most of our products, we typically select one factory to be the primary supplier of any given product. Lead times for inventory purchases from our Asian suppliers, from order placement to receipt of goods, generally range from approximately two to three months, of which transit time represents three-to-four weeks. The length of our lead times requires us to place advance manufacturing orders based on management forecasts of future demand for our products. We attempt to compensate for our long replenishment lead times by maintaining adequate levels of inventory at our warehousing facilities.

We monitor our suppliers' ability to meet our product needs and we participate in quality assurance activities to reinforce adherence to our quality standards. Our third-party manufacturing contracts are generally of annual or shorter duration, or manufactured products are sourced on the basis of individual purchase orders. Our manufacturing relationships are non-exclusive, and we are permitted to procure our products from other sources at our discretion. None of our manufacturing contracts include production volume or purchase commitments on the part of either party. Our third-party manufacturers are responsible for the sourcing of raw materials and producing parts and finished products to our specifications.

## **LOGISTICS**

Our warehousing and distribution facilities are located in Oregon and Ohio. In addition to Company-operated distribution centers, we utilize third-party warehouses and logistics providers to fulfill orders. In our Direct business, we strive to maintain inventory levels that will allow us to ship our products shortly after receiving a customer's order. We use common carriers for substantially all of our merchandise shipments to Direct customers.

In our Retail business, we manage our inventory levels to accommodate anticipated seasonal changes in demand. Generally, we maintain higher inventory levels at the end of the third and fourth quarters to satisfy relatively higher consumer demand in the fourth and first quarters of each year. Many of our Retail customers place orders well in advance of peak periods of consumer demand to ensure an adequate supply for the anticipated selling season.

In 2016, approximately 52% of our Retail customers' orders were shipped by our contract manufacturers in Asia directly to our Retail customer locations, typically in container loads. The use of such direct shipments allows us to maintain lower levels of inventory in our warehouses, resulting in lower storage, handling, freight, insurance and other costs, with much of the savings being passed on to our customers. We use various commercial truck lines for our merchandise shipments to Retail customers.

## **COMPETITION**

The markets for all of our products are highly competitive. We believe the principal competitive factors affecting our business are quality, brand recognition, innovation and pricing. We believe we are well positioned to compete in markets in which we can take advantage of our strong brand names, and that our focus on innovative product design, quality, and performance distinguishes our products from the competition.

Our products compete directly with those offered by a large number of companies that market consumer fitness equipment and fitness programs. As the use of Internet websites for product sales by traditional retailers has increased, our competitors have become increasingly similar across our Direct and Retail sales channels.

Our principal competitors include: Fitness Quest, ICON Health & Fitness, Johnson Health Tech, Beach Body, American Telecast, Life Fitness, and Precor. We also compete with marketers of computer-based physical activity products, such as the Nintendo Wii<sup>®</sup> and Microsoft Xbox<sup>®</sup> Kinect<sup>®</sup>, weight management companies, such as Weight Watchers, gym memberships and group fitness, such as cross-fit classes, each of which offers alternative solutions for a fit and healthy lifestyle.

## **EMPLOYEES**

As of February 24, 2017, we had approximately 469 employees, substantially all of whom were full-time. None of our employees are subject to collective bargaining agreements. We have not experienced a material interruption of our operations due to labor disputes.

## **INTELLECTUAL PROPERTY**

Trademarks, patents and other forms of intellectual property are vital to the success of our business and are an essential factor in maintaining our competitive position in the health and fitness industry.

**Trademarks**

We own many trademarks, including Nautilus<sup>®</sup>, Bowflex<sup>®</sup>, Max Trainer<sup>®</sup>, TreadClimber<sup>®</sup>, Power Rod<sup>®</sup>, Bowflex Revolution<sup>®</sup>, SelectTech<sup>®</sup>, Octane Fitness<sup>®</sup>, LateralX<sup>®</sup>, xRide<sup>®</sup>, Zero Runner<sup>®</sup>, Airdyne<sup>®</sup>, and Universal<sup>®</sup>. Nautilus is the exclusive licensee under the Schwinn<sup>®</sup> mark for indoor fitness products. We believe that having distinctive trademarks that are readily identifiable by consumers is an important factor in creating a market for our products, maintaining a strong company identity and developing brand loyalty among our customers. In addition, we have granted licenses to certain third-parties to use the Nautilus, Schwinn and TreadClimber trademarks on commercial fitness products, for which we receive royalty income and expanded consumer awareness of our brands.

Each federally registered trademark is renewable indefinitely if the trademark is still in use at the time of renewal.

**Patents and Designs**

Building our intellectual property portfolio is an important factor in maintaining our competitive position in the health and fitness equipment industry. We have followed a policy of filing applications for U.S. and non-U.S. patents on utility and design inventions that we deem valuable to our business.

We own or license patents and design registrations covering a variety of technologies, some of which are utilized in our selectorized dumbbells, treadmills, exercise bikes, and elliptical machines. Patent and design protection for these technologies, which are utilized in products sold in both the Direct and Retail segments, extends as far as 2028.

We maintain a portfolio of patents related to our TreadClimber<sup>®</sup> specialized cardio machines, which are sold primarily in our Direct segment. The portfolio includes approximately 25 issued U.S. patents. A patent covering certain aspects of our TreadClimber<sup>®</sup> products expired in 2013. Additional individual U.S. patents covering elements of our TreadClimber<sup>®</sup> products have expiration dates ranging from 2021 to 2027. Expiration or invalidity of patents within our TreadClimber<sup>®</sup> portfolio could trigger the introduction of similar products by our competitors. Although we view each of the patents within our portfolio as valuable, we do not view any single patent as critical to our success or ability to differentiate our TreadClimber<sup>®</sup> products from similar products that may be introduced by competitors in the future. We regularly monitor commercial activity in our industry to guard against potential infringement. We protect our proprietary rights and take prompt, reasonable actions to prevent counterfeit products and other infringement on our intellectual property.

We maintain a portfolio of patents related to our MaxTrainer<sup>®</sup> specialized cardio machines, which are sold primarily in our Direct segment. The portfolio includes 1 issued U.S. patent and additional pending patents. The issued patent expires in 2034.

Nautilus is also the licensee of patents related to the Bowflex Revolution<sup>®</sup> home gyms. These patents have expiration dates ranging from 2018 to 2025. Through its Octane Fitness subsidiary, Nautilus owns and licenses certain patents related to Octane's LateralX<sup>®</sup>, xRide<sup>®</sup> and Zero Runner<sup>®</sup> products. These patents have expiration dates ranging from 2017 to 2034.

**BACKLOG**

We define our customer order backlog to include firm orders for future shipment to our Retail customers, as well as unfulfilled consumer orders within the Direct segment.

Backlog as of a given date fluctuates based on specific timing of product shipment within the typical shipment timeframes for each of our segments. Retail orders comprise the larger portion of our order backlog, while Direct orders comprise a smaller portion of our backlog due to shorter fulfillment timeframes.

Our customer order backlog as of December 31, 2016 and 2015 was approximately \$4.9 million and \$5.0 million, respectively.

**SIGNIFICANT CUSTOMERS**

In 2016, 2015 and 2014, Amazon.com accounted for 11.3%, 11.1% and 11.3%, respectively, of our net sales.



## ENVIRONMENTAL AND OTHER REGULATORY MATTERS

Our operations are subject to various laws and regulations both domestically and abroad. In the U.S., federal, state and local regulations impose standards on our workplace and our relationship with the environment. For example, the U.S. Environmental Protection Agency, Occupational Safety and Health Administration and other federal agencies have the authority to promulgate regulations that may impact our operations. In particular, we are subject to legislation placing restrictions on our generation, emission, treatment, storage and disposal of materials, substances and wastes. Such legislation includes: the Toxic Substances Control Act; the Resource Conservation and Recovery Act; the Clean Air Act; the Clean Water Act; the Safe Drinking Water Act; and the Comprehensive Environmental Response and the Compensation and Liability Act (also known as Superfund). We are also subject to the requirements of the Consumer Product Safety Commission and the Federal Trade Commission, in addition to regulations concerning employee health and safety matters.

Our operations and certain disposed components of our former Commercial business expose us to claims related to environmental matters. Although compliance with federal, state, local and international environmental legislation has not had a material adverse effect on our financial condition or results of operations or cash flows in the past, there can be no assurance that material costs or liabilities will not be incurred in connection with such environmental matters in the future.

## AVAILABLE INFORMATION

Our common stock is listed on the New York Stock Exchange and trades under the symbol "NLS." Our principal executive offices are located at 17750 SE 6th Way, Vancouver, Washington 98683, and our telephone number is (360) 859-2900. The Internet address of our corporate website is <http://www.nautilusinc.com>.

We file annual reports, quarterly reports, current reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934, as amended. You can inspect and obtain a copy of our reports, proxy statements and other information filed with the SEC at the offices of the SEC's Public Reference Room at 100 F Street N.E., Washington, D.C. 20549, on official business days during the hours of 10 a.m. to 3 p.m. EST. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. The SEC maintains an Internet website at <http://www.sec.gov> where you can access copies of most of our SEC filings.

We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, and other information as filed with the SEC, available free of charge on our corporate website. In addition, our Code of Business Conduct and Ethics, corporate governance policies, and the charters of our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee are available on our corporate website. The information presented on our corporate website is not part of this report.

### Item 1A. Risk Factors

Nautilus operates in an environment that involves a number of risks and uncertainties. The risks and uncertainties described in this Annual Report on Form 10-K are not the only risks and uncertainties that we face. Additional risks and uncertainties that presently are not considered material or are not known to us, and therefore are not mentioned herein, may impair our business operations. If any of the risks described in this Annual Report on Form 10-K actually occur, our business, operating results and financial position could be adversely affected.

### **Our revenues and profitability can fluctuate from period to period and are often difficult to predict due to factors beyond our control.**

Our results of operations in any particular period may not be indicative of results to be expected in future periods, and have historically been, and are expected to continue to be, subject to periodic fluctuations arising from a number of factors, including:

- Introduction and market acceptance of new products and sales trends affecting specific existing products;
- Variations in product selling prices and costs and the mix of products sold;
- Size and timing of Retail customer orders, which, in turn, often depend upon the success of our customers' businesses or specific products;
- Changes in the market conditions for consumer fitness equipment;
- Changes in macroeconomic factors;
- Availability of consumer credit;
- Timing and availability of products coming from our offshore contract manufacturing suppliers;
- Seasonality of markets, which vary from quarter-to-quarter and are influenced by outside factors such as overall consumer confidence and the availability and cost of television advertising time;

- Effectiveness of our media and advertising programs;
- Customer consolidation in our Retail segment, or the bankruptcy of any of our larger Retail customers;
- Restructuring charges;
- Goodwill and other intangible asset impairment charges; and
- Legal and contract settlement charges.

These trends and factors could adversely affect our business, operating results, financial position and cash flows in any particular period.

**The loss of one or more of our large Retail customers could negatively impact our revenue and operating results.**

We derive a significant portion of our revenue from a small number of Retail customers. A Retail customer recently closed down its business, and other retail partners may in the future experience difficulties in their businesses that could prompt store closures or reorganizations. A loss of business from one or more of these large customers, if not replaced with new business, could negatively affect our operating results and cash flows.

**A decline in sales of TreadClimber<sup>®</sup> and/or Max Trainer<sup>®</sup> products without a corresponding increase in sales of other products would negatively affect our future revenues and operating results.**

Sales of cardio products, especially TreadClimber<sup>®</sup> and Max Trainer<sup>®</sup> products, represent a substantial portion of our Direct segment revenues. Our products are sold in highly competitive markets with limited barriers to entry. Introduction by competitors of comparable products at lower price-points, a maturing product lifecycle or other factors could result in a decline in our revenues derived from these products. A significant decline in our revenue of these products would have a material adverse effect on our operating results, financial position and cash flows.

**Portions of our operating expenses and costs of goods sold are relatively fixed, and we may have limited ability to reduce expenses sufficiently in response to any revenue shortfalls.**

Many of our operating expenses are relatively fixed. We may not be able to adjust our operating expenses or other costs sufficiently to adequately respond to any revenue shortfalls. If we are unable to reduce operating expenses or other costs quickly in response to any declines in revenue, it would negatively impact our operating results, financial condition and cash flows.

**If we are unable to anticipate consumer preferences or to effectively develop, market and sell future products, our future revenues and operating results could be adversely affected.**

Our future success depends on our ability to effectively develop, market and sell new products that respond to new and evolving consumer preferences. Accordingly, our revenues and operating results may be adversely affected if we are unable to develop or acquire rights to new products that satisfy consumer preferences. In addition, any new products that we market may not generate sufficient revenues to recoup their acquisition, development, production, marketing, selling and other costs.

**Decline in consumer spending would likely negatively affect our product revenues and earnings.**

Success of each of our products depends substantially on the amount of discretionary funds available to our customers. Global credit and financial markets have experienced extreme disruptions in the recent past, including severely diminished liquidity and credit availability, declines in consumer confidence, declines in economic growth, increases in unemployment rates and uncertainty about economic stability. There can be no assurance that similar disruptions will not occur in the future. Deterioration in general economic conditions may depress consumer spending, especially spending for discretionary consumer products such as ours. Poor economic conditions could in turn lead to substantial decreases in our net sales or have a material adverse effect on our operating results, financial position and cash flows.

**Our business is affected by seasonality which results in fluctuations in our operating results.**

We experience fluctuations in aggregate sales volume during the year. Sales are typically strongest in the first and fourth quarters, followed by the third quarter, and are generally weakest in the second quarter. However, the mix of product sales may vary considerably from time to time as a result of changes in seasonal and geographic demand for particular types of fitness equipment. In addition, our customers may cancel orders, change delivery schedules or change the mix of products ordered with minimal notice. As a result, we may not be able to accurately predict our quarterly sales. Accordingly, our results of operations are likely to fluctuate significantly from period to period.

**Government regulatory actions could disrupt our marketing efforts and product sales.**

Various international and U.S. federal, state and local governmental authorities, including the Federal Trade Commission, the Consumer Product Safety Commission, the Securities and Exchange Commission and the Consumer Financial Protection Bureau, regulate our product and marketing efforts. Our revenue and profitability could be significantly harmed if any of these authorities commence a regulatory enforcement action that interrupts our marketing efforts, results in a product recall or negative publicity, or requires changes in product design or marketing materials.

**Substantially higher advertising rates or a significant decline in availability of media time may hinder our ability to effectively market our products and may reduce profitability.**

We depend on television advertising to market certain products sold directly to consumers. Consequently, a marked increase in the price we must pay for our preferred media time and/or a reduction in its availability may adversely impact our financial performance.

**We may be unable to adapt to significant changes in media consumption habits and media coverage of current events may compete for consumer attention, which could diminish the effectiveness or efficiency of our advertising.**

New television technologies and services, such as video-on-demand, digital video recorders and Internet streaming services are changing traditional patterns of television viewing. Additionally, consumer attention is increasingly fragmented across a variety of games, apps, the Internet and other digital media, the balance of which may shift at any time in response to media coverage of current events and the advancement of new technologies. We believe that consumer attention to media coverage of major events like the Olympics and the U.S. presidential election have in the past impacted the effectiveness of our media advertising. Future events that draw significant media coverage may similarly impact our ability to engage consumers with our media advertising. If we are unable to successfully adapt our media strategies to new television viewing and media consumption habits, or if consumer attention is focused on other events, the effectiveness and efficiency of our media placements could be adversely affected, and our operating results may be harmed.

**Our revenues could decline due to changes in credit markets and decisions made by credit providers.**

Historically, a significant portion of our Direct sales have been financed for our customers under various programs offered by third-party consumer credit financing sources. Reductions in consumer lending and the availability of consumer credit could limit the number of customers with the financial means to purchase our products. Higher interest rates could increase monthly payments for consumer products financed through one of our financing partners or through other sources of consumer financing. In the past, we have partnered with financial service companies to assist our customers in obtaining financing to purchase our products. Our present agreements with our third party consumer credit financing providers enable certain customers to obtain financing if they qualify for the provider's private label revolving credit card. We cannot be assured that our third party financing providers will continue to provide consumers with access to credit or that credit limits under such arrangements will not be reduced. Such restrictions or reductions in the availability of consumer credit could have a material adverse impact on our results of operations, financial position and cash flows.

**We may encounter difficulties in integrating acquired businesses and anticipated benefits of acquisitions may not be realized.**

On December 31, 2015, we acquired all of the outstanding capital stock of OF Holdings, Inc., sole parent of Octane. The ultimate success of our acquisition of Octane, and any future acquisitions we may complete, depends, in part, on our ability to realize the anticipated synergies, channel and product diversification and growth opportunities from integrating newly-acquired businesses or assets into our existing businesses. However, the acquisition and successful integration of independent businesses or assets is a complex, costly and time-consuming process, and the benefits we realize may not meet targeted expectations. The risk and difficulties associated with acquiring and integrating companies and other assets include, among others:

- Consolidating research and development, logistics, product sourcing, human resources, information technology and other aspects of the combined operations, where appropriate;
- Integrating newly-acquired businesses and product lines into a uniform financial reporting system;
- Coordinating sales, distribution and marketing functions and strategies across new and existing channels of trade;
- Establishing or expanding manufacturing, research and development, sales, distribution and marketing functions in order to accommodate newly-acquired businesses or product lines or rationalizing these functions to take advantage of synergies;
- Preserving the important licensing, research and development, manufacturing and supply, distribution, marketing, customer and other relationships of acquired businesses;

- Minimizing the diversion of management’s attention from ongoing business concerns;
- Potential loss of key employees of the acquired business;
- Coordinating geographically separate operations; and
- Regulatory and legal issues relating to the integration of legacy and newly-acquired businesses.

The purchase consideration and other costs and expenses of acquisitions could negatively impact our net income and earnings per share and a failure to realize the anticipated benefits of acquisitions would have a material adverse effect on our business, results of operations or financial condition.

**If our contract manufacturers experience any delay, disruption or quality control problems in their operations, we could lose revenues, and our reputation and market share may be harmed.**

We have outsourced the production of all of our products to third-party manufacturers. We rely on our contract manufacturers to procure components and provide spare parts in support of our warranty and customer service obligations. We generally commit the manufacturing of each product to a single contract manufacturer.

Our reliance on contract manufacturers exposes us to the following risks over which we may have limited control:

- Unexpected increases in manufacturing and repair costs;
- Interruptions in shipments if our contract manufacturer is unable to complete production;
- Inability to completely control the quality of finished products;
- Inability to completely control delivery schedules;
- Changes in our contract manufacturer’s business models or operations;
- Potential increases in our negotiated product costs as a result of fluctuations in currency exchange rates;
- Impact of the global market and economic conditions on the financial stability of our contract manufacturers and their ability to operate without requesting earlier payment terms or letters of credit;
- Potential lack of adequate capacity to manufacture all or a part of the products we require; and
- Potential unauthorized reproduction or counterfeiting of our products.

Substantially all of our contract manufacturers are located in Asia, primarily China and Taiwan, and may be subject to disruption by natural disasters, as well as political, social or economic instability. The temporary or permanent loss of the services of any of our primary contract manufacturers could cause a significant disruption in our product supply chain and operations and delays in product shipments.

Our third-party manufacturing contracts are generally of annual or shorter duration, or manufactured products are sourced on the basis of individual purchase orders. There is no assurance that we will be able to maintain our current relationships with these parties or, if necessary, establish future arrangements with other third-party manufacturers on commercially reasonable terms. Further, while we maintain an active quality control, factory inspection and qualification program, we cannot assure that their manufacturing and quality control processes will be maintained at a level sufficient to meet our inventory needs or prevent the inadvertent sale of substandard products. While we believe that products manufactured by our current third-party manufacturers could generally be procured from alternative sources, temporary or permanent loss of services from a significant manufacturer could cause disruption in our supply chain and operations.

**Changes in international trade policy could adversely affect our business and results of operations.**

All of our products are produced by third-party manufacturers, substantially all of which are located in Asia, primarily in China and Taiwan. Additionally, we make significant sales to customers worldwide, in particular to customers in Canada. Most of our imported products are subject to duties or tariffs that affect the cost and quantity of various types of goods imported into the U.S. or our other markets. The new U.S. presidential administration has indicated that it may seek changes to or withdraw the United States from various international treaties and trade arrangements. Uncertainty regarding policies affecting global trade may make it difficult for our management to accurately forecast our business, and increases in the duties, tariffs and other charges imposed on our products by the United States or other countries in which our products are manufactured or sold, or other restraints on international trade, could negatively affect our business and the results of our operations.

**Our inventory purchases are subject to long lead times, which could negatively impact our revenue, cash flows and liquidity.**

All of our products are produced by third-party manufacturers, substantially all of which are located in Asia, primarily China and Taiwan. Lead times for inventory purchases from our Asian suppliers, from order placement to receipt of goods, generally range from approximately two to three months, of which transit time represents three-to-four weeks. The length of our lead times requires

us to place advance manufacturing orders based on management forecasts of future demand for our products. Due to the length of our lead times, our revenue and cash flows may be negatively impacted if we do not have sufficient inventory on hand to meet customer demand for such items. In addition, our liquidity and cash flows may be negatively affected, and inventory obsolescence may increase, if the quantity of products we order exceeds customer demand for such items.

**A delay in getting non-U.S.-sourced products through port operations and customs in a timely manner could result in reduced sales, canceled sales orders and unanticipated inventory accumulation.**

Our business depends on our ability to source and distribute products in a timely manner. As a result, we rely on the free flow of goods through open and operational ports worldwide. Labor disputes or other disruptions at ports create significant risks for our business, particularly if work slowdowns, lockouts, strikes or other disruptions occur during our peak importing seasons. Any of these factors could result in reduced sales, canceled sales orders and unanticipated inventory accumulation and have a material adverse effect on our operating results, financial position and cash flows.

**Unpredictable events and circumstances relating to our international operations, including our use of non-U.S. manufacturers, could have a material adverse effect on our business.**

Substantially all of our products are manufactured outside of the U.S. and a portion of our revenue is derived from sales outside the U.S., primarily in Canada, but also in markets outside North America. Accordingly, our future results could be materially adversely affected by a variety of factors pertaining to international trade, including: changes in a specific country's or region's political or economic conditions; trade restrictions; import and export licensing requirements; changes in regulatory requirements; additional efforts to comply with a variety of foreign laws and regulations; and longer payment cycles in certain countries, thus requiring us to finance customer purchases over a longer period than those made in the U.S. In addition, we rely on the performance of our employees located in foreign countries. Our ability to control the actions of these employees may be limited by the laws and regulations in effect in each country. Changes in any of the above factors could have a material adverse effect on our operating results, financial position and cash flows.

**Currency exchange rate fluctuations could result in higher costs, reduced margins or decreased international sales.**

Substantially all of our products are manufactured outside of the U.S. and, therefore, currency exchange rate fluctuations could result in higher costs for our products, or could disrupt the business of independent manufacturers that produce our products, by making their purchases of raw materials more expensive and more difficult to finance. Our future financial results could be significantly affected by the value of the U.S. dollar in relation to the foreign currencies in which we, our customers or our suppliers conduct business. Past fluctuations in currency exchange rates versus the U.S. dollar have caused our costs for certain products to increase, reducing our margins and cash flows. Similar fluctuations and cost increases may occur in the future. If we are unable to increase our selling prices to offset such cost increases, or if such increases have a negative impact on sales of our products, our revenues and margins would be reduced and our operating results and cash flows would be negatively impacted. In addition, a portion of our revenue is derived from sales outside the U.S., primarily in Canada and Europe. Currency rate fluctuations could make our products more expensive for foreign consumers and reduce our revenue, which would negatively affect our operating results and cash flows.

**We may face competition from providers of comparable products in categories where our patent protection is limited or reduced due to patent expiration. Increased competition in those product categories could negatively affect our future revenues and operating results.**

While we own a number of patents covering aspects of our TreadClimber<sup>®</sup> products, the introduction of comparable products designed to compete with our TreadClimber<sup>®</sup> line of specialized cardio machines may increase in the future as a result of certain patent expirations. Sales of cardio products, including TreadClimber<sup>®</sup> and Max Trainer<sup>®</sup> products, represent a substantial portion of our Direct segment revenues. Introduction by competitors of comparable products, a maturing product lifecycle or other factors could result in a decline in our revenues derived from these products. A significant decline in our revenue of these products, without offsetting sales gains, would have a material adverse effect on our operating results, financial position and cash flows.

**Failure or inability to protect our intellectual property could significantly harm our competitive position.**

Protecting our intellectual property is an essential factor in maintaining our competitive position in the health and fitness industry. Failure to maximize or to successfully assert our intellectual property rights could impact our competitiveness. We rely on trademark, trade secret, patent and copyright laws to protect our intellectual property rights. Many factors bear upon the exclusive ownership and right to exploit intellectual properties, including, without limitation, prior rights of third parties and nonuse and/or nonenforcement by us and/or related entities. While we make efforts to develop and protect our intellectual property, the validity,

enforceability and commercial value of our intellectual property rights may be reduced or eliminated. We cannot be sure that our intellectual property rights will be maximized or that they can be successfully asserted. There is a risk that we will not be able to obtain and perfect our own intellectual property rights or, where appropriate, license intellectual property rights necessary to compete successfully within the marketplace for our products. We cannot be sure that these rights, if obtained, will not be invalidated, circumvented or challenged in the future. If we do not, or are unable to, adequately protect our intellectual property, then we may face difficulty in differentiating our products from those of our competitors and our business, operating results and financial condition may be adversely affected.

**Trademark infringement or other intellectual property claims relating to our products could increase our costs.**

Our industry is susceptible to litigation regarding trademark and patent infringement and other intellectual property rights. We could become a plaintiff or defendant in litigation involving trademark or patent infringement claims or claims for breach of a license agreement. The prosecution or defense of intellectual property litigation is both costly and disruptive of the time and resources of our management, regardless of the claim's merit. We could also be required to pay substantial damages or settlement costs to resolve intellectual property litigation or related matters.

We may not be able to successfully acquire intellectual property rights, protect existing rights, or potentially prevent others from claiming that we have violated their proprietary rights. We could incur substantial costs in defending against such claims even if they are without basis, and we could become subject to judgments or settlements requiring us to pay substantial damages, royalties or other charges.

**Future impairments of intangible assets could negatively impact our operating results.**

We had goodwill of \$61.9 million and other intangible assets of \$69.8 million as of December 31, 2016 . Any future impairment charges, if significant, could materially and adversely affect our operating results. An unexpected decline in revenue, changes in market conditions, changes in competitive products or technologies or a change in management's intentions regarding utilization of intangible assets could lead to future impairment charges.

**We are subject to periodic litigation, product liability risk and other regulatory proceedings, which could result in unexpected expense of time and resources.**

From time to time, we may be a defendant in lawsuits and regulatory actions relating to our business or the former operations of our discontinued Commercial business segment. Due to the inherent uncertainties of litigation and regulatory proceedings, we cannot accurately predict the ultimate outcome of any such proceedings. An unfavorable outcome could have a material adverse impact on our business, financial condition and results of operations. In addition, any significant litigation in the future, regardless of its merits, could divert management's attention from our operations and may result in substantial legal costs.

**We are subject to warranty claims for our products, which could result in unexpected expense.**

Many of our products carry warranties for defects in quality and workmanship. We may experience significant expense as the result of product quality issues, product recalls or product liability claims which may have a material adverse effect on our business. We maintain a warranty reserve for estimated future warranty claims. However, the actual costs of servicing future warranty claims may exceed the reserve and have a material adverse effect on our results of operations, financial condition and cash flows.

**Disruption to our information and communication systems could result in interruptions to our business and potential implementation of new systems for critical business functions may heighten the risk of disruption.**

Our business is reliant on information and communication technology, and a substantial portion of our revenues are generated with the support of information and communication systems. The success of our Direct business is heavily dependent on our ability to respond to customer sales inquiries and process sales transactions using our call center communication systems, Internet websites and similar data monitoring and communication systems provided and supported by third-parties. If such systems were to fail, or experience significant or lengthy interruptions in availability or service, our revenues could be materially affected. We also rely on information systems in all stages of our product cycle, from design to distribution, and we use such systems as a method of communication between employees, suppliers and customers. In addition, we use information systems to maintain our accounting records, assist in trade receivables collection and customer service efforts, and forecast operating results and cash flows.

System failures or service interruptions may occur as the result of a number of factors, including: computer viruses; hacking or other unlawful activities by third parties; disasters; equipment, hardware or software failures; ineffective design or implementation of new systems or systems upgrades; cable outages, extended power failures, or our inability or failure to properly protect, repair

or maintain our communication and information systems. To mitigate the risk of business interruption, we have in place a disaster recovery program that targets our most critical operational systems. If our disaster recovery system is ineffective, in whole or in part, or efforts conducted by us or third-parties to prevent or respond to system interruptions in a timely manner are ineffective, our ability to conduct operations would be significantly affected. If we do not consider the potential impact of critical decisions related to systems or process design and implementation, this could lead to operational challenges and increased costs. Any of the aforementioned factors could have a material adverse effect on our operating results, financial position and cash flows.

**System security risks, data protection breaches and cyber-attacks could disrupt our operations.**

We manage and store various proprietary information and sensitive or confidential data relating to our business, including sensitive and personally identifiable information. Breaches of our security measures or the accidental loss, inadvertent disclosure or unapproved dissemination of proprietary information or sensitive or confidential data about us, or our customers, including the potential loss or disclosure of such information or data as a result of fraud, trickery or other forms of deception, could expose us, our customers or the individuals affected to a risk of loss or misuse of this information, result in litigation and potential liability for us, damage our brand and reputation or otherwise harm our business. In addition, the cost and operational consequences of implementing further data protection measures could be significant.

Experienced computer programmers and hackers may be able to penetrate our network security and misappropriate or compromise our confidential information or that of third parties, create system disruptions or cause shutdowns. Computer programmers and hackers also may be able to develop and deploy viruses, worms and other malicious software programs that attack or otherwise exploit any security vulnerabilities of our systems. In addition, sophisticated hardware and operating system software and applications that we procure from third parties may contain defects in design or manufacture, including "bugs" and other problems that could unexpectedly interfere with the operation of the system. The costs to us to eliminate or alleviate cyber or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities could be significant, and our efforts to address these problems may not be successful and could result in interruptions, delays, cessation of service and loss of existing or potential customers that may impede our revenue, manufacturing, distribution or other critical functions.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

Following is a summary of each of our properties as of December 31, 2016 :

| Company  | Location    | Primary Function(s)   | Owned or Leased |
|----------|-------------|---|-----------------|
| Nautilus | Washington  | Corporate headquarters, customer call center, retail store and R&D facility | Leased          |
| Octane   | Minnesota   | Design, sales, service and R&D facility                                     | Leased          |
| Nautilus | Ohio        | Warehouse and distribution facility   | Leased          |
| Nautilus | Oregon      | Warehouse and distribution facility   | Leased          |
| Nautilus | China       | Quality assurance office  | Leased          |
| Octane   | Indonesia   | Sales office  | Leased          |
| Octane   | Netherlands | Sales and service office  | Leased          |

The Nautilus properties are used by both our Direct and Retail segments, and the Octane properties are primarily used for our Retail segment. The properties generally are well-maintained, adequate and suitable for their intended purposes, and we believe our existing properties will meet our operational needs for the foreseeable future. If we require additional warehouse or office space in the future, we believe we will be able to obtain such space on commercially reasonable terms.

**Item 3. Legal Proceedings**

**Patent Infringement Case**

In 2004, we were sued in the Southern District of New York by BioSig Instruments, Inc. for alleged patent infringement in connection with our incorporation of heart rate monitors into certain cardio products. No significant activity in the litigation occurred until 2008. In 2012, the U.S. District Court granted summary judgment to us on grounds that BioSig’s patents were invalid as a matter of law. BioSig appealed the grant of summary judgment and, in April 2013, the U.S. Court of Appeals for the Federal Circuit reversed the District Court’s decision on summary judgment and remanded the case to the District Court for further proceedings. On January 10, 2014, the U. S. Supreme Court granted our petition for a writ of certiorari to address the legal standard applied by the Federal Circuit in determining whether the patents may be valid under applicable law. The case was argued before the Supreme Court on April 28, 2014. By decision dated June 2, 2014, the Supreme Court unanimously reversed the Federal Circuit, holding that its standard of when a patent may be “indefinite” was incorrect and remanding to the Federal Circuit for reconsideration under the correct standard. The remand hearing in the Federal Circuit was held on October 29, 2014. By decision dated April 27, 2015, the same panel of the Federal Circuit affirmed its earlier reversal of the District Court’s decision on summary

judgment. On May 27, 2015, we filed a petition for a rehearing en banc in the Federal Circuit, which was denied on August 4, 2015 and a Petition for Review by the U. S. Supreme Court which was also denied. The case has been returned to the District Court, and the parties are currently engaged in discovery and other pre-trial motion practice. We do not believe that our use of heart rate monitors utilized or purchased from third parties, and otherwise, infringes the BioSig patents.

In addition to the matter described above, from time to time, we may be involved in various claims, lawsuits and other proceedings. These legal and tax proceedings involve uncertainty as to the eventual outcomes and losses which may be realized when one or more future events occur or fail to occur.

**Item 4. Mine Safety Disclosures**

Not applicable.



## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

#### *Market for our Common Stock*

Our common stock is listed on the New York Stock Exchange (the "NYSE") and trades under the symbol "NLS." As of February 24, 2017, there were 45 holders of record of our common stock and approximately 10,500 beneficial shareholders. The following table sets forth the high and low sales prices of our common stock for each period presented:

|             | High     | Low      |
|-------------|----------|----------|
| <b>2016</b> |          |          |
| Quarter 1   | \$ 21.04 | \$ 16.80 |
| Quarter 2   | \$ 21.10 | \$ 16.80 |
| Quarter 3   | \$ 24.99 | \$ 17.68 |
| Quarter 4   | \$ 22.59 | \$ 15.65 |
| <b>2015</b> |          |          |
| Quarter 1   | \$ 15.97 | \$ 14.13 |
| Quarter 2   | \$ 22.81 | \$ 15.42 |
| Quarter 3   | \$ 22.63 | \$ 14.15 |
| Quarter 4   | \$ 19.68 | \$ 14.57 |

We did not pay any dividends on our common stock in 2016 or 2015, and we currently have no plans to pay dividends on our common stock in future periods. Payment of any future dividends, in accordance with our borrowing arrangements, is at the discretion of our Board of Directors, which considers various factors such as our financial condition, operating results, current and anticipated cash needs and future expansion plans.

#### *Equity Compensation Plans*

See Part III, Item 12 for equity compensation plan information.

#### *Issuer Purchases of Equity Securities*

The following table provides information about our repurchases of our equity securities during the fourth quarter ended December 31, 2016. See Note 17 of Notes to Consolidated Financial Statements for information regarding our public share repurchase programs.

| Period                   | (a)<br>Total Number of<br>Shares Purchased <sup>(1)</sup> | (b)<br>Average<br>Price Paid<br>per Share | (c)<br>Total Number of Shares<br>Purchased<br>as Part of Publicly<br>Announced Plans or<br>Programs <sup>(2),(3)</sup> | (d)<br>Approximate Dollar<br>Value of Shares that May Yet Be<br>Purchased Under the Plans or<br>Programs <sup>(2),(3)</sup> |
|--------------------------|---|---|--|---|
| October 1 - October 31   | 79,586  | \$17.78                                   | 78,609   | \$12,034,844  |
| November 1 - November 30 | 241,196   | 16.55                                     | 241,196  | 8,042,118   |
| December 1 - December 31 | —   | —   | —  | 8,042,118   |
| <b>Total</b>             | <b>320,782</b>  | <b>\$16.86</b>                            | <b>319,805</b>   | <b>\$8,042,118</b>  |

<sup>(1)</sup> Includes shares withheld from the vesting portions of stock unit awards made to certain management personnel to satisfy their tax withholding obligations incident to said vesting.

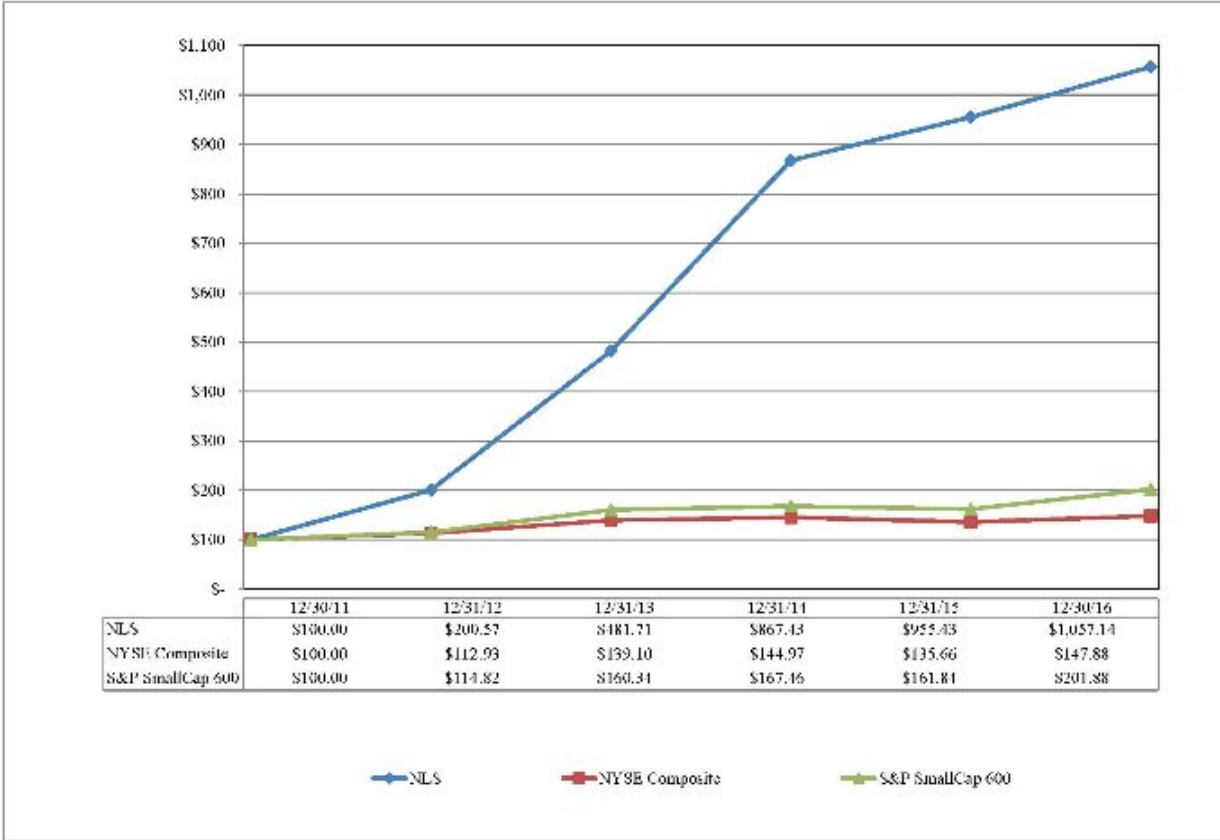
<sup>(2)</sup> On November 3, 2014, our Board of Directors approved a stock repurchase program that authorized us to repurchase up to \$15.0 million of our outstanding common stock from time to time over a period of 24 months. We repurchased the full \$15.0 million, and the original repurchase program expired on November 3, 2016.

<sup>(3)</sup> On May 4, 2016, our Board of Directors approved an expansion of our stock repurchase program that authorized us to repurchase up to an additional \$10.0 million of our outstanding common stock from time to time during the period of 24 months following such approval. The repurchase program expansion expires on May 4, 2018.

**Stock Performance Graph**

The graph below compares the cumulative total stockholder return of our common stock with the cumulative total return of the *NYSE Composite Index* and the *S&P SmallCap 600* index for the period commencing December 31, 2011 and ending on December 31, 2016. The *S&P SmallCap 600* was chosen because we do not believe we can reasonably identify an industry index or specific peer issuer that would offer a meaningful comparison. The *S&P SmallCap 600* represents a broad-based index of companies with similar market capitalization.

The graph assumes \$100 was invested, on December 31, 2011, in our common stock and each index presented. The comparisons in the table below are not intended to forecast or be indicative of future performance of our common stock.



## Item 6. Selected Financial Data

The following selected consolidated financial data should be read in connection with our audited consolidated financial statements and related notes thereto and with Management's Discussion and Analysis of Financial Condition and Results of Operations, which are included elsewhere in this Form 10-K. The consolidated statements of operations data for fiscal years 2016, 2015 and 2014, and the selected consolidated balance sheets data as of December 31, 2016 and 2015 are derived from, and are qualified by reference to, the audited consolidated financial statements which are included in this Form 10-K. The consolidated statements of operations data for fiscal 2013 and 2012 and the consolidated balance sheets data as of December 31, 2014, 2013 and 2012 are derived from audited consolidated financial statements which are not included in this Form 10-K.

| (In thousands, except per share amounts)                      | For the Year Ended December 31, |            |            |            |            |
|---|---------------------------------|------------|------------|------------|------------|
|   | 2016                            | 2015       | 2014       | 2013       | 2012       |
| <b>Consolidated Statements of Operations Data</b>             |                                 |            |            |            |            |
| Net sales   | \$ 406,039                      | \$ 335,764 | \$ 274,447 | \$ 218,803 | \$ 193,926 |
| Cost of sales   | 194,514                         | 162,530    | 133,872    | 112,326    | 102,889    |
| Gross profit  | 211,525                         | 173,234    | 140,575    | 106,477    | 91,037     |
| Operating expenses:   |                                 |            |            |            |            |
| Selling and marketing   | 115,437                         | 101,618    | 81,059     | 66,486     | 58,617     |
| General and administrative                                    | 28,775                          | 21,441     | 22,131     | 18,705     | 17,669     |
| Research and development                                      | 13,919                          | 9,904      | 7,231      | 5,562      | 4,163      |
| Total operating expenses                                      | 158,131                         | 132,963    | 110,421    | 90,753     | 80,449     |
| Operating income  | 53,394                          | 40,271     | 30,154     | 15,724     | 10,588     |
| Other income (expense):                                       |                                 |            |            |            |            |
| Interest income   | 234                             | 218        | 63         | 14         | 18         |
| Interest expense  | (1,928)                         | (22)       | (25)       | (36)       | 56         |
| Other, net  | (119)                           | (445)      | 32         | 337        | (246)      |
| Total other income (expense)                                  | (1,813)                         | (249)      | 70         | 315        | (172)      |
| Income from continuing operations before income taxes         | 51,581                          | 40,022     | 30,224     | 16,039     | 10,416     |
| Income tax expense (benefit) <sup>(1)</sup>                   | 16,480                          | 13,219     | 9,841      | (32,085)   | (226)      |
| Income from continuing operations                             | 35,101                          | 26,803     | 20,383     | 48,124     | 10,642     |
| Income (loss) from discontinued operations                    | (923)                           | (201)      | (1,588)    | (170)      | 6,241      |
| Net income  | \$ 34,178                       | \$ 26,602  | \$ 18,795  | \$ 47,954  | \$ 16,883  |
| Basic income per share from continuing operations             | \$ 1.13                         | \$ 0.86    | \$ 0.65    | \$ 1.55    | \$ 0.34    |
| Basic income (loss) per share from discontinued operations    | (0.03)                          | (0.01)     | (0.05)     | (0.01)     | 0.21       |
| Basic net income per share                                    | \$ 1.10                         | \$ 0.85    | \$ 0.60    | \$ 1.54    | \$ 0.55    |
| Diluted income per share from continuing operations           | \$ 1.12                         | \$ 0.85    | \$ 0.64    | \$ 1.53    | \$ 0.34    |
| Diluted income (loss) per share from discontinued operations  | (0.03)                          | (0.01)     | (0.05)     | (0.01)     | 0.21       |
| Diluted net income per share                                  | \$ 1.09                         | \$ 0.84    | \$ 0.59    | \$ 1.52    | \$ 0.55    |
| Shares used in per share calculations:                        |                                 |            |            |            |            |
| Basic   | 31,032                          | 31,288     | 31,253     | 31,072     | 30,851     |
| Diluted   | 31,301                          | 31,589     | 31,688     | 31,457     | 30,974     |
| <b>As of December 31,</b>                                     |                                 |            |            |            |            |
| <b>Consolidated Balance Sheets Data</b>                       |                                 |            |            |            |            |
| Cash and investments <sup>(2)</sup>                           | \$ 79,617                       | \$ 60,776  | \$ 72,190  | \$ 40,979  | \$ 23,207  |
| Working capital <sup>(2)</sup>                                | 84,951                          | 69,373     | 83,080     | 45,662     | 25,410     |
| Total assets  | 333,066                         | 315,912    | 175,654    | 143,567    | 94,311     |
| Long-term note payable, net of current portion <sup>(3)</sup> | 47,979                          | 63,971     | —          | —          | —          |
| Other long-term liabilities                                   | 25,825                          | 29,432     | 4,911      | 4,077      | 6,508      |
| Total shareholders' equity                                    | 160,857                         | 126,991    | 111,072    | 91,565     | 43,326     |

- (1) Income tax benefit in 2013 includes a \$38.9 million credit related to the reversal of our deferred tax asset valuation allowance.
- (2) The decreases in cash and investments and working capital at December 31, 2015 compared to December 31, 2014 were primarily due to our purchase of Octane on December 31, 2015. See Note 2 of Notes to Consolidated Financial Statements for additional information.
- (3) The increase in long-term notes payable at December 31, 2015 compared to December 31, 2014 was due to our purchase of Octane on December 31, 2015. See Notes 2 and 13 of Notes to Consolidated Financial Statements for additional information.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis of our financial condition and results of operations together with the consolidated financial statements and related notes that are included in Part II, Item 8 of this Form 10-K. This discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties.

Our results of operations may vary significantly from period-to-period. Our revenues typically fluctuate due to the seasonality of our industry, customer buying patterns, product innovation, the nature and level of competition for health and fitness products, our ability to procure products to meet customer demand, the level of spending on, and effectiveness of, our media and advertising programs and our ability to attract new customers and maintain existing sales relationships. In addition, our revenues are highly susceptible to economic factors, including, among other things, the overall condition of the economy and the availability of consumer credit in both the U.S. and Canada. Our profit margins may vary in response to the aforementioned factors and our ability to manage product costs. Profit margins may also be affected by fluctuations in the costs or availability of materials used to manufacture our products, product warranty costs, the cost of fuel, and changes in costs of other distribution or manufacturing-related services. Our operating profits or losses may also be affected by the efficiency and effectiveness of our organization. Historically, our operating expenses have been influenced by media costs to produce and distribute advertisements of our products on television, the Internet and other media, facility costs, operating costs of our information and communications systems, product supply chain management, customer support and new product development activities. In addition, our operating expenses have been affected from time-to-time by asset impairment charges, restructuring charges and other significant unusual or infrequent expenses.

As a result of the above and other factors, our period-to-period operating results may not be indicative of future performance. You should not place undue reliance on our operating results and should consider our prospects in light of the risks, expenses and difficulties typically encountered by us and other companies, both within and outside our industry. We may not be able to successfully address these risks and difficulties and, consequently, we cannot assure you any future growth or profitability. For more information, see our discussion of Risk Factors located at Part I, Item 1A of this Form 10-K.

### OVERVIEW

We are committed to providing innovative, quality solutions to help people achieve a fit and healthy lifestyle. Our principal business activities include designing, developing, sourcing and marketing high-quality cardio and strength fitness products and related accessories for consumer use, primarily in the U.S., Canada and Europe. Our products are sold under some of the most-recognized brand names in the fitness industry: Nautilus<sup>®</sup>, Bowflex<sup>®</sup>, Octane Fitness<sup>®</sup>, Schwinn<sup>®</sup> and Universal<sup>®</sup>.

We market our products through two distinct distribution channels, Direct and Retail, which we consider to be separate business segments. Our *Direct* business offers products directly to consumers through television advertising, catalogs and the Internet. Our *Retail* business offers our products through a network of independent retail companies and specialty retailers with stores and websites located in the U.S. and internationally. We also derive a portion of our revenue from the licensing of our brands and intellectual property.

Net sales in 2016 were \$406.0 million, an increase of \$70.3 million, or 20.9%, compared to net sales of \$335.8 million in 2015. Net sales of our Direct segment decreased \$0.5 million, or 0.2%, compared to 2015, primarily due to decreased consumer demand for our TreadClimber<sup>®</sup> cardio products, partially offset by growth in the Max Trainer<sup>®</sup> product line. Net sales of our Retail segment increased by \$71.7 million, or 67.5% in 2016, compared to 2015, primarily due to the acquisition of Octane Fitness, coupled with strong organic growth in the segment.

Income from continuing operations was \$35.1 million, or \$1.12 per diluted share, in 2016, compared to \$26.8 million, or \$0.85 per diluted share, in 2015. Income from continuing operations in 2016 included a non-recurring tax benefit of \$2.7 million related to the release of previously unrecognized tax benefits associated with certain non-U.S. filing positions, which resulted from

completing the deregistration of a certain foreign entity. In 2015, income from continuing operations included a \$2.4 million credit related to the reversal of our deferred tax asset valuation allowance. Further, results for 2015 were negatively impacted by several unusual items including the following: settlement expense related to a licensing arbitration (\$2.5 million); write-off of nutrition inventory (\$1.4 million); unrecorded current period royalty revenue and reversal of prior period royalty revenue related to a dispute with the licensee (\$1.4 million); an accounts receivable reserve related to potentially uncollectible balances from a large sporting goods retailer (\$0.9 million); and transaction expenses related to the acquisition of Octane (\$0.6 million). Without consideration of the reversals of deferred tax asset valuation allowances and the other unusual items noted above, the improvement in our results from continuing operations in 2016, compared to 2015, was driven primarily by higher sales and increased operating income in both our Direct and Retail segments.

Net income was \$34.2 million, or \$1.09 per diluted share, in 2016, compared to \$26.6 million, or \$0.84 per diluted share, in 2015.

## **BUSINESS ACQUISITION**

On December 31, 2015, we acquired all of the outstanding capital stock of OF Holdings, Inc., sole parent of Octane, for an aggregate base purchase price of \$115.0 million, plus adjustments for working capital and cash on the closing date. We funded the acquisition through an \$80.0 million term loan and cash on hand. Based in Brooklyn Park, Minnesota, Octane is a leader in zero-impact training with a line of fitness equipment focused on Retail specialty and commercial channels. The acquisition of Octane strengthened and diversified our brand portfolio, broadened our distribution and deepened our talent pool. Octane's business is highly complementary to our existing business from both product and channel perspectives and is expected to create numerous revenue synergies for us.

## **DISCONTINUED OPERATIONS**

Results from discontinued operations relate to the disposal of our former Commercial business, which was completed in April 2011. We reached substantial completion of asset liquidation at December 31, 2012. Although there was no revenue related to the Commercial business in 2016, 2015 or 2014, we continue to incur legal and accounting expenses as we work with authorities on final deregistration of each international entity, as well as product liability and other legal expenses associated with product previously sold into the Commercial channel.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of financial statements in conformity with generally accepted accounting principles requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements. An accounting estimate is considered to be critical if it meets both of the following criteria: (i) the estimate requires assumptions about matters that are highly uncertain at the time the accounting estimate is made, and (ii) different estimates reasonably could have been used, or changes in the estimate that are reasonably likely to occur from period to period may have a material impact on the presentation of our financial condition, changes in financial condition or results of operations.

Our critical accounting policies and estimates are discussed below. We have not made any material changes in the methodologies we use in our critical accounting estimates during the past three fiscal years. If our assumptions or estimates change in future periods, the impact on our financial position and operating results could be material.

### ***Business Combinations***

The Company accounts for its business combinations under the provisions of Accounting Standards Codification ("ASC") Topic 805-10, Business Combinations ("ASC 805-10"), which requires that the purchase method of accounting be used for all business combinations. Assets acquired and liabilities assumed, including non-controlling interests, are recorded at the date of acquisition at their respective fair values. ASC 805-10 also specifies criteria that intangible assets acquired in a business combination must meet to be recognized and reported apart from goodwill. Goodwill represents the excess purchase price over the fair value of the tangible net assets and intangible assets acquired in a business combination. Acquisition-related expenses are recognized separately from the business combinations and are expensed as incurred.

The estimated fair value of net assets acquired, including the allocation of the fair value to identifiable assets and liabilities, was determined using third-party valuations. The estimated fair value of the net assets acquired was determined using the income approach to valuation based on the discounted cash flow method. Under this method, expected future cash flows of the business on a stand-alone basis are discounted back to a present value. The estimated fair value of identifiable intangible assets, consisting of trade names, patents and customer relationships were determined using the relief-from-royalty method for trade names and patents, and the multi-period excess earnings method for the customer relationships.

The most significant assumptions under the relief of royalty method used to value trade names and patents include: projected revenue attributable to the products or services using the asset, estimated economic life of the asset, royalty rate and discount rate. Significant assumptions under the multi-period excess earnings method include: forecasted revenue and earnings generated by the asset, expected economic life of the asset, contributory asset charges, and discount rate.

Management has developed these assumptions on the basis of historical knowledge of the business and projected financial information of the Company. These assumptions may vary based on future events, perceptions of different market participants and other factors outside the control of management, and such variations may be significant to estimated values.

#### ***Revenue Recognition***

Direct and Retail product sales and shipping revenues are recorded when products are shipped and title passes to customers. In most instances, Retail sales to customers are made pursuant to a sales contract that provides for transfer of both title and risk of loss to the customer upon our delivery to the carrier. For Direct sales, revenue is generally recognized when product is shipped. Revenue is recognized net of applicable sales incentives, such as promotional discounts, rebates and return allowances. We estimate the revenue impact of incentive programs based on the planned duration of the program and historical experience.

#### ***Sales Discounts and Allowances***

Product sales and shipping revenues are reported net of promotional discounts and return allowances. We estimate the revenue impact of retail sales incentive programs based on the planned duration of the program and historical experience. If the amount of sales incentives is reasonably estimable, the impact of such incentives is recorded at the later of the time the customer is notified of the sales incentive or the time of the sale. We estimate our liability for product returns based on historical experience and record the expected obligation as a reduction of revenue. If actual return costs differ from previous estimates, the amount of the liability and corresponding revenue are adjusted in the period in which such costs occur.

Our calculations of amounts owed for sales discounts and allowances contain uncertainties because they require management to make assumptions in interim periods and to apply judgment regarding a number of factors, including estimated future customer purchases and returns.

#### ***Goodwill and Other Long-Term Assets Valuation***

We evaluate our indefinite-lived intangible assets and goodwill for potential impairment annually or when events or circumstances indicate their carrying value may be impaired. Definite-lived intangible assets, including acquired trade names, customer relationships, patents and patent rights, and other long-lived assets, primarily property, plant and equipment, are evaluated for impairment when events or circumstances indicate the carrying value may be impaired. No goodwill or other long-term asset impairment charges were recognized in 2016, 2015 or 2014.

Our impairment evaluations contain uncertainties because they require management to make assumptions and to apply judgment in order to estimate future cash flows and asset fair values. Our judgments regarding potential impairment are based on a number of factors including: the timing and amount of anticipated cash flows; market conditions; relative levels of risk; the cost of capital; terminal values; royalty rates; and the allocation of revenues, expenses and assets and liabilities to reporting units. Each of these factors can significantly affect the value of our goodwill or other long-term assets and, thereby, could have a material adverse effect on our financial position and results of operations.

#### ***Product Warranty Obligations***

Our products carry defined warranties for defects in materials or workmanship. Our product warranties generally obligate us to pay for the cost of replacement parts, cost of shipping the parts to our customers and, in certain instances, service labor costs. At the time of sale, we record a liability for the estimated costs of fulfilling future warranty claims. The estimated warranty costs are recorded as a component of cost of sales, based on historical warranty claim experience and available product quality data. If necessary, we adjust our liability for specific warranty matters when they become known and are reasonably estimable. Our estimates of warranty expenses are based on significant judgment, and the frequency and cost of warranty claims are subject to variation. Warranty expenses are affected by the performance of new products, significant manufacturing or design defects not discovered until after the product is delivered to the customer, product failure rates and variances in expected repair costs.

***Litigation and Loss Contingencies***

From time to time, we may be involved in claims, lawsuits and other proceedings. Such matters involve uncertainty as to the eventual outcomes and any losses or gains we may ultimately realize when one or more future events occur or fail to occur. We record expenses for litigation and loss contingencies when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We estimate the probability of such losses based on the advice of internal and external counsel, outcomes from similar litigation, status of the lawsuits (including settlement initiatives), legislative developments and other factors.

Due to the numerous variables associated with these judgments and assumptions, both the precision and reliability of the resulting estimates of the related loss contingencies are subject to substantial uncertainties. We regularly monitor our estimated exposure to these contingencies and, as additional information becomes known, we may change our estimates accordingly.

***Deferred Tax Assets - Valuation Allowance***

We account for income taxes based on the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. Deferred tax assets and liabilities are measured using the enacted tax rates that are expected to be in effect when the temporary differences are expected to be included, as income or expense, in the applicable tax return. The effect of a change in tax rates on our deferred tax assets and liabilities is recognized in the period of the enactment.

We have recorded a valuation allowance to reduce our deferred income tax assets to the amount we believe is more likely than not to be realized. Each quarter, we assess the total weight of positive and negative evidence including cumulative income or loss for the past three years and forecasted taxable income and re-evaluate whether any adjustments or release of all or any portion of valuation allowance is appropriate. As a result of this evaluation, in 2014, we determined that a portion of the existing valuation allowance against state net operating loss deferred tax assets was no longer necessary. Accordingly, an income tax benefit of \$1.2 million was recorded in the fourth quarter of 2014 related to the reduction of our existing valuation allowance. Further, in the fourth quarter of 2015, after re-evaluating the potential realization of the remainder of our deferred income tax assets, we concluded that, as of December 31, 2015, the existing valuation allowance against the foreign tax credit deferred tax assets, as well as substantially all of the remaining state net operating loss deferred tax assets, were no longer necessary. As such, an income tax benefit of \$2.4 million was recorded in the fourth quarter of 2015 related to the reduction of our existing valuation allowance.

As of December 31, 2016, we had a valuation allowance against net deferred income tax assets of \$0.9 million. If our assumptions change and we determine we will be able to realize any portion of deferred income tax assets, the tax benefits related to any reversal of the valuation allowance will be accounted for in the period in which we make such determination. Likewise, should we determine that we would not be able to realize our deferred income tax assets in the future, an adjustment to the valuation allowance to reserve for the deferred income tax assets would increase expense in the period such determination is made.

***Unrecognized Tax Benefits***

Significant judgments are required in determining tax provisions and evaluating tax positions. Such judgments require us to interpret existing tax law and other published guidance as applied to our circumstances. If our financial results or other relevant facts change, thereby impacting the likelihood of realizing the tax benefit of an uncertain tax position, significant judgment would be applied in determining the effect of the change. A tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained based on the technical merits of the position upon examination, including resolutions of any related appeals or litigation.

## RESULTS OF OPERATIONS

The discussion that follows should be read in conjunction with our consolidated financial statements and the related notes in this report. All comparisons to prior year results are in reference to continuing operations only in each period, unless otherwise indicated.

Results of operations information was as follows (in thousands):

|  | Year Ended December 31, |            | Change    | % Change |
|--|-------------------------|------------|-----------|----------|
|  | 2016                    | 2015       |           |          |
| Net sales  | \$ 406,039              | \$ 335,764 | \$ 70,275 | 20.9%    |
| Cost of sales  | 194,514                 | 162,530    | 31,984    | 19.7%    |
| Gross profit   | 211,525                 | 173,234    | 38,291    | 22.1%    |
| Operating expenses:                                    |                         |            |           |          |
| Selling and marketing                                  | 115,437                 | 101,618    | 13,819    | 13.6%    |
| General and administrative                             | 28,775                  | 21,441     | 7,334     | 34.2%    |
| Research and development                               | 13,919                  | 9,904      | 4,015     | 40.5%    |
| Total operating expenses                               | 158,131                 | 132,963    | 25,168    | 18.9%    |
| Operating income                                       | 53,394                  | 40,271     | 13,123    | 32.6%    |
| Other income (expense):                                |                         |            |           |          |
| Interest income  | 234                     | 218        | 16        |          |
| Interest expense                                       | (1,928)                 | (22)       | (1,906)   |          |
| Other, net   | (119)                   | (445)      | 326       |          |
| Total other income (expense), net                      | (1,813)                 | (249)      | (1,564)   |          |
| Income before income taxes                             | 51,581                  | 40,022     | 11,559    |          |
| Income tax expense                                     | 16,480                  | 13,219     | 3,261     |          |
| Income from continuing operations                      | 35,101                  | 26,803     | 8,298     |          |
| Loss from discontinued operations, net of income taxes | (923)                   | (201)      | (722)     |          |
| Net income   | \$ 34,178               | \$ 26,602  | \$ 7,576  |          |

|  | Year Ended December 31, |            | Change    | % Change |
|--|-------------------------|------------|-----------|----------|
|  | 2015                    | 2014       |           |          |
| Net sales  | \$ 335,764              | \$ 274,447 | \$ 61,317 | 22.3 %   |
| Cost of sales  | 162,530                 | 133,872    | 28,658    | 21.4 %   |
| Gross profit   | 173,234                 | 140,575    | 32,659    | 23.2 %   |
| Operating expenses:                                    |                         |            |           |          |
| Selling and marketing                                  | 101,618                 | 81,059     | 20,559    | 25.4 %   |
| General and administrative                             | 21,441                  | 22,131     | (690)     | (3.1)%   |
| Research and development                               | 9,904                   | 7,231      | 2,673     | 37.0 %   |
| Total operating expenses                               | 132,963                 | 110,421    | 22,542    | 20.4 %   |
| Operating income                                       | 40,271                  | 30,154     | 10,117    | 33.6 %   |
| Other income (expense):                                |                         |            |           |          |
| Interest income  | 218                     | 63         | 155       |          |
| Interest expense                                       | (22)                    | (25)       | 3         |          |
| Other, net   | (445)                   | 32         | (477)     |          |
| Total other income (expense), net                      | (249)                   | 70         | (319)     |          |
| Income before income taxes                             | 40,022                  | 30,224     | 9,798     |          |
| Income tax expense                                     | 13,219                  | 9,841      | 3,378     |          |
| Income from continuing operations                      | 26,803                  | 20,383     | 6,420     |          |
| Loss from discontinued operations, net of income taxes | (201)                   | (1,588)    | 1,387     |          |
| Net income   | \$ 26,602               | \$ 18,795  | \$ 7,807  |          |



Results of operations information by segment was as follows (in thousands):

|                       | Year Ended December 31, |                   | Change           | % Change      |
|-----------------------|-------------------------|-------------------|------------------|---------------|
|                       | 2016                    | 2015              |                  |               |
| <b>Net sales:</b>     |                         |                   |                  |               |
| Direct                | \$ 225,057              | \$ 225,595        | \$ (538)         | (0.2)%        |
| Retail                | 177,920                 | 106,195           | 71,725           | 67.5 %        |
| Royalty               | 3,062                   | 3,974             | (912)            | (22.9)%       |
|                       | <u>\$ 406,039</u>       | <u>\$ 335,764</u> | <u>\$ 70,275</u> | <u>20.9 %</u> |
| <b>Cost of sales:</b> |                         |                   |                  |               |
| Direct                | \$ 75,390               | \$ 83,238         | \$ (7,848)       | (9.4)%        |
| Retail                | 119,080                 | 79,292            | 39,788           | 50.2 %        |
| Royalty               | 44                      | —                 | 44               | — %           |
|                       | <u>\$ 194,514</u>       | <u>\$ 162,530</u> | <u>\$ 31,984</u> | <u>19.7 %</u> |
| <b>Gross profit:</b>  |                         |                   |                  |               |
| Direct                | \$ 149,667              | \$ 142,357        | \$ 7,310         | 5.1 %         |
| Retail                | 58,840                  | 26,903            | 31,937           | 118.7 %       |
| Royalty               | 3,018                   | 3,974             | (956)            | (24.1)%       |
|                       | <u>\$ 211,525</u>       | <u>\$ 173,234</u> | <u>\$ 38,291</u> | <u>22.1 %</u> |
| <b>Gross margin:</b>  |                         |                   |                  |               |
| Direct                | 66.5%                   | 63.1%             | 340              | basis points  |
| Retail                | 33.1%                   | 25.3%             | 780              | basis points  |

|                       | Year Ended December 31, |                   | Change           | % Change      |
|-----------------------|-------------------------|-------------------|------------------|---------------|
|                       | 2015                    | 2014              |                  |               |
| <b>Net sales:</b>     |                         |                   |                  |               |
| Direct                | \$ 225,595              | \$ 175,593        | \$ 50,002        | 28.5 %        |
| Retail                | 106,195                 | 93,223            | 12,972           | 13.9 %        |
| Royalty               | 3,974                   | 5,631             | (1,657)          | (29.4)%       |
|                       | <u>\$ 335,764</u>       | <u>\$ 274,447</u> | <u>\$ 61,317</u> | <u>22.3 %</u> |
| <b>Cost of sales:</b> |                         |                   |                  |               |
| Direct                | \$ 83,238               | \$ 64,362         | \$ 18,876        | 29.3 %        |
| Retail                | 79,292                  | 69,510            | 9,782            | 14.1 %        |
|                       | <u>\$ 162,530</u>       | <u>\$ 133,872</u> | <u>\$ 28,658</u> | <u>21.4 %</u> |
| <b>Gross profit:</b>  |                         |                   |                  |               |
| Direct                | \$ 142,357              | \$ 111,231        | \$ 31,126        | 28.0 %        |
| Retail                | 26,903                  | 23,713            | 3,190            | 13.5 %        |
| Royalty               | 3,974                   | 5,631             | (1,657)          | (29.4)%       |
|                       | <u>\$ 173,234</u>       | <u>\$ 140,575</u> | <u>\$ 32,659</u> | <u>23.2 %</u> |
| <b>Gross margin:</b>  |                         |                   |                  |               |
| Direct                | 63.1%                   | 63.3%             | (20)             | basis points  |
| Retail                | 25.3%                   | 25.4%             | (10)             | basis points  |

The following tables compare the net sales of our major product lines within each business segment (in thousands):

|                                  | Year Ended December 31, |                   | Change           | % Change      |
|----------------------------------|-------------------------|-------------------|------------------|---------------|
|                                  | 2016                    | 2015              |                  |               |
| <b>Direct net sales:</b>         |                         |                   |                  |               |
| Cardio products <sup>(1)</sup>   | \$ 209,569              | \$ 210,578        | \$ (1,009)       | (0.5)%        |
| Strength products <sup>(2)</sup> | 15,488                  | 15,017            | 471              | 3.1 %         |
|                                  | <u>225,057</u>          | <u>225,595</u>    | <u>(538)</u>     | <u>(0.2)%</u> |
| <b>Retail net sales:</b>         |                         |                   |                  |               |
| Cardio products <sup>(1)</sup>   | 135,562                 | 63,762            | 71,800           | 112.6 %       |
| Strength products <sup>(2)</sup> | 42,358                  | 42,433            | (75)             | (0.2)%        |
|                                  | <u>177,920</u>          | <u>106,195</u>    | <u>71,725</u>    | <u>67.5 %</u> |
| <b>Royalty income</b>            |                         |                   |                  |               |
|                                  | 3,062                   | 3,974             | (912)            | (22.9)%       |
|                                  | <u>\$ 406,039</u>       | <u>\$ 335,764</u> | <u>\$ 70,275</u> | <u>20.9 %</u> |

|                                  | Year Ended December 31, |                   | Change           | % Change      |
|----------------------------------|-------------------------|-------------------|------------------|---------------|
|                                  | 2015                    | 2014              |                  |               |
| <b>Direct net sales:</b>         |                         |                   |                  |               |
| Cardio products <sup>(1)</sup>   | \$ 210,578              | \$ 160,249        | \$ 50,329        | 31.4 %        |
| Strength products <sup>(2)</sup> | 15,017                  | 15,344            | (327)            | (2.1)%        |
|                                  | <u>225,595</u>          | <u>175,593</u>    | <u>50,002</u>    | <u>28.5 %</u> |
| <b>Retail net sales:</b>         |                         |                   |                  |               |
| Cardio products <sup>(1)</sup>   | 63,762                  | 56,262            | 7,500            | 13.3 %        |
| Strength products <sup>(2)</sup> | 42,433                  | 36,961            | 5,472            | 14.8 %        |
|                                  | <u>106,195</u>          | <u>93,223</u>     | <u>12,972</u>    | <u>13.9 %</u> |
| <b>Royalty income</b>            |                         |                   |                  |               |
|                                  | 3,974                   | 5,631             | (1,657)          | (29.4)%       |
|                                  | <u>\$ 335,764</u>       | <u>\$ 274,447</u> | <u>\$ 61,317</u> | <u>22.3 %</u> |

<sup>(1)</sup> Cardio products include: MaxTrainer<sup>®</sup>, TreadClimber<sup>®</sup>, Zero Runner<sup>®</sup>, treadmills, exercise bikes and ellipticals.

<sup>(2)</sup> Strength products include: home gyms, selectorized dumbbells, kettlebell weights and accessories.

### **Net Sales and Cost of Sales**

#### Direct

The 0.2% decrease in year-over-year Direct net sales for 2016 compared to 2015 was primarily due to decreased consumer demand for our TreadClimber<sup>®</sup> cardio products, partially offset by growth in the Max Trainer<sup>®</sup> cardio product line and a 3.1% increase in strength products. The 28.5% increase in year-over-year Direct net sales for 2015 compared to 2014 was due primarily to growth of the Max Trainer<sup>®</sup> cardio product line, partially offset by declines in TreadClimber<sup>®</sup> cardio products and a 2.1% decline in strength products. The business also benefited from higher U.S. consumer credit approval rates in both years.

Combined consumer credit approvals by our primary and secondary U.S. third-party financing providers were 50.6% in 2016 compared to 48.1% in 2015 and 41.4% in 2014.

The decrease in Direct cost of sales in 2016 compared to 2015 was related to improvements in product mix and supply chain efficiencies. In addition, unusual items that occurred in 2015, including an arbitration settlement of \$2.5 million and write-off of nutrition inventory of \$1.4 million, contributed to the decrease in the year-over-year cost of sales for 2016 compared to 2015.

The majority of the increase in Direct cost of sales in 2015 compared to 2014 was related to the growth in Direct net sales. In addition, unusual items including an arbitration settlement of \$2.5 million and write-off of nutrition inventory of \$1.4 million contributed to the increase in the year-over-year cost of sales for 2015 compared to 2014.

The 340 basis point increase in the gross margin of our Direct business for 2016 compared to 2015 was primarily driven by the arbitration settlement and reserves for nutrition product inventory discussed above, as well as improvements in product mix and improved supply chain efficiencies.

The 20 basis point decrease in the gross margin of our Direct business for 2015 compared to 2014 was primarily driven by the aforementioned unusual items in 2015.

### Retail

The 67.5% increase in Retail net sales in 2016 compared to 2015 was driven primarily by increased sales of our cardio products, due to the acquisition of Octane Fitness, coupled with growth in organic product sales.

The 13.9% increase in Retail net sales in 2015 compared to 2014 was driven primarily by increased sales of our cardio products. The 13.3% increase in Retail cardio sales for 2015 compared to 2014 was primarily due to the strong acceptance of our new line of cardio products introduced in the third quarter of 2013, along with additional cardio products launched in the third quarter of 2014. Net sales of strength products in the Retail business increased 14.8% in 2015 compared to 2014, primarily driven by higher sales of SelectTech® dumbbells.

The increases in Retail cost of sales in 2016 compared to 2015, and in 2015 compared to 2014, were due to the increases in Retail net sales mentioned above.

The 780 basis point increase in Retail gross margin in 2016 compared to 2015 was primarily due to the acquisition of Octane Fitness, which had a higher gross margin, coupled with improvements in product mix and supply chain efficiencies.

The 10 basis point decrease in Retail gross margin in 2015 compared to 2014 was primarily due to unfavorable product and customer mix as increased treadmill sales drove product mix and currency exchange rates negatively impacted international sales.

### **Selling and Marketing**

| Dollars in thousands  | Year Ended December 31, |           | Change   |       |
|-----------------------|-------------------------|-----------|----------|-------|
|                       | 2016                    | 2015      | \$       | %     |
| Selling and marketing | \$115,437               | \$101,618 | \$13,819 | 13.6% |
| As % of net sales     | 28.4%                   | 30.3%     |          |       |

| Dollars in thousands  | Year Ended December 31, |          | Change   |       |
|-----------------------|-------------------------|----------|----------|-------|
|                       | 2015                    | 2014     | \$       | %     |
| Selling and marketing | \$101,618               | \$81,059 | \$20,559 | 25.4% |
| As % of net sales     | 30.3%                   | 29.5%    |          |       |

The increase in selling and marketing in 2016 compared to 2015 was primarily due to incremental sales and marketing expenses of \$10.3 million related to the acquisition of Octane Fitness, coupled with a \$4.9 million increase in media advertising, partially offset by decreased program costs of \$0.8 million.

The increase in selling and marketing in 2015 compared to 2014 was primarily due to increases in media advertising of \$12.1 million, as well as increased variable sales expenses and program costs of \$6.5 million and \$0.9 million, respectively.

The decrease in sales and marketing as a percentage of net sales in 2016 compared to 2015 was primarily due to the acquisition of Octane and growth in the organic Retail business, both of which have a lower selling and marketing expense percentage than the company-wide average.

The increase in sales and marketing as a percentage of net sales in 2015 compared to 2014 was primarily due to the increased investment in media advertising, as well as new marketing initiatives intended to broaden the reach of Direct products to the consumer.

Media advertising expense of our Direct business is the largest component of selling and marketing and was as follows:

| Dollars in thousands | Year Ended December 31, |          | Change  |      |
|----------------------|-------------------------|----------|---------|------|
|                      | 2016                    | 2015     | \$      | %    |
| Media advertising    | \$59,638                | \$54,756 | \$4,882 | 8.9% |

| Dollars in thousands | Year Ended December 31, |          | Change   |       |
|----------------------|-------------------------|----------|----------|-------|
|                      | 2015                    | 2014     | \$       | %     |
| Media advertising    | \$54,756                | \$42,643 | \$12,113 | 28.4% |

We continued to increase investment in media during 2016 to grow sales of the Max Trainer<sup>®</sup> and optimize TreadClimber<sup>®</sup> sales.

#### **General and Administrative**

| Dollars in thousands       | Year Ended December 31, |          | Change  |       |
|----------------------------|-------------------------|----------|---------|-------|
|                            | 2016                    | 2015     | \$      | %     |
| General and administrative | \$28,775                | \$21,441 | \$7,334 | 34.2% |
| As % of net sales          | 7.1%                    | 6.4%     |         |       |

| Dollars in thousands       | Year Ended December 31, |          | Change  |        |
|----------------------------|-------------------------|----------|---------|--------|
|                            | 2015                    | 2014     | \$      | %      |
| General and administrative | \$21,441                | \$22,131 | \$(690) | (3.1)% |
| As % of net sales          | 6.4%                    | 8.1%     |         |        |

The increase in general and administrative in 2016 compared to 2015 was attributable to the inclusion of the Octane business in the amount of \$3.8 million and amortization of Octane acquired assets of \$3.1 million .

The decrease in general and administrative in 2015 compared to 2014 was due to reduced spending on intellectual property registration and legal fees for patent enforcement of \$0.7 million and state business tax refunds and credits of \$0.6 million , offset by increased employee-related costs of \$0.8 million , and transaction costs related to the Octane acquisition of \$0.6 million .

The increase in general and administrative as a percentage of net sales in 2016 compared to 2015 was primarily due to the amortization of Octane acquired assets.

The decrease in general and administrative as a percentage of net sales in 2015 compared to 2014 was primarily due to higher net sales.

#### **Research and Development**

| Dollars in thousands     | Year Ended December 31, |         | Change  |       |
|--------------------------|-------------------------|---------|---------|-------|
|                          | 2016                    | 2015    | \$      | %     |
| Research and development | \$13,919                | \$9,904 | \$4,015 | 40.5% |
| As % of net sales        | 3.4%                    | 2.9%    |         |       |

| Dollars in thousands     | Year Ended December 31, |         | Change  |       |
|--------------------------|-------------------------|---------|---------|-------|
|                          | 2015                    | 2014    | \$      | %     |
| Research and development | \$9,904                 | \$7,231 | \$2,673 | 37.0% |
| As % of net sales        | 2.9%                    | 2.6%    |         |       |

The increases in research and development in 2016 compared to 2015 , and in 2015 compared to 2014 , were primarily due to our investment in additional engineering and product development headcount as we continue to supplement our new product development resources required to innovate and broaden our product portfolio, coupled with the addition, in 2016 , of the research and development expenses related to Octane.

### **Interest Expense**

Interest expense of \$1.9 million in 2016 was primarily related to the term loan that was used to finance the Octane acquisition.

Interest expense in 2015 and 2014 was less than \$0.1 million each year, and was related to financing costs associated with capital equipment lease payments.

### **Other, Net**

Other, net primarily relates to the effect of exchange rate fluctuations between the U.S. and the currencies of our foreign subsidiaries, primarily Canada, China and Europe. In addition, 2015 included losses on asset dispositions of \$0.3 million, and 2014 included gains of \$0.1 million related to refunds of state sales taxes previously paid by us.

### **Income Tax Expense**

| Dollars in thousands | Year Ended December 31, |          | Change  |       |
|----------------------|-------------------------|----------|---------|-------|
|                      | 2016                    | 2015     | \$      | %     |
| Income tax expense   | \$16,480                | \$13,219 | \$3,261 | 24.7% |
| Effective tax rate   | 31.9%                   | 33.0%    |         |       |

| Dollars in thousands | Year Ended December 31, |         | Change  |       |
|----------------------|-------------------------|---------|---------|-------|
|                      | 2015                    | 2014    | \$      | %     |
| Income tax expense   | \$13,219                | \$9,841 | \$3,378 | 34.3% |
| Effective tax rate   | 33.0%                   | 32.6%   |         |       |

Income tax expense in 2016 was primarily attributable to the income generated domestically and internationally, partially offset by a \$2.7 million of income tax benefit related to the release of previously unrecognized tax benefits associated with certain non-U.S. filing positions. These resulted from completing the deregistration of a certain foreign entity during 2016. Income tax expense for 2015 and 2014 included a \$2.4 million and a \$1.2 million release of our domestic valuation allowance, respectively.

Each quarter, we assess the total weight of positive and negative evidence including cumulative income or loss for the past three years and forecasted taxable income, and re-evaluate whether any adjustments or release of all or any portion of the valuation allowance is appropriate. As a result of this evaluation, in 2014, we determined that a portion of the existing valuation allowance against state net operating loss deferred tax assets was no longer necessary. Accordingly, an income tax benefit of \$1.2 million related to the reduction of our existing valuation allowance was recorded in the fourth quarter of 2014. Further, in 2015, after re-evaluating the potential realization of the remainder of our deferred income tax assets, we concluded that the existing valuation allowance against the foreign tax credit deferred tax assets as well as substantially all remaining valuation allowance against the state net operating loss deferred tax assets were no longer necessary. Accordingly, an income tax benefit of \$2.4 million was recorded in the fourth quarter of 2015 related to the reduction of our existing valuation allowance.

The amount of valuation allowance offsetting our deferred tax assets was \$0.9 million as of December 31, 2016. Of the total remaining valuation allowance, \$0.6 million primarily relates to domestic state credit carryforwards as we currently do not anticipate generating income of appropriate character to utilize those credits. Should it be determined in the future that it is more likely than not that our domestic deferred income tax assets will be realized, an additional valuation allowance would be released during the period in which such an assessment is made. In addition, \$0.3 million of the remaining valuation allowance relates to foreign net operating loss carryforwards. There have been no material changes to our foreign operations since December 31, 2015 and, accordingly, we maintain our existing valuation allowance on foreign deferred income tax assets in such jurisdictions at December 31, 2016.

Refer to Note 14, *Income Taxes*, to our consolidated financial statements included in Part II, Item 8 of this report for additional information.

### **LIQUIDITY AND CAPITAL RESOURCES**

As of December 31, 2016, we had \$79.6 million of cash and investments, compared to \$60.8 million as of December 31, 2015. The balance sheet as of December 31, 2015 included Octane, which was acquired on December 31, 2015. For additional information on the acquisition, see Note 2, *Business Acquisition*, to our consolidated financial statements included in Part II, Item 8 of this report for additional information.

Cash provided by operating activities was \$45.9 million for 2016 , compared to cash provided by operating activities of \$41.1 million for 2015 . We expect our cash, cash equivalents and available-for-sale securities at December 31, 2016 , along with cash expected to be generated from operations, to be sufficient to fund our operating and capital requirements for at least twelve months from December 31, 2016 .

The increase in cash flows from operating activities for 2016 , compared to 2015 , was primarily due to improved operating performance and the changes in our operating assets and liabilities as discussed below.

Trade receivables increased \$0.3 million to \$45.5 million as of December 31, 2016 , compared to \$45.2 million as of December 31, 2015 , due to the timing of sales during the quarter.

Inventories increased \$4.3 million to \$47.0 million as of December 31, 2016 , compared to \$42.7 million as of December 31, 2015 , due to the increased stocking of specific product lines.

Prepays and other current assets increased \$1.1 million to \$8.0 million as of December 31, 2016 , compared to \$6.9 million as of December 31, 2015 , due to increased advertising and creative content for 2017.

Net deferred income tax liabilities increased by \$7.5 million to \$17.0 million as of December 31, 2016 , compared to \$9.5 million as of December 31, 2015 , primarily due to the utilization of tax credit carryforwards from prior periods.

Trade payables increased \$4.3 million to \$66.0 million as of December 31, 2016 , compared to \$61.7 million as of December 31, 2015 , primarily due to increased inventory purchases to support select product lines.

Accrued liabilities decreased \$0.1 million to \$12.9 million as of December 31, 2016 compared to \$13.0 million as of December 31, 2015 , due to reductions in accrued compensation, offset by increased royalties payable and deferred revenues.

Warranty obligations decreased \$1.1 million to \$7.5 million as of December 31, 2016 compared to \$8.5 million as of December 31, 2015 , primarily due to improvement in the experience rates of our products, resulting from better product quality, full stock of parts availability and sales mix.

Cash used in investing activities of \$9.9 million for 2016 was primarily related to \$3.5 million used for the purchase of Octane and the net purchases of \$1.7 million of marketable securities. In addition, \$4.7 million was used for capital expenditures during 2016 , primarily for tooling and implementation of new software and hardware information system upgrades. We anticipate spending \$7.0 million to \$8.0 million in 2017 for product tooling and systems integration.

Cash used in financing activities of \$19.0 million for 2016 was primarily related to principal repayments of our term loan of \$16.0 million related to the 2015 Octane acquisition and share repurchase program spending of \$5.4 million , partially offset by \$1.9 million of recognized excess tax benefits related to stock-based compensation.

#### ***Financing Arrangements***

On December 31, 2015 we entered into an amendment (the “Amendment”) to our existing Credit Agreement, dated December 5, 2014, with JPMorgan Chase Bank, N.A. (“Chase Bank”) that provided for an \$80.0 million term loan (the “Term Loan”) to finance the acquisition of Octane. The Term Loan and our existing \$20.0 million revolving line of credit with Chase Bank are secured by substantially all of the assets of Nautilus. The Term Loan matures on December 31, 2020. Under the terms of the Amendment, the maturity date of our existing revolving line of credit was extended to December 31, 2020.

The Credit Agreement, as amended, contains customary covenants, including minimum fixed charge coverage ratio and funded debt to EBITDA ratio, and limitations on capital expenditures, mergers and acquisitions, indebtedness, liens, dispositions, dividends and investments. The Credit Agreement also contains customary events of default. Upon an event of default, the lender may terminate its credit line commitment, accelerate all outstanding obligations and exercise its remedies under the continuing security agreement.

Borrowing availability under the Credit Agreement is subject to our compliance with certain financial and operating covenants at the time borrowings are requested. Letters of credit under the Credit Agreement are treated as a reduction of the available borrowing amount and are subject to covenant testing.

The interest rate applicable to the Term Loan, as well as each advance under the revolving line of credit, is based on either Chase Bank's floating prime rate or adjusted LIBOR, plus an applicable margin. As of December 31, 2016 our borrowing rate for both the Term Loan and line of credit advances was 1.86% .

As of December 31, 2016, we had outstanding borrowings of \$64.0 million on our term loan and \$0.5 million in letters of credit issued under the Credit Agreement with expiration dates through April 2017. As of December 31, 2016, we were in compliance with the financial covenants of the Credit Agreement and approximately \$19.5 million was available for borrowing under the line of credit.

#### **Stock Repurchase Program**

On November 3, 2014, our Board of Directors approved a stock repurchase program that authorized us to repurchase up to \$15.0 million of our outstanding common stock from time to time during the ensuing period of 24 months. On May 4, 2016, our Board of Directors approved an expansion of our share repurchase program that authorized us to repurchase up to an additional \$10.0 million of our outstanding common stock from time to time during the period of 24 months following such approval. The repurchase program expired on November 3, 2016 as to the original \$15.0 million authorization. The repurchase program expires on May 4, 2018 as to the \$10.0 million expansion. Share repurchases are funded with existing cash balances and repurchased shares are retired and returned to unissued authorized shares. During 2016, we repurchased 319,805 shares at an average price of \$16.86 per share for an aggregate purchase price of \$5.4 million. As of December 31, 2016, \$8.0 million remained available for future repurchases.

#### **Commitments and Contingencies**

For a description of our commitments and contingencies, refer to Note 21, *Commitments and Contingencies*, to our consolidated financial statements in Part II, Item 8 of this report.

#### **Non-Cancellable Contractual Obligations**

Our operating cash flows include the effect of certain non-cancellable, contractual obligations. A summary of such obligations as of December 31, 2016 is as follows (in thousands):

|  | Payments due by period |                     |                  |                  |                      |
|--|------------------------|---------------------|------------------|------------------|----------------------|
|  | Total                  | Less than 1<br>year | 1-3 years        | 3-5 years        | More than 5<br>years |
| Long-term debt obligations, including interest | \$ 67,162              | \$ 17,371           | \$ 33,581        | \$ 16,210        | \$ —                 |
| Operating lease obligations                    | 30,620                 | 4,608               | 9,968            | 8,993            | 7,051                |
| Purchase obligations <sup>(1)</sup>            | 17,630                 | 17,630              | —                | —                | —                    |
| Minimum royalty obligations                    | 4,458                  | 4,458               | —                | —                | —                    |
| Total  | <u>\$ 119,870</u>      | <u>\$ 44,067</u>    | <u>\$ 43,549</u> | <u>\$ 25,203</u> | <u>\$ 7,051</u>      |

<sup>(1)</sup> Our purchase obligations are comprised primarily of inventory purchase commitments. Because substantially all of our inventory is sourced from Asia, we have long lead times and therefore need to secure factory capacity from our vendors in advance.

Due to uncertainty with respect to the timing of future cash flows associated with our unrecognized tax benefits at December 31, 2016, we are unable to make reasonably reliable estimates of the timing of any cash settlements with the respective taxing authorities. Therefore, approximately \$2.6 million of liabilities related to unrecognized tax benefits, including interest and penalties on uncertain tax positions, have been excluded from the contractual table above. For further information, refer to Note 14, *Income Taxes*, to our consolidated financial statements in Part II, Item 8 of this report.

#### **Off-Balance Sheet Arrangements**

In the ordinary course of business, we enter into agreements that require us to indemnify counterparties against third-party claims. These may include: agreements with vendors and suppliers, under which we may indemnify them against claims arising from our use of their products or services; agreements with customers, under which we may indemnify them against claims arising from their use or sale of our products; real estate and equipment leases, under which we may indemnify lessors against third party claims relating to the use of their property; agreements with licensees or licensors, under which we may indemnify the licensee or licensor against claims arising from their use of our intellectual property or our use of their intellectual property; and agreements with parties to debt arrangements, under which we may indemnify them against claims relating to their participation in the transactions.

The nature and terms of these indemnifications vary from contract to contract, and generally a maximum obligation is not stated. We hold insurance policies that mitigate potential losses arising from certain types of indemnifications. Because we are unable to estimate our potential obligation, and because management does not expect these obligations to have a material adverse effect on our consolidated financial position, results of operations or cash flows, no liabilities are recorded at December 31, 2016.

## SEASONALITY

We expect our revenue from fitness equipment products to vary seasonally. Sales are typically strongest in the first and fourth quarters, followed by the third quarter, and are generally weakest in the second quarter. We believe that consumers tend to be involved in outdoor activities during the spring and summer months, including outdoor exercise, which impacts sales of indoor fitness equipment. This seasonality can have a significant effect on our inventory levels, working capital needs and resource utilization.

## INFLATION

We do not believe that inflation had a material effect on our business, financial condition or results of operations in 2016, 2015 or 2014. Inflation pressures do exist in countries where our contract manufacturers are based; however, we have largely mitigated these increases through cost improvement measures.

## NEW ACCOUNTING PRONOUNCEMENTS

See Note 1, *Significant Accounting Policies*, to our consolidated financial statements in Part II, Item 8 of this report.

## Item 7A. Quantitative and Qualitative Disclosures About Market Risk

### *Interest Rate Risk*

Our exposure to market risk from changes in interest rates relates primarily to our cash equivalents, marketable securities, variable-rate debt obligations, and derivative liabilities. As of December 31, 2016, we had cash equivalents of \$13.6 million held in a combination of money market funds and commercial paper, and marketable securities of \$31.7 million, held in a combination of certificates of deposit, corporate bonds, and U.S. government bonds. Our cash equivalents mature within three months or less from the date of purchase. Marketable securities with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. We have classified our marketable securities as available-for-sale and, therefore, we may choose to sell or hold them as changes in the market occur. Because of the short-term nature of the instruments in our portfolio, a decline in interest rates would reduce our interest income over time, and an increase in interest rates may negatively affect the market price or liquidity of certain securities within the portfolio, but a change in interest rates would not have a material impact on our results of operations, financial position or cash flows.

Our negotiated credit facilities generally charge interest based on a benchmark rate such as LIBOR. Fluctuations in short-term interest rates may cause interest payments on term loan principal and drawn amounts on the revolving line to increase or decrease. As of December 31, 2016, the outstanding balances on our credit facilities totaled \$64.0 million.

In January 2016, we entered into an \$80.0 million receive-variable, pay-fixed interest rate swap agreement, amortizing monthly in line with the outstanding principal balance on our term loan. The swap is classified as a cash flow hedge and effectively fixes the interest rate on our variable-rate term loan. The interest rate swap matures on December 31, 2020 and has a fixed interest rate of 1.42% per annum. The variable rate on the interest rate swap is the one-month LIBOR benchmark, which was 0.61% at December 31, 2016.

The fair value of our interest rate swap agreement represents the estimated receipts or payments that would be made to terminate the agreement. The amounts related to our cash flow hedge are recorded as deferred gains or losses in our consolidated balance sheets with the offset recorded in accumulated other comprehensive income, net of tax. At December 31, 2016, the fair value of our interest rate swap agreement was a liability of \$0.04 million. The estimated amount expected to be reclassified into earnings within the next twelve months was \$0.04 million at December 31, 2016.

We do not enter into derivative instruments for any purpose other than to manage our interest rate exposure. That is, we do not engage in interest rate speculation using derivative instruments.



**Item 8. Financial Statements and Supplementary Data**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of  
Nautilus, Inc.  
Vancouver, Washington

We have audited the accompanying consolidated balance sheets of Nautilus, Inc. and subsidiaries (the “Company”) as of December 31, 2016 and 2015 , and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2016 . These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Nautilus, Inc. and subsidiaries as of December 31, 2016 and 2015 , and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016 , in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2016 , based on the criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2017 expressed an unqualified opinion on the Company's internal control over financial reporting.

*/s/ Deloitte & Touche LLP*

Portland, Oregon  
February 27, 2017

**NAUTILUS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands)

|  | As of December 31, |            |
|--|--------------------|------------|
|  | 2016               | 2015       |
| <b>Assets</b>  |                    |            |
| Cash and cash equivalents  | \$ 47,874          | \$ 30,778  |
| Available-for-sale securities  | 31,743             | 29,998     |
| Trade receivables, net of allowances of \$170 and \$918  | 45,458             | 45,155     |
| Inventories  | 47,030             | 42,729     |
| Prepays and other current assets   | 8,020              | 6,888      |
| Income taxes receivable  | 3,231              | 439        |
| Deferred income tax assets   | —                  | 8,904      |
| Total current assets   | 183,356            | 164,891    |
| Property, plant and equipment, net   | 17,468             | 16,764     |
| Goodwill   | 61,888             | 60,470     |
| Other intangible assets, net   | 69,800             | 73,354     |
| Deferred income tax assets, non-current  | 11                 | —          |
| Other assets   | 543                | 433        |
| Total assets   | \$ 333,066         | \$ 315,912 |
| <b>Liabilities and Shareholders' Equity</b>  |                    |            |
| Trade payables   | \$ 66,020          | \$ 61,745  |
| Accrued liabilities  | 12,892             | 13,027     |
| Warranty obligations, current portion  | 3,500              | 4,753      |
| Note payable, current portion, net of unamortized debt issuance costs of \$7 and \$7                   | 15,993             | 15,993     |
| Total current liabilities  | 98,405             | 95,518     |
| Warranty obligations, non-current  | 3,950              | 3,792      |
| Income taxes payable, non-current  | 2,403              | 4,116      |
| Deferred income tax liabilities, non-current   | 16,991             | 18,380     |
| Other long-term liabilities  | 2,481              | 3,144      |
| Note payable, non-current, net of unamortized debt issuance costs of \$21 and \$29                     | 47,979             | 63,971     |
| Total liabilities  | 172,209            | 188,921    |
| Commitments and contingencies (Note 21)  |                    |            |
| Shareholders' equity:  |                    |            |
| Common stock - no par value, 75,000 shares authorized, 30,825 and 31,005 shares issued and outstanding | 578                | 796        |
| Retained earnings  | 161,496            | 127,522    |
| Accumulated other comprehensive loss   | (1,217)            | (1,327)    |
| Total shareholders' equity   | 160,857            | 126,991    |
| Total liabilities and shareholders' equity   | \$ 333,066         | \$ 315,912 |

See accompanying Notes to Consolidated Financial Statements.

**NAUTILUS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands, except per share amounts)

|   | Year Ended December 31, |            |            |
|---|-------------------------|------------|------------|
|   | 2016                    | 2015       | 2014       |
| Net sales   | \$ 406,039              | \$ 335,764 | \$ 274,447 |
| Cost of sales   | 194,514                 | 162,530    | 133,872    |
| Gross profit  | 211,525                 | 173,234    | 140,575    |
| Operating expenses:                                     |                         |            |            |
| Selling and marketing                                   | 115,437                 | 101,618    | 81,059     |
| General and administrative                              | 28,775                  | 21,441     | 22,131     |
| Research and development                                | 13,919                  | 9,904      | 7,231      |
| Total operating expenses                                | 158,131                 | 132,963    | 110,421    |
| Operating income  | 53,394                  | 40,271     | 30,154     |
| Other income (expense):                                 |                         |            |            |
| Interest income   | 234                     | 218        | 63         |
| Interest expense  | (1,928)                 | (22)       | (25)       |
| Other, net  | (119)                   | (445)      | 32         |
| Total other income (expense), net                       | (1,813)                 | (249)      | 70         |
| Income from continuing operations before income taxes   | 51,581                  | 40,022     | 30,224     |
| Income tax expense                                      | 16,480                  | 13,219     | 9,841      |
| Income from continuing operations                       | 35,101                  | 26,803     | 20,383     |
| Discontinued operations:                                |                         |            |            |
| Loss from discontinued operations before income taxes   | (1,077)                 | (601)      | (1,134)    |
| Income tax expense (benefit) of discontinued operations | (154)                   | (400)      | 454        |
| Loss from discontinued operations                       | (923)                   | (201)      | (1,588)    |
| Net income  | \$ 34,178               | \$ 26,602  | \$ 18,795  |
| Basic income per share from continuing operations       | \$ 1.13                 | \$ 0.86    | \$ 0.65    |
| Basic loss per share from discontinued operations       | (0.03)                  | (0.01)     | (0.05)     |
| Basic net income per share                              | \$ 1.10                 | \$ 0.85    | \$ 0.60    |
| Diluted income per share from continuing operations     | \$ 1.12                 | \$ 0.85    | \$ 0.64    |
| Diluted loss per share from discontinued operations     | (0.03)                  | (0.01)     | (0.05)     |
| Diluted net income per share                            | \$ 1.09                 | \$ 0.84    | \$ 0.59    |
| Shares used in per share calculations:                  |                         |            |            |
| Basic   | 31,032                  | 31,288     | 31,253     |
| Diluted   | 31,301                  | 31,589     | 31,688     |

See accompanying Notes to Consolidated Financial Statements.

**NAUTILUS, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In thousands)

|   | Year Ended December 31, |           |           |
|---|-------------------------|-----------|-----------|
|   | 2016                    | 2015      | 2014      |
| Net income  | \$ 34,178               | \$ 26,602 | \$ 18,795 |
| Other comprehensive income (loss):  |                         |           |           |
| Unrealized gain (loss) on marketable securities, net of income tax expense (benefit) of \$5, \$1 and \$(11) | 8                       | 2         | (18)      |
| Loss on derivative securities, effective portion, net of income tax benefit of \$(14), \$0 and \$0          | (24)                    | —         | —         |
| Foreign currency translation adjustment, net of income tax expense (benefit) of \$(5), \$17, and \$15       | 126                     | (1,021)   | (534)     |
| Other comprehensive income (loss)   | 110                     | (1,019)   | (552)     |
| Comprehensive income  | \$ 34,288               | \$ 25,583 | \$ 18,243 |

See accompanying Notes to Consolidated Financial Statements.

**NAUTILUS, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(In thousands)

|   | Common Stock |          | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|--------------|----------|-------------------|---|----------------------------|
|   | Shares       | Amount   |                   |   |                            |
| <b>Balances at January 1, 2014</b>  | 31,162       | \$ 6,769 | \$ 84,552         | \$ 244  | \$ 91,565                  |
| Net income  | —            | —        | 18,795            | —   | 18,795                     |
| Unrealized loss on marketable securities, net of income tax benefit of \$(11)               | —            | —        | —                 | (18)  | (18)                       |
| Foreign currency translation adjustment, net of income tax expense of \$15                  | —            | —        | —                 | (534)   | (534)                      |
| Stock-based compensation expense  | —            | 1,066    | —                 | —   | 1,066                      |
| Common stock issued under equity compensation plan, net of shares withheld for tax payments | 171          | 378      | —                 | —   | 378                        |
| Tax deficiency related to stock-based awards  | —            | (180)    | —                 | —   | (180)                      |
| <b>Balances at December 31, 2014</b>  | 31,333       | 8,033    | 103,347           | (308)   | 111,072                    |
| Net income  | —            | —        | 26,602            | —   | 26,602                     |
| Unrealized gain on marketable securities, net of income tax expense of \$1                  | —            | —        | —                 | 2   | 2                          |
| Foreign currency translation adjustment, net of income tax expense of \$17                  | —            | —        | —                 | (1,021)                                       | (1,021)                    |
| Stock-based compensation expense  | —            | 1,484    | —                 | —   | 1,484                      |
| Common stock issued under equity compensation plan, net of shares withheld for tax payments | 377          | 275      | —                 | —   | 275                        |
| Common stock issued under employee stock purchase plan                                      | 7            | 116      | —                 | —   | 116                        |
| Tax benefit related to stock-based awards   | —            | 28       | —                 | —   | 28                         |
| Repurchased shares  | (712)        | (9,140)  | (2,427)           | —   | (11,567)                   |
| <b>Balances at December 31, 2015</b>  | 31,005       | 796      | 127,522           | (1,327)                                       | 126,991                    |
| Net income  | —            | —        | 34,178            | —   | 34,178                     |
| Unrealized gain on marketable securities, net of income tax expense of \$5                  | —            | —        | —                 | 8   | 8                          |
| Loss on derivative securities, effective portion, net of income tax benefit of \$(14)       | —            | —        | —                 | (24)  | (24)                       |
| Foreign currency translation adjustment, net of income tax benefit of \$(5)                 | —            | —        | —                 | 126   | 126                        |
| Stock-based compensation expense  | —            | 2,613    | —                 | —   | 2,613                      |
| Common stock issued under equity compensation plan, net of shares withheld for tax payments | 116          | 117      | —                 | —   | 117                        |
| Common stock issued under employee stock purchase plan                                      | 24           | 381      | —                 | —   | 381                        |
| Tax benefit related to stock-based awards   | —            | 1,857    | —                 | —   | 1,857                      |
| Repurchased shares  | (320)        | (5,186)  | (204)             | —   | (5,390)                    |
| <b>Balances at December 31, 2016</b>  | 30,825       | \$ 578   | \$ 161,496        | \$ (1,217)                                    | \$ 160,857                 |

See accompanying Notes to Consolidated Financial Statements.

**NAUTILUS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

|   | Year Ended December 31, |                  |                  |
|---|-------------------------|------------------|------------------|
|   | 2016                    | 2015             | 2014             |
| <b>Cash flows from operating activities:</b>                                      |                         |                  |                  |
| Income from continuing operations   | \$ 35,101               | \$ 26,803        | \$ 20,383        |
| Loss from discontinued operations   | (923)                   | (201)            | (1,588)          |
| Net income  | 34,178                  | 26,602           | 18,795           |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |                  |                  |
| Depreciation and amortization   | 7,874                   | 3,412            | 4,024            |
| Bad debt expense  | 289                     | 786              | 104              |
| Inventory lower-of-cost-or-market adjustments                                     | 245                     | 1,583            | 457              |
| Stock-based compensation expense  | 2,613                   | 1,484            | 1,066            |
| Loss on asset disposals   | 147                     | 313              | 145              |
| Deferred income taxes, net of valuation allowances                                | 9,510                   | 11,669           | 8,007            |
| Excess tax (benefit) deficiency related to stock-based awards                     | (1,857)                 | (28)             | 180              |
| Other   | 5                       | —                | —                |
| Changes in operating assets and liabilities, net of effects of acquisition:       |                         |                  |                  |
| Trade receivables   | (694)                   | (6,812)          | (1,331)          |
| Inventories   | (3,110)                 | (7,147)          | (9,560)          |
| Prepays and other current assets  | (1,415)                 | 1,365            | (314)            |
| Income taxes receivable   | (2,792)                 | (389)            | 30               |
| Trade payables  | 6,464                   | 4,506            | 10,456           |
| Accrued liabilities, including warranty obligations                               | (5,606)                 | 3,776            | 2,313            |
| <b>Net cash provided by operating activities</b>                                  | <b>45,851</b>           | <b>41,120</b>    | <b>34,372</b>    |
| <b>Cash flows from investing activities:</b>                                      |                         |                  |                  |
| Acquisition of business, net of cash acquired                                     | (3,468)                 | (114,062)        | —                |
| Purchases of property, plant and equipment and intangible assets                  | (4,656)                 | (5,734)          | (3,181)          |
| Purchases of available-for-sale securities  | (34,739)                | (61,933)         | (37,434)         |
| Proceeds from maturities of available-for-sale securities                         | 32,923                  | 55,292           | 10,450           |
| Proceeds from sales of available-for-sale securities                              | 71                      | 3,602            | —                |
| <b>Net cash used in investing activities</b>                                      | <b>(9,869)</b>          | <b>(122,835)</b> | <b>(30,165)</b>  |
| <b>Cash flows from financing activities:</b>                                      |                         |                  |                  |
| Proceeds from long-term debt  | —                       | 80,000           | —                |
| Payments on long-term debt  | (16,000)                | —                | —                |
| Proceeds from employee stock purchases  | 381                     | 116              | —                |
| Proceeds from exercise of stock options   | 356                     | 1,050            | 378              |
| Tax payments related to stock award issuances                                     | (239)                   | (775)            | —                |
| Excess tax benefit (deficiency) related to stock-based awards                     | 1,857                   | 28               | (180)            |
| Payments for stock repurchases  | (5,390)                 | (11,567)         | —                |
| <b>Net cash provided by (used in) financing activities</b>                        | <b>(19,035)</b>         | <b>68,852</b>    | <b>198</b>       |
| <b>Effect of exchange rate changes on cash and cash equivalents</b>               | <b>149</b>              | <b>(1,565)</b>   | <b>(178)</b>     |
| <b>Increase (decrease) in cash and cash equivalents</b>                           | <b>17,096</b>           | <b>(14,428)</b>  | <b>4,227</b>     |
| <b>Cash and cash equivalents:</b>   |                         |                  |                  |
| <b>Beginning of year</b>  | <b>30,778</b>           | <b>45,206</b>    | <b>40,979</b>    |
| <b>End of year</b>  | <b>\$ 47,874</b>        | <b>\$ 30,778</b> | <b>\$ 45,206</b> |
| <b>Supplemental disclosure of cash flow information:</b>                          |                         |                  |                  |
| Cash paid for income taxes, net   | \$ (11,511)             | \$ (1,308)       | \$ (923)         |
| Cash paid for interest  | \$ (1,920)              | \$ (22)          | \$ (25)          |
| <b>Supplemental disclosure of non-cash investing activities:</b>                  |                         |                  |                  |
| Acquisition consideration owed but not yet paid                                   | \$ —                    | \$ 2,813         | \$ —             |
| Capital expenditures incurred but not yet paid                                    | \$ 210                  | \$ 1,000         | \$ 86            |

**Supplemental disclosure of non-cash financing activities:**

|                                     |    |   |    |    |    |   |
|-------------------------------------|----|---|----|----|----|---|
| Loan fees incurred but not yet paid | \$ | — | \$ | 36 | \$ | — |
|-------------------------------------|----|---|----|----|----|---|

See accompanying Notes to Consolidated Financial Statements.

**NAUTILUS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) SIGNIFICANT ACCOUNTING POLICIES**

***Organization and Business***

Nautilus, Inc. and subsidiaries (collectively, "Nautilus" or the "Company") was founded in 1986 and incorporated in the State of Washington in 1993. Our headquarters are located in Vancouver, Washington.

We are committed to providing innovative, quality solutions to help people achieve their fitness goals through a fit and healthy lifestyle. Our principal business activities include designing, developing, sourcing and marketing high-quality cardio and strength fitness products and related accessories for consumer use, primarily in the U.S. and Canada, but also in international markets outside North America. Our products are sold under some of the most-recognized brand names in the fitness industry: Nautilus<sup>®</sup>, Bowflex<sup>®</sup>, Octane Fitness<sup>®</sup>, Schwinn<sup>®</sup> and Universal<sup>®</sup>.

We market our products through two distinct distribution channels, Direct and Retail, which we consider to be separate business segments. Our *Direct* business offers products directly to consumers through television advertising, catalogs and the Internet. Our *Retail* business offers our products through a network of independent retail companies with stores and websites located in the U.S. and internationally. We also derive a portion of our revenue from the licensing of our brands and intellectual property.

***Basis of Presentation***

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and relate to Nautilus, Inc. and its subsidiaries, all of which are wholly-owned, directly or indirectly. Intercompany transactions and balances have been eliminated in consolidation.

***Discontinued Operations***

Results from discontinued operations relate to the disposal of our former Commercial business, which began in 2009 and was completed in April 2011. We reached substantial completion of asset liquidation at December 31, 2012. However, we continue to have legal and accounting expenses as we work with authorities on final deregistration of each entity and product liability and other legal expenses associated with product previously sold into the Commercial channel.

Results of operations related to the Commercial business have been presented in the consolidated financial statements as discontinued operations for all periods presented.

***Use of Estimates***

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses and the disclosure of contingent assets and liabilities in the financial statements. Our most significant estimates relate to the following:

- Revenue recognition, net of returns and allowances;
- Sales discounts and allowances;
- Allowance for uncollectible trade receivables;
- Valuation of excess and obsolete inventory;
- Goodwill and other long-term assets valuation;
- Product warranty obligations;
- Litigation and loss contingencies;
- Deferred tax assets and the related valuation allowance;
- Unrecognized tax benefits; and
- Valuation of assets and liabilities related to acquisition.

Actual results could differ from our estimates.

***Concentrations***

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents held in bank accounts in excess of federally-insured limits and trade receivables. Trade receivables are generally unsecured and therefore collection is affected by the economic conditions in each of our principal markets.

We rely on third-party contract manufacturers in Asia for substantially all of our products and for certain product engineering support. Business operations could be disrupted by natural disasters, difficulties in transporting products from non-U.S. suppliers,



as well as political, social or economic instability in the countries where contract manufacturers or their vendors or customers conduct business. While any such contract manufacturing arrangement could be replaced over time, the temporary loss of the services of any primary contract manufacturer could delay product shipments and cause a significant disruption in our operations.

We derive a significant portion of our net sales from a small number of our Retail customers. A loss of business from one or more of these large customers, if not replaced with new business, would negatively affect our operating results and cash flows. In each of 2016, 2015 and 2014, one customer accounted for more than 10%, but less than 15%, of our net sales.

#### ***Cash and Cash Equivalents***

All highly liquid investments with maturities of three months or less at purchase are considered to be cash equivalents. As of December 31, 2016, cash equivalents consisted of money market funds and commercial paper and totaled \$13.6 million. Our cash equivalents as of December 31, 2015 consisted of money market funds and corporate bonds and totaled \$0.7 million.

#### ***Available-For-Sale Securities***

We classify our marketable securities as available-for-sale and, accordingly, record them at fair value. Marketable securities with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. Unrealized holding gains and losses, which are immaterial, are excluded from earnings and are reported net of tax in other comprehensive income until realized. Dividend and interest income is recognized when earned. Realized gains and losses, which were not material in 2016 or 2015, are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

We periodically evaluate whether declines in fair values of our investments below their cost are "other-than-temporary." This evaluation consists of qualitative and quantitative factors regarding the severity and duration of the unrealized loss, as well as our ability and intent to hold the investment until a forecasted recovery occurs.

For additional information, refer to Note 4, *Fair Value Measurements*.

#### ***Derivative Securities***

We record our derivative securities at fair value, and our portfolio currently consists of an interest rate swap contract. The fair value of our interest rate swap agreement represents the estimated receipts or payments that would be made to terminate the agreement. The amounts related to our cash flow hedge are recorded as deferred gains or losses in our consolidated balance sheets with the offset recorded in accumulated other comprehensive income, net of tax. We do not enter into derivative instruments for any purpose other than to manage our interest rate exposure. That is, we do not engage in interest rate speculation using derivative instruments.

#### ***Trade Receivables***

Accounts receivable primarily consists of trade receivables due from our Retail segment customers. We determine an allowance for doubtful accounts based on historical customer experience and other currently available evidence. When a specific account is deemed uncollectible, the account is written off against the allowance.

#### ***Inventories***

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

Inventories acquired from Octane as of December 31, 2015 have been recorded at final fair values as of December 31, 2016. For additional information, see Note 2, *Business Acquisition*.

#### ***Property, Plant and Equipment***

Property, plant and equipment is stated at cost, net of accumulated depreciation. Improvements or betterments which add new functionality or significantly extend the life of an asset are capitalized. Expenditures for maintenance and repairs are expensed as incurred. The cost of assets retired, or otherwise disposed of, and the related accumulated depreciation, are removed from the accounts at the time of disposal. Gains and losses resulting from asset sales and dispositions are recognized in the period in which assets are disposed. Depreciation is recognized, using the straight-line method, over the lesser of the estimated useful lives of the assets or, in the case of leasehold improvements, the lease term, including renewal periods if we expect to exercise our renewal

options. Depreciation on computer equipment, machinery and equipment and furniture and fixtures is determined based on estimated useful lives, which generally range from three -to- seven years.

Property, plant and equipment acquired from Octane as of December 31, 2015 have been recorded at final fair values as of December 31, 2016 . For additional information, see Note 2, *Business Acquisition* .

### ***Goodwill***

Goodwill consists of the excess of acquisition costs over the fair values of net assets acquired in business combinations. We review goodwill for impairment in the fourth quarter of each year and when events or changes in circumstances indicate that the carrying amount may be impaired. For this purpose, goodwill is evaluated at the reporting unit level. Our goodwill asset related to our Canadian subsidiary is attributable to our Direct reporting unit, and our goodwill related to the Octane acquisition is attributable to our Retail reporting unit. We performed assessments of goodwill in the fourth quarters of 2016 , 2015 and 2014 . For further information regarding goodwill, see Note 9, *Goodwill* .

### ***Other Intangible Assets***

Definite-lived intangible assets, primarily acquired trade names, customer relationships, patents and patent rights, are stated at cost, net of accumulated amortization. We recognize amortization expense for our definite-lived intangible assets on a straight-line basis over the estimated useful lives.

Indefinite-lived intangible assets consist of acquired trademarks, specifically trade names. Indefinite-lived intangible assets are stated at cost and are not amortized; instead, they are tested for impairment at least annually. We review our indefinite-lived trademarks for impairment in the fourth quarter of each year and when events or changes in circumstances indicate that the assets may be impaired. The fair value of trademarks is estimated using the relief from royalty method to estimate the value of the cost savings and a discounted cash flows method to estimate the value of future income. The sum of these two values for each trademark is the fair value of the trademark. If the carrying amount of trademarks exceeds the estimated fair value, we calculate impairment as the excess of carrying amount over the estimate of fair value. We tested our indefinite-lived trademarks for impairment in the fourth quarters of 2016 , 2015 and 2014 and determined that no impairment was indicated. For further information regarding other intangible assets, see Note 10, *Other Intangible Assets* .

Other intangible assets acquired from Octane as of December 31, 2015 have been recorded at final fair values as of December 31, 2016 . For additional information, see Note 2, *Business Acquisition* .

### ***Impairment of Long-Lived Assets***

Long-lived assets, including property, plant and equipment and definite-lived intangible assets, are evaluated for impairment when events or circumstances indicate the carrying value may be impaired. When such an event or condition occurs, we estimate the future undiscounted cash flows to be derived from the use and eventual disposition of the asset to determine whether a potential impairment exists. If the carrying value exceeds estimated future undiscounted cash flows, we record impairment expense to reduce the carrying value of the asset to its estimated fair value. No impairment charges were recorded in 2016 , 2015 or 2014 .

### ***Revenue Recognition***

Direct and Retail product sales and shipping revenues are recorded when products are shipped and title passes to customers. In most instances, Retail sales to customers are made pursuant to a sales contract that provides for transfer of both title and risk of loss to the customer upon our delivery to the carrier. For Direct sales, revenue is generally recognized when products are shipped. Revenue is recognized net of applicable sales incentives, such as promotional discounts, rebates and return allowances. We estimate the revenue impact of incentive programs based on the planned duration of the program and historical experience.

Many Direct business customers finance their purchases through a third-party credit provider, for which we pay a commission or financing fee to the credit provider. Revenue for such transactions is recognized based on the sales price charged to the customer and the related commission or financing fee is included in selling and marketing expense.

### ***Sales Discounts and Returns Allowance***

Product sales and shipping revenues are reported net of promotional discounts and return allowances. We estimate the revenue impact of retail sales incentive programs based on the planned duration of the program and historical experience. If the amount of sales incentives is reasonably estimable, the impact of such incentives is recorded at the later of the time the customer is notified of the sales incentive or the time of the sale. We estimate our liability for product returns based on historical experience and record the expected obligation as a reduction of revenue. If actual return costs differ from previous estimates, the amount of the liability and corresponding revenue are adjusted in the period in which such costs occur. Activity in our sales discounts and returns allowance was as follows (in thousands):

|  | 2016            | 2015            | 2014            |
|--|-----------------|-----------------|-----------------|
| <b>Balance, January 1</b>                  | \$ 5,677        | \$ 4,296        | \$ 4,106        |
| Charges to reserve                         | 12,935          | 16,700          | 15,285          |
| Reductions for sales discounts and returns | (12,711)        | (15,569)        | (15,095)        |
| Business acquisition (Note 2)              | —               | 250             | —               |
| <b>Balance, December 31</b>                | <u>\$ 5,901</u> | <u>\$ 5,677</u> | <u>\$ 4,296</u> |

### ***Taxes Collected from Customers and Remitted to Governmental Authorities***

Taxes collected from customers and remitted to governmental authorities are recorded on a net basis and excluded from net sales.

### ***Shipping and Handling Fees***

Shipping and handling fees billed to customers are recorded net of discounts and included in both net sales and cost of sales.

### ***Cost of Sales***

Cost of sales primarily consists of: inventory costs; royalties paid to third parties; employment and occupancy costs of warehouse and distribution facilities, including depreciation of improvements and equipment; transportation expenses; product warranty expenses; distribution information systems expenses; and allocated expenses for shared administrative functions.

### ***Product Warranty Obligations***

Our products carry defined warranties for defects in materials or workmanship which, according to their terms, generally obligate us to pay the costs of supplying and shipping replacement parts to customers and, in certain instances, pay for labor and other costs to service products. Outstanding product warranty periods range from thirty days to, in limited circumstances, the lifetime of certain product components. We record a liability at the time of sale for the estimated costs of fulfilling future warranty claims. If necessary, we adjust the liability for specific warranty-related matters when they become known and are reasonably estimable. Estimated warranty expense is included in cost of sales, based on historical warranty claim experience and available product quality data. Warranty expense is affected by the performance of new products, significant manufacturing or design defects not discovered until after the product is delivered to the customer, product failure rates, and higher or lower than expected repair costs. If warranty expense differs from previous estimates, or if circumstances change such that the assumptions inherent in previous estimates are no longer valid, the amount of product warranty obligations is adjusted accordingly.

### ***Litigation and Loss Contingencies***

From time to time, we may be involved in various claims, lawsuits and other proceedings. These legal and tax proceedings involve uncertainty as to the eventual outcomes and losses which may be realized when one or more future events occur or fail to occur. We record expenses for litigation and loss contingencies as a component of general and administrative expense when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. When a loss contingency is not both probable and estimable, we do not establish an accrued liability. However, if the loss (or an additional loss in excess of the accrual) is at least a reasonable possibility and material, then we disclose an estimate of the possible loss or range of loss, if such estimate can be made, or disclose that an estimate cannot be made.

### ***Advertising and Promotion***

We expense our advertising and promotion costs as incurred. Production costs of television advertising commercials are recorded in prepaids and other current assets until the initial broadcast, at which time such costs are expensed. Advertising and promotion costs are included in selling and marketing expenses and totaled \$60.7 million, \$54.8 million and \$42.6 million for the years ended December 31, 2016, 2015 and 2014, respectively. Prepaid advertising and promotion costs were \$3.5 million and \$1.5 million as of December 31, 2016 and 2015, respectively.

**Research and Development**

Internal research and development costs, which primarily consist of salaries and wages, employee benefits, expenditures for materials, and fees to use licensed technologies, are expensed as incurred. Third party research and development costs for products under development or being researched, if any, are expensed as the contracted work is performed.

**Income Taxes**

We account for income taxes based on the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using the enacted tax rates expected to be in effect when the temporary differences are expected to be included, as income or expense, in the applicable tax return. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in the period of the enactment. Valuation allowances are provided against deferred income tax assets if we determine it is more likely than not that such assets will not be realized.

**Unrecognized Tax Benefits**

We recognize a tax benefit from an uncertain tax position when it is more likely than not that the position will be sustained based on the technical merits of the position upon examination, including resolutions of any related appeals or litigation. We recognize tax-related interest and penalties as a component of income tax expense.

**Foreign Currency Translation**

We translate the accounts of our non-U.S. subsidiaries into U.S. dollars as follows: revenues, expenses, gains and losses are translated at weighted-average exchange rates during the year; and assets and liabilities are translated at the exchange rate on the balance sheet date. Translation gains and losses are reported in our consolidated balance sheets as a component of accumulated other comprehensive income.

Gains and losses arising from foreign currency transactions, including transactions between us and our non-U.S. subsidiaries, are recorded as a component of other income (expense) in our consolidated statements of operations.

**Fair Value of Financial Instruments**

The carrying values of cash and cash equivalents, trade receivables, prepaids and other current assets, trade payables and accrued liabilities approximate fair value due to their short maturities.

For additional information on financial instruments recorded at fair value on a recurring basis as of December 31, 2016 and 2015, refer to Note 4, *Fair Value Measurements*.

**Stock-Based Compensation**

We recognize stock-based compensation expense on a straight-line basis over the applicable vesting period, based on the grant-date fair value of the award. To the extent a stock-based award is subject to performance conditions, the amount of expense recorded in a given period, if any, reflects our assessment of the probability of achieving the performance targets.

Fair value of stock options is estimated using the Black-Scholes-Merton option valuation model; fair value of performance share unit ("PSU") awards, restricted stock unit ("RSU") awards and restricted stock awards ("RSA") is based on the closing market price on the day preceding the grant.

We estimate future forfeitures, at the time of grant and in subsequent periods, based on historical turnover rates, previous forfeiture experience and changes in the business or key personnel that would suggest future forfeitures may differ from historical data. We recognize compensation expense for only those stock options and other stock-based awards that are expected to vest. We reevaluate estimated forfeitures monthly and, if applicable, recognize a cumulative effect adjustment in the period of the change if the revised estimate of the impact of forfeitures differs significantly from the previous estimate.

**Income Per Share Amounts**

Basic income per share amounts were computed using the weighted average number of common shares outstanding. Diluted income per share amounts were calculated using the number of basic weighted average shares outstanding increased by dilutive potential common shares related to stock-based awards, as determined by the treasury stock method.

## ***New Accounting Pronouncements***

### ***ASU 2017-04***

In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-04, "Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment". ASU 2017-04 simplifies the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. An entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, if applicable. The loss recognized should not exceed the total amount of goodwill allocated to the reporting unit. The same impairment test also applies to any reporting unit with a zero or negative carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. ASU 2017-04 is effective for public companies' fiscal years, including interim periods within those fiscal years, beginning after December 15, 2019, on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed after January 1, 2017. We do not expect the adoption of ASU 2017-04 to have a material effect on our financial position, results of operations or cash flows.

### ***ASU 2016-15***

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments." The amendments in ASU 2016-15 are intended to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows, with the intent of reducing diversity in practice for the eight (8) types of cash flows identified. ASU 2016-15 is effective for public companies' fiscal years, including interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. Entities must apply the guidance retrospectively to all periods presented, but may apply it prospectively if retrospective application would be impracticable. We do not expect the adoption of ASU 2016-15 to have a material effect on our financial position, results of operations or cash flows.

### ***ASU 2016-13***

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments." The amendments in ASU 2016-13 replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. ASU 2016-13 is effective for public companies' annual periods, including interim periods within those fiscal years, beginning after December 15, 2019, using a modified-retrospective approach, with certain exceptions. Early adoption is permitted. While we do not expect the adoption of ASU 2016-13 to have a material effect on our business, we are evaluating any potential impact that adoption of ASU 2016-13 may have on our financial position, results of operations or cash flows.

### ***ASU 2016-12***

In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606) - Narrow-Scope Improvements and Practical Expedients." ASU 2016-12 clarifies aspects of Topic 606 related to assessing collectibility, presentation of sales taxes, non-cash consideration, and completed contracts and contract modifications at transition, while retaining the related core principles for those areas. The effective date and transition requirements for ASU 2016-12 are the same as the effective date and transition requirements for Topic 606 (ASU 2014-09). While we do not expect the adoption of ASU 2016-12 to have a material effect on our business, we are evaluating any potential impact that adoption of ASU 2016-12 may have on our financial position, results of operations or cash flows.

### ***ASU 2016-10***

In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers (Topic 606) - Identifying Performance Obligations and Licensing." ASU 2016-10 clarifies aspects of Topic 606 related to identifying performance obligations and the licensing implementation guidance, while retaining the related core principles for those areas. The effective date and transition requirements for ASU 2016-10 are the same as the effective date and transition requirements for Topic 606 (ASU 2014-09). While we do not expect the adoption of ASU 2016-10 to have a material effect on our business, we are evaluating any potential impact that adoption of ASU 2016-10 may have on our financial position, results of operations or cash flows.

### ***ASU 2016-09***

In March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation (Topic 718) - Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for public companies' annual periods, including interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted subject to certain requirements, and the method of application (i.e., retrospective, modified retrospective or prospective) depends on the transaction area that is being amended. We do not expect the adoption of ASU 2016-09 to have a material effect on our financial position, results of operations or cash flows.

**ASU 2016-02**

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 replaces the existing guidance in Accounting Standards Codification ("ASC") 840, Leases. The new standard would require companies and other organizations to include lease obligations on their balance sheets, including a dual approach for lessee accounting under which a lessee would account for leases as finance leases or operating leases. Both finance leases and operating leases will result in the lessee recognizing a right-of-use ("ROU") asset and a corresponding lease liability. For finance leases the lessee would recognize interest expense and amortization of the ROU asset, and for operating leases the lessee would recognize a straight-line total lease expense. Lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. ASU 2016-02 is effective for public companies' annual periods, and interim periods within those fiscal years, beginning after December 15, 2018. We are currently evaluating any potential impact that adoption of ASU 2016-02 may have on our financial position, results of operations and cash flows.

**ASU 2015-17**

In November 2015, the FASB issued ASU 2015-17, "Income Taxes (Topic 740) - Balance Sheet Classification of Deferred Taxes." ASU 2015-17 simplifies the presentation of deferred income taxes, and requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments apply to all entities that present a classified statement of financial position, and aligns the presentation of deferred income tax assets and liabilities with International Financial Reporting Standards ("IFRS") IAS 1. ASU 2015-17 is effective for public companies' financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early application is permitted and may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. Our early adoption of ASU 2015-17 in January 2016 did not have a material effect on our financial position, results of operations or cash flows. We are applying ASU 2015-17 on a prospective basis to all deferred tax liabilities and assets, and prior periods have not been retrospectively adjusted.

**ASU 2015-16**

In September 2015, the FASB issued ASU 2015-16, "Business Combinations (Topic 805) - Simplifying the Accounting for Measurement-Period Adjustments." ASU 2015-16 simplifies the presentation of provisional amounts reported for items in a business combination for which the accounting is incomplete by the end of the reporting period in which the combination occurs and during the measurement period have an adjustment to provisional amounts recognized. The amendments in ASU 2015-16 require an entity to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined, and to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. ASU 2015-16 is effective for public companies' financial statements issued for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2015 on a prospective basis. Our adoption of ASU 2015-16 as of January 2016 did not have a material effect on our financial position, results of operations or cash flows.

**ASU 2015-11**

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory (Topic 330)." ASU 2015-11 simplifies the accounting for the valuation of all inventory not accounted for using the last-in, first-out ("LIFO") method by prescribing inventory be valued at the lower of cost and net realizable value. ASU 2015-11 is effective for public companies' annual periods, including interim periods within those fiscal years, beginning after December 15, 2016 on a prospective basis. Early adoption is permitted. We do not expect the adoption of ASU 2015-11 to have a material effect on our financial position, results of operations or cash flows.

**ASU 2015-05**

In April 2015, the FASB issued ASU 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40)." ASU 2015-05 provides guidance regarding the accounting for a customer's fees paid in a cloud computing arrangement, specifically about whether a cloud computing arrangement includes a software license, and if so, how to account for the software license. ASU 2015-05 is effective for public companies' annual periods, including interim periods, beginning after December 15, 2015. Early adoption is permitted. Our adoption of ASU 2015-05 in January 2016 did not have a material effect on our financial position, results of operations or cash flows.

**ASU 2014-12**

In June 2014, the FASB issued ASU No. 2014-12, "Compensation - Stock Compensation (Topic 718)." ASU No. 2014-12 addresses accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. ASU 2014-12 indicates that, in such situations, the performance target should be treated as a performance condition and, accordingly, the performance target should not be reflected in estimating the grant-date fair value of the award. Instead, compensation cost should be recognized in the period in which it becomes probable that the performance target will be

achieved. ASU 2014-12 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Our adoption of ASU 2014-12 in January 2016 did not have a material effect on our financial position, results of operations or cash flows.

***ASU 2014-09***

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." ASU 2014-09 replaces most existing revenue recognition guidance, and requires companies to recognize revenue based upon the transfer of promised goods and/or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and/or services. In addition, the new guidance requires enhanced disclosures, including revenue recognition policies to identify performance obligations to customers and significant judgments in measurement and recognition. ASU 2014-09 is effective, as amended, for annual and interim periods beginning on or after December 15, 2017, applied retrospectively to each prior period presented or retrospectively with a cumulative effect adjustment recognized as of the adoption date. We expect to adopt the new standard on January 1, 2018, and have not yet selected a transition method. We are currently evaluating the overall impact this guidance will have on our consolidated financial statements. Based on our preliminary assessment, we do not expect the adoption of ASU 2014-09 to materially change the timing of revenue recognition and classification of transactions within our consolidated financial statements. We are, however, continuing our assessment, which may identify potential impacts.

**(2) BUSINESS ACQUISITION**

On December 31, 2015, we acquired all of the outstanding capital stock of OF Holdings, Inc., sole parent of Octane Fitness, LLC ("Octane") for an aggregate base purchase price of \$115.0 million, plus net adjustments for working capital and cash acquired on the closing date. We funded the acquisition through an \$80.0 million term loan and cash on hand. Based in Brooklyn Park, Minnesota, Octane is a leader in zero-impact training with a line of fitness equipment focused on Retail specialty and commercial channels. The acquisition of Octane strengthened and diversified our brand portfolio, broadened our distribution and deepened our talent pool. Octane's business is highly complementary to our existing business from both product and channel perspectives and is expected to create numerous revenue synergies for us.

For the year ended December 31, 2016, Octane contributed net sales and net income of \$61.9 million and \$2.3 million, respectively. Operating results for 2016 included amortization of acquired assets of \$3.1 million, and purchase accounting related inventory step-up charges of \$1.5 million. Working capital and other measurement period adjustments for the year ended December 31, 2016 totaled \$0.7 million and are detailed in the valuation table below.

Total acquisition costs incurred in 2016 were \$0.3 million, and cumulative-to-date costs total \$0.9 million. These charges were expensed as incurred in general and administrative costs.

***Purchase Price Allocation***

Acquired assets and liabilities were recorded at estimated fair value as of the acquisition date, and subsequently adjusted and finalized during 2016. The excess of the purchase price over the fair value of identifiable net assets resulted in the recognition of goodwill of \$59.7 million, all of which was assigned to the Retail segment. The goodwill is not deductible for income tax purposes.

The following table summarizes the fair values of the net assets acquired and liabilities assumed, and measurement period adjustments since December 31, 2015, the acquisition date (in thousands):

|                                       | Preliminary valuation at<br>December 31, 2015 | Measurement period<br>adjustments | Final valuation at<br>December 31, 2016 |
|---------------------------------------|---|-----------------------------------|---|
| Cash                                  | \$ 7,759                                      | \$ —                              | \$ 7,759                                |
| Accounts receivable                   | 12,507  | (31)                              | 12,476                                  |
| Inventories                           | 12,168  | 966                               | 13,134                                  |
| Prepaid expenses                      | 1,028   | (143)                             | 885                                     |
| Deferred tax assets                   | 1,287   | 16                                | 1,303                                   |
| Property, plant and equipment         | 3,240   | 132                               | 3,372                                   |
| Intangible assets                     | 63,100  | —                                 | 63,100                                  |
| Total assets acquired                 | \$ 101,089                                    | \$ 940                            | \$ 102,029                              |
| Accounts payable                      | 6,215   | 282                               | 6,497                                   |
| Accrued liabilities                   | 1,614   | 1,354                             | 2,968                                   |
| Warranty obligations                  | 5,550   | —                                 | 5,550                                   |
| Deferred tax liabilities, non-current | 20,914  | 119                               | 21,033                                  |
| Other non-current liabilities         | 519   | (129)                             | 390                                     |
| Total liabilities assumed             | \$ 34,812                                     | \$ 1,626                          | \$ 36,438                               |
| Net identifiable assets acquired      | \$ 66,277                                     | \$ (686)                          | \$ 65,591                               |
| Goodwill                              | 58,357  | 1,348                             | 59,705                                  |
| Net assets acquired                   | \$ 124,634                                    | \$ 662                            | \$ 125,296                              |

The allocation of the purchase price is complete as of December 31, 2016.

The following table sets forth the components of identifiable intangible assets and their fair values, net of any measurement period changes since December 31, 2015, the acquisition date (dollars in thousands):

|                                  | Fair value | Estimated useful life<br>(years) | Weighted-average<br>amortization period<br>(years) |
|----------------------------------|------------|----------------------------------|--|
| Trade name - Octane Fitness      | \$ 23,000  | Indefinite                       | N/A  |
| Trade name - others              | 2,600      | 10 - 15                          | 12.5   |
| Patents                          | 12,800     | 11 - 24                          | 18   |
| Customer relationships           | 24,700     | 10 - 15                          | 13   |
| Definite-lived intangible assets | 40,100     |                                  |  |
| Total intangible assets          | \$ 63,100  |                                  |  |



### Summary of Unaudited Pro Forma Information

The following table reflects the unaudited pro forma consolidated results of operations for the periods presented, as though the acquisition of Octane had occurred on January 1, 2014 (in thousands):

|                       | (unaudited)             |            |            |
|-----------------------|-------------------------|------------|------------|
|                       | Year Ended December 31, |            |            |
|                       | 2016                    | 2015       | 2014       |
| Net sales             | \$ 406,039              | \$ 400,078 | \$ 338,990 |
| Net income            | 35,683                  | 29,352     | 20,233     |
| Net income per share: |                         |            |            |
| Basic                 | \$ 1.15                 | \$ 0.94    | \$ 0.65    |
| Diluted               | 1.14                    | 0.93       | 0.64       |

The unaudited pro forma financial information is presented for illustrative purposes only and is not indicative of the results of operations that would have been realized if the acquisition had been completed on the date indicated, nor is it indicative of future operating results. The pro forma results do not include, for example, the effects of anticipated synergies from combining the two companies.

### (3) DISCONTINUED OPERATIONS

Following is a summary of certain financial information regarding our discontinued operations (in thousands):

|   | Year Ended December 31, |          |            |
|---|-------------------------|----------|------------|
|   | 2016                    | 2015     | 2014       |
| Loss from discontinued operations before income taxes | \$ (1,077)              | \$ (601) | \$ (1,134) |
| Income tax expense (benefit)                          | (154)                   | (400)    | 454        |
| Total loss from discontinued operations               | \$ (923)                | \$ (201) | \$ (1,588) |

The following table summarizes liabilities for exit costs related to discontinued operations, included in accrued liabilities and other long-term liabilities in our consolidated balance sheets (in thousands):

|  | Facilities<br>Leases |
|--|----------------------|
| <b>Balance as of January 1, 2014</b>   | \$ 831               |
| Payments                               | (258)                |
| <b>Balance as of December 31, 2014</b> | 573                  |
| Payments                               | (273)                |
| <b>Balance as of December 31, 2015</b> | 300                  |
| Payments                               | (300)                |
| <b>Balance as of December 31, 2016</b> | \$ —                 |

### (4) FAIR VALUE MEASUREMENTS

Factors used in determining the fair value of financial assets and liabilities are summarized into three broad categories:

- Level 1 - observable inputs such as quoted prices (unadjusted) in active liquid markets for identical securities as of the reporting date;
- Level 2 - other significant directly or indirectly observable inputs, including quoted prices for similar securities, interest rates, prepayment speeds and credit risk; or observable market prices in markets with insufficient volume and/or infrequent transactions; and
- Level 3 - significant inputs that are generally unobservable inputs for which there is little or no market data available, including our own assumptions in determining fair value.

Assets and liabilities measured at fair value on a recurring basis were as follows (in thousands):

|   | <b>December 31, 2016</b> |                  |                |                  |
|---|--------------------------|------------------|----------------|------------------|
|   | <u>Level 1</u>           | <u>Level 2</u>   | <u>Level 3</u> | <u>Total</u>     |
| <b>Assets:</b>                                  |                          |                  |                |                  |
| Cash Equivalents                                |                          |                  |                |                  |
| Money market funds                              | \$ 9,635                 | \$ —             | \$ —           | \$ 9,635         |
| Commercial paper                                | —                        | 3,999            | —              | 3,999            |
| <b>Total Cash Equivalents</b>                   | <b>9,635</b>             | <b>3,999</b>     | <b>—</b>       | <b>13,634</b>    |
| Available-for-Sale Securities                   |                          |                  |                |                  |
| Certificates of deposit <sup>(1)</sup>          | —                        | 22,820           | —              | 22,820           |
| Corporate bonds                                 | —                        | 6,922            | —              | 6,922            |
| U.S. government bonds                           | —                        | 2,001            | —              | 2,001            |
| <b>Total Available-for-Sale Securities</b>      | <b>—</b>                 | <b>31,743</b>    | <b>—</b>       | <b>31,743</b>    |
| <b>Total assets measured at fair value</b>      | <b>\$ 9,635</b>          | <b>\$ 35,742</b> | <b>\$ —</b>    | <b>\$ 45,377</b> |
| <b>Liabilities:</b>                             |                          |                  |                |                  |
| Derivatives                                     |                          |                  |                |                  |
| Interest rate swap contract                     | \$ —                     | \$ (38)          | \$ —           | \$ (38)          |
| <b>Total liabilities measured at fair value</b> | <b>\$ —</b>              | <b>\$ (38)</b>   | <b>\$ —</b>    | <b>\$ (38)</b>   |

|  | <b>December 31, 2015</b> |                  |                |                  |
|--|--------------------------|------------------|----------------|------------------|
|  | <u>Level 1</u>           | <u>Level 2</u>   | <u>Level 3</u> | <u>Total</u>     |
| <b>Assets:</b>                             |                          |                  |                |                  |
| Cash Equivalents                           |                          |                  |                |                  |
| Money market funds                         | \$ 1                     | \$ —             | \$ —           | \$ 1             |
| Corporate bonds                            | —                        | 733              | —              | 733              |
| <b>Total Cash Equivalents</b>              | <b>1</b>                 | <b>733</b>       | <b>—</b>       | <b>734</b>       |
| Available-for-Sale Securities              |                          |                  |                |                  |
| Certificates of deposit <sup>(1)</sup>     | —                        | 25,234           | —              | 25,234           |
| Corporate bonds                            | —                        | 4,764            | —              | 4,764            |
| <b>Total Available-for-Sale Securities</b> | <b>—</b>                 | <b>29,998</b>    | <b>—</b>       | <b>29,998</b>    |
| <b>Total assets measured at fair value</b> | <b>\$ 1</b>              | <b>\$ 30,731</b> | <b>\$ —</b>    | <b>\$ 30,732</b> |

<sup>(1)</sup> All certificates of deposit are within current FDIC insurance limits.

We did not have any liabilities measured at fair value on a recurring basis as of December 31, 2015 .

For our assets measured at fair value on a recurring basis, we recognize transfers between levels at the actual date of the event or change in circumstance that caused the transfer. There were no transfers between levels during the years ended December 31, 2016 and 2015 . Additionally, we did not have any changes to our valuation techniques during the years ended December 31, 2016 and 2015 .

We classify our marketable securities as available-for-sale and, accordingly, record them at fair value. Level 1 investment valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets. Level 2 investment valuations are obtained from inputs, other than quoted market prices in active markets for identical assets, that are directly or indirectly observable in the marketplace and quoted prices in markets with limited volume or infrequent transactions. The factors or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. Unrealized holding gains and losses are excluded from earnings and are reported net of tax in comprehensive income until realized.

The fair value of our interest rate swap contract is calculated as the present value of estimated future cash flows using discount factors derived from relevant Level 2 market inputs, including forward curves and volatility levels.

We recognize or disclose the fair value of certain assets, such as non-financial assets, primarily property, plant and equipment, goodwill, other intangible assets and certain other long-lived assets in connection with impairment evaluations. All of our nonrecurring valuations use significant unobservable inputs and therefore fall under Level 3 of the fair value hierarchy. Other than our annual goodwill and indefinite-lived trade names impairment valuations effective as of October 1, 2016 and 2015, we did not perform any valuations on assets or liabilities that are valued at fair value on a nonrecurring basis. During the years ended December 31, 2016 and 2015, we did not record any other-than-temporary impairments on our financial assets required to be measured at fair value on a nonrecurring basis.

The carrying value of our term loan approximates its fair value and falls under Level 2 of the fair value hierarchy, as the interest rate is variable and based on current market rates.

## (5) DERIVATIVES

From time to time, we enter into interest rate swaps to fix a portion of our interest expense. We do not enter into derivative instruments for any purpose other than to manage interest rate exposure to fluctuations in the one-month LIBOR benchmark. That is, we do not engage in interest rate speculation using derivative instruments.

As of December 31, 2016, we had a \$64.0 million interest rate swap outstanding with JPMorgan Chase Bank, N.A. This interest rate swap matures on December 31, 2020 and has a fixed rate of 1.42% per annum. The variable rate on the interest rate swap is the one-month LIBOR benchmark. At December 31, 2016, the one-month LIBOR rate was 0.61%.

We typically designate all interest rate swaps as cash flow hedges and, accordingly, record the change in fair value for the effective portion of these interest rate swaps in accumulated other comprehensive income rather than current period earnings until the underlying hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. For the year ended December 31, 2016, there was no ineffectiveness. As of December 31, 2016, we expected to reclassify a loss of \$0.04 million from accumulated other comprehensive loss to earnings within the next twelve months.

The fair value of our derivative instruments was included in our consolidated balance sheets as follows (in thousands):

|  | Balance Sheet<br>Classification | As of December 31, |      |
|--|---------------------------------|--------------------|------|
|  |                                 | 2016               | 2015 |
| Derivative instruments designated as cash flow hedges: |                                 |                    |      |
| Interest rate swap contract                            | Accrued liabilities             | \$ 38              | \$ — |

The effect of derivative instruments on our consolidated statements of operations was as follows (in thousands):

|   | Statement of Operations<br>Classification | Year Ended December 31, |      |
|---|---|-------------------------|------|
|   |   | 2016                    | 2015 |
| Derivative instruments designated as cash flow hedges:  |   |                         |      |
| Loss recognized in other comprehensive income before reclassifications                              | ---                                       | \$ (450)                | \$ — |
| Loss reclassified from accumulated other comprehensive income to earnings for the effective portion | Interest expense                          | \$ (626)                | \$ — |
| Related tax effect  | Income tax benefit                        | \$ 200                  | \$ — |

See also Note 4.

## (6) TRADE RECEIVABLES

Trade receivables, net, consisted of the following (in thousands):

|                                 | As of December 31, |                  |
|---------------------------------|--------------------|------------------|
|                                 | 2016               | 2015             |
| Trade receivables               | \$ 45,628          | \$ 46,073        |
| Allowance for doubtful accounts | (170)              | (918)            |
|                                 | <u>\$ 45,458</u>   | <u>\$ 45,155</u> |

Changes in our allowance for doubtful trade receivables were as follows (in thousands):

|                              | 2016          | 2015          | 2014          |
|------------------------------|---------------|---------------|---------------|
| <b>Balance, January 1</b>    | \$ 918        | \$ 108        | \$ 53         |
| Charges to bad debt expense  | 289           | 786           | 104           |
| Recoveries (write-offs), net | (1,037)       | 24            | (49)          |
| <b>Balance, December 31</b>  | <u>\$ 170</u> | <u>\$ 918</u> | <u>\$ 108</u> |

## (7) INVENTORIES

Inventories are stated at the lower of cost or market, with cost determined based on the first-in, first-out method. Our inventories consisted of the following (in thousands):

|                      | As of December 31, |                  |
|----------------------|--------------------|------------------|
|                      | 2016               | 2015             |
| Finished goods       | \$ 43,130          | \$ 39,115        |
| Parts and components | 3,900              | 3,614            |
|                      | <u>\$ 47,030</u>   | <u>\$ 42,729</u> |

## (8) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following (in thousands):

|                                 | Estimated Useful Life (in years) | As of December 31, |                  |
|---------------------------------|----------------------------------|--------------------|------------------|
|                                 |                                  | 2016               | 2015             |
| Automobiles                     | 5 to 6                           | \$ 139             | \$ 139           |
| Leasehold improvements          | 4 to 20                          | 3,388              | 3,397            |
| Computer software and equipment | 3 to 7                           | 25,899             | 23,991           |
| Machinery and equipment         | 3 to 5                           | 13,085             | 10,867           |
| Furniture and fixtures          | 5 to 20                          | 2,238              | 1,605            |
| Work in progress <sup>(1)</sup> | N/A                              | 768                | 1,655            |
| Total cost                      |                                  | <u>45,517</u>      | <u>41,654</u>    |
| Accumulated depreciation        |                                  | <u>(28,049)</u>    | <u>(24,890)</u>  |
|                                 |                                  | <u>\$ 17,468</u>   | <u>\$ 16,764</u> |

<sup>(1)</sup> Work in progress primarily includes production tooling and equipment.

Depreciation expense was as follows (in thousands):

|                      | Year Ended December 31, |          |          |
|----------------------|-------------------------|----------|----------|
|                      | 2016                    | 2015     | 2014     |
| Depreciation expense | \$ 4,320                | \$ 2,558 | \$ 1,983 |

## (9) GOODWILL

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

|   | <u>Direct</u>   | <u>Retail</u>    | <u>Total</u>     |
|---|-----------------|------------------|------------------|
| <b>Balance, January 1, 2014</b>         | \$ 2,740        | \$ —             | \$ 2,740         |
| Currency exchange rate adjustment       | (220)           | —                | (220)            |
| <b>Balance, December 31, 2014</b>       | 2,520           | —                | 2,520            |
| Currency exchange rate adjustment       | (407)           | —                | (407)            |
| Business acquisition (Note 2)           | —               | 58,357           | 58,357           |
| <b>Balance, December 31, 2015</b>       | 2,113           | 58,357           | 60,470           |
| Currency exchange rate adjustment       | 67              | 3                | 70               |
| Measurement period adjustments (Note 2) | —               | 1,348            | 1,348            |
| <b>Balance, December 31, 2016</b>       | <u>\$ 2,180</u> | <u>\$ 59,708</u> | <u>\$ 61,888</u> |

## (10) OTHER INTANGIBLE ASSETS

Other intangible assets consisted of the following (in thousands):

|   | <u>Estimated<br/>Useful Life<br/>(in years)</u> | <u>As of December 31,</u> |                  |
|---|---|---------------------------|------------------|
|   |   | <u>2016</u>               | <u>2015</u>      |
| Indefinite-lived trademarks                                 | N/A   | \$ 32,052                 | \$ 32,052        |
| Definite-lived trademarks                                   | 10 to 15  | 2,600                     | 2,600            |
| Patents   | 8 to 24   | 31,487                    | 31,487           |
| Customer relationships                                      | 10 to 15  | 24,700                    | 24,700           |
|   |   | 90,839                    | 90,839           |
| Accumulated amortization - definite-lived intangible assets |   | (21,039)                  | (17,485)         |
|   |   | <u>\$ 69,800</u>          | <u>\$ 73,354</u> |

Amortization expense was as follows (in thousands):

|                      | <u>Year Ended December 31,</u> |             |             |
|----------------------|--------------------------------|-------------|-------------|
|                      | <u>2016</u>                    | <u>2015</u> | <u>2014</u> |
| Amortization expense | \$ 3,554                       | \$ 854      | \$ 2,040    |

Future amortization of definite-lived intangible assets is as follows (in thousands):

|            |                  |
|------------|------------------|
| 2017       | \$ 3,256         |
| 2018       | 3,164            |
| 2019       | 3,134            |
| 2020       | 3,108            |
| 2021       | 3,078            |
| Thereafter | 22,008           |
|            | <u>\$ 37,748</u> |

## (11) ACCRUED LIABILITIES

Accrued liabilities consisted of the following (in thousands):

|                                 | As of December 31, |                  |
|---------------------------------|--------------------|------------------|
|                                 | 2016               | 2015             |
| Payroll and related liabilities | \$ 4,579           | \$ 6,556         |
| Other                           | 8,313              | 6,471            |
| Total accrued liabilities       | <u>\$ 12,892</u>   | <u>\$ 13,027</u> |

## (12) PRODUCT WARRANTIES

Changes in our product warranty obligations were as follows (in thousands):

|                               | 2016            | 2015            | 2014            |
|-------------------------------|-----------------|-----------------|-----------------|
| <b>Balance, January 1</b>     | \$ 8,545        | \$ 2,246        | \$ 1,638        |
| Accruals                      | 2,480           | 2,302           | 2,264           |
| Payments                      | (3,575)         | (1,553)         | (1,656)         |
| Business acquisition (Note 2) | —               | 5,550           | —               |
| <b>Balance, December 31</b>   | <u>\$ 7,450</u> | <u>\$ 8,545</u> | <u>\$ 2,246</u> |

## (13) BORROWINGS

### *Term Loan and Line of Credit*

On December 31, 2015 we entered into an amendment (the "Amendment") to our existing Credit Agreement, dated December 5, 2014, with JPMorgan Chase Bank, N.A. ("Chase Bank") that provided for an \$80 million term loan to finance the acquisition described in Note 2, *Business Acquisition*, above (the "Term Loan"). The Term Loan and our existing \$20 million revolving line of credit with Chase Bank are secured by substantially all of the assets of Nautilus. The Term Loan matures on December 31, 2020. The Amendment also extended the maturity date of our existing revolving line of credit to December 31, 2020.

The Credit Agreement, as amended, contains customary covenants, including minimum fixed charge coverage ratio and funded debt to EBITDA ratio, and limitations on capital expenditures, mergers and acquisitions, indebtedness, liens, dispositions, dividends and investments. The Credit Agreement also contains customary events of default. Upon an event of default, the lender may terminate its credit line commitment, accelerate all outstanding obligations and exercise its remedies under the continuing security agreement.

Borrowing availability under the Credit Agreement is subject to our compliance with certain financial and operating covenants at the time borrowings are requested. Letters of credit under the Credit Agreement are treated as a reduction of the available borrowing amount and are subject to covenant testing.

The interest rate applicable to the Term Loan and to each advance under the revolving line of credit is based on either Chase Bank's floating prime rate or adjusted LIBOR, plus an applicable margin. As of December 31, 2016, our borrowing rate for the Term Loan and line of credit advances was 1.86%.

As of December 31, 2016, we had outstanding borrowings of \$64.0 million on our term loan and \$0.5 million in letters of credit issued under the Credit Agreement with expiration dates through April 2017. As of December 31, 2016, we were in compliance with the financial covenants of the Credit Agreement and approximately \$19.5 million was available for borrowing under the line of credit.

Principal maturities of our Term Loan over the next five years are as follows (in thousands):

|  |           |               |
|--|-----------|---------------|
|  | 2017 \$   | 16,000        |
|  | 2018      | 16,000        |
|  | 2019      | 16,000        |
|  | 2020      | 16,000        |
|  | <u>\$</u> | <u>64,000</u> |

#### (14) INCOME TAXES

##### *Income Tax Expense*

Income from continuing operations before income taxes was as follows (in thousands):

|          | Year Ended December 31, |                  |                  |
|----------|-------------------------|------------------|------------------|
|          | 2016                    | 2015             | 2014             |
| U.S.     | \$ 50,651               | \$ 39,242        | \$ 29,115        |
| Non-U.S. | 930                     | 780              | 1,109            |
|          | <u>\$ 51,581</u>        | <u>\$ 40,022</u> | <u>\$ 30,224</u> |

Income tax expense (benefit) from continuing operations was as follows (in thousands):

|                | Year Ended December 31, |                  |                 |
|----------------|-------------------------|------------------|-----------------|
|                | 2016                    | 2015             | 2014            |
| Current:       |                         |                  |                 |
| U.S. federal   | \$ 6,765                | \$ 858           | \$ 1,086        |
| U.S. state     | 318                     | 171              | 100             |
| Non-U.S.       | 118                     | 355              | 222             |
| Total current  | <u>7,201</u>            | <u>1,384</u>     | <u>1,408</u>    |
| Deferred:      |                         |                  |                 |
| U.S. federal   | 8,130                   | 11,324           | 8,913           |
| U.S. state     | 1,037                   | 573              | (558)           |
| Non-U.S.       | 112                     | (62)             | 78              |
| Total deferred | <u>9,279</u>            | <u>11,835</u>    | <u>8,433</u>    |
|                | <u>\$ 16,480</u>        | <u>\$ 13,219</u> | <u>\$ 9,841</u> |

Following is a reconciliation of the U.S. statutory federal income tax rate with our effective income tax rate for continuing operations:

|  | Year Ended December 31, |        |        |
|--|-------------------------|--------|--------|
|  | 2016                    | 2015   | 2014   |
| U.S. statutory income tax rate             | 35.0 %                  | 35.0 % | 35.0 % |
| State tax, net of U.S. federal tax benefit | 2.4                     | 2.6    | 2.5    |
| Non-U.S. income taxes                      | 0.3                     | (0.1)  | (0.3)  |
| Nondeductible operating expenses           | 0.3                     | 0.8    | 0.2    |
| Research and development credit            | (1.0)                   | (0.6)  | (2.4)  |
| Change in deferred tax measurement rate    | (0.1)                   | —      | 0.1    |
| Change in uncertain tax positions          | (5.1)                   | 1.1    | 1.5    |
| Change in valuation allowance              | 0.2                     | (5.8)  | (4.1)  |
| Other                                      | (0.1)                   | —      | 0.1    |
| Effective income tax rate                  | 31.9 %                  | 33.0 % | 32.6 % |

### Deferred Income Taxes

Individually significant components of deferred income tax assets and liabilities were as follows (in thousands):

|  | As of December 31, |            |
|--|--------------------|------------|
|  | 2016               | 2015       |
| Deferred income tax assets:                            |                    |            |
| Accrued liabilities                                    | \$ 5,089           | \$ 6,392   |
| Allowance for doubtful accounts                        | 40                 | 467        |
| Inventory valuation                                    | 199                | 818        |
| Capitalized indirect inventory costs                   | 497                | 671        |
| Stock-based compensation expense                       | 1,346              | 693        |
| Deferred rent  | 865                | 869        |
| Accrued royalty  | 429                | —          |
| Net operating loss carryforward                        | 2,377              | 3,361      |
| Basis difference on long-lived assets                  | 1,052              | 1,810      |
| Credit carryforward                                    | 615                | 3,736      |
| Other  | 140                | 171        |
| Gross deferred income tax assets                       | 12,649             | 18,988     |
| Valuation allowance                                    | (886)              | (888)      |
| Deferred income tax assets, net of valuation allowance | 11,763             | 18,100     |
| Deferred income tax liabilities:                       |                    |            |
| Prepaid advertising                                    | (1,302)            | (523)      |
| Other prepaids   | (744)              | (579)      |
| Basis difference on long-lived assets                  | (26,215)           | (26,285)   |
| Undistributed earnings of foreign subsidiaries         | (457)              | (188)      |
| Other  | (25)               | (1)        |
| Deferred income tax liabilities                        | (28,743)           | (27,576)   |
| Net deferred income tax liabilities                    | \$ (16,980)        | \$ (9,476) |



Our net deferred income tax assets (liabilities) were recorded on our consolidated balance sheets as follows (in thousands):

|   | As of December 31, |            |
|---|--------------------|------------|
|   | 2016               | 2015       |
| Deferred income tax assets                | \$ —               | \$ 8,904   |
| Long-term deferred income tax assets      | 11                 | —          |
| Long-term deferred income tax liabilities | (16,991)           | (18,380)   |
| Net deferred income tax liabilities       | \$ (16,980)        | \$ (9,476) |

The table of deferred tax assets and liabilities shown above does not include certain deferred tax assets as of December 31, 2015, that arose directly from tax deductions related to equity compensation greater than compensation recognized for financial reporting. During 2016 however, equity was increased by \$1.9 million as we determined that such deferred tax assets arose directly from tax deductions related to equity compensation can be realized. We use FASB ASC 740 ordering for purposes of determining when excess tax benefits have been realized.

We account for income taxes based on the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. We have recorded a valuation allowance to reduce our deferred income tax assets to the amount we believe is more likely than not to be realized. Evaluating the need for, and amount of, a valuation allowance for deferred tax assets often requires significant judgment and extensive analysis of all available evidence on a jurisdiction-by-jurisdiction basis. Such judgments require us to interpret existing tax law and other published guidance as applied to our circumstances. As part of this assessment, we consider both positive and negative evidence. The weight given to the potential effect of positive and negative evidence must be commensurate with the extent to which the strength of the evidence can be objectively verified.

As of December 31, 2016, we had a valuation allowance against net deferred income tax assets of \$0.9 million. Of the remaining valuation allowance, \$0.6 million primarily relates to domestic state tax credit carryforwards as we currently do not anticipate generating the income of appropriate character to utilize those credits. The remainder of \$0.3 million relates to foreign net operating loss carryforwards. Should it be determined in the future that it is more likely than not that our domestic deferred income tax assets will be realized, an additional valuation allowance would be released during the period in which such an assessment is made. There have been no material changes to our foreign operations since December 31, 2015 and, accordingly, we maintain our existing valuation allowance on foreign deferred income tax assets in such jurisdictions at December 31, 2016.

#### **Income Tax Carryforwards**

As of December 31, 2016, we had the following income tax carryforwards (in millions):

|   | Amount  | Expires in  |
|---|---------|-------------|
| <b>Net operating loss carryforwards</b> |         |             |
| U.S. State                              | \$ 50.9 | 2017 - 2035 |
| China                                   | \$ 0.7  | 2020 - 2021 |
| Italy                                   | \$ 0.5  | 2017        |
| <b>Income tax credit carryforwards</b>  |         |             |
| U.S. State                              | \$ 0.6  | 2018 - 2031 |

The timing and manner in which we are permitted to utilize our net operating loss carryforwards may be limited by Internal Revenue Code Section 382, *Limitation on Net Operating Loss Carry-forwards and Certain Built-in-Losses Following Ownership Change*.

### Unrecognized Tax Benefits

Following is a reconciliation of gross unrecognized tax benefits from uncertain tax positions, excluding the impact of penalties and interest (in thousands):

|   | Year Ended December 31, |                 |                 |
|---|-------------------------|-----------------|-----------------|
|   | 2016                    | 2015            | 2014            |
| <b>Balance, January 1</b>                               | \$ 2,519                | \$ 2,768        | \$ 1,964        |
| Additions for tax positions taken in prior years        | 21                      | 1               | 72              |
| Reductions for tax positions taken in prior years       | (523)                   | (426)           | —               |
| Additions for tax positions related to the current year | 83                      | 43              | 821             |
| Lapses of statutes of limitations                       | (130)                   | —               | (89)            |
| Other   | —                       | 133             | —               |
| <b>Balance, December 31</b>                             | <u>\$ 1,970</u>         | <u>\$ 2,519</u> | <u>\$ 2,768</u> |

Of the \$2.0 million of gross unrecognized tax benefits from uncertain tax positions outstanding as of December 31, 2016, \$1.7 million would affect our effective tax rate if recognized.

We recorded tax-related interest and penalty expense (benefit) of \$(1.9) million, \$0.5 million and \$0.4 million in 2016, 2015 and 2014, respectively. We had a cumulative liability for interest and penalties related to uncertain tax positions as of December 31, 2016 and 2015 of \$0.7 million and \$2.5 million, respectively.

Our U.S. federal income tax returns for 2009 through 2016 are open to review by the U.S. Internal Revenue Service. Our state income tax returns for 2006 through 2016 are open to review, depending on the respective statute of limitation in each state. In addition, we file income tax returns in several non-U.S. jurisdictions with varying statutes of limitation.

As of December 31, 2016, we believe it is reasonably likely that, within the next 12 months, \$0.8 million of the previously unrecognized tax benefits related to certain non-U.S. filing positions will be recognized as we anticipate the deregistration of a certain entity.

### (15) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive income (loss), net of applicable taxes, reported on our consolidated balance sheets consists of unrealized holding gains and losses on available-for-sale securities, effective portions of gains and losses of derivative securities designated as cash flow hedges, and foreign currency translation adjustments. The following table sets forth the changes in accumulated other comprehensive income (loss), net of tax (in thousands) for the periods presented:

|   | Unrealized Gain (Loss) on Available-for-Sale Securities | Loss on Derivative Securities (Effective Portion) | Foreign Currency Translation Adjustments | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|--|---|
| <b>Balance, January 1, 2014</b>   | \$ —  | \$ —  | \$ 244                                   | \$ 244  |
| Current period other comprehensive loss                                   | (18)  | —   | (534)                                    | (552)   |
| <b>Balance, December 31, 2014</b>   | (18)  | —   | (290)                                    | (308)   |
| Current period other comprehensive income (loss)                          | 2   | —   | (1,021)                                  | (1,019)                                       |
| <b>Balance, December 31, 2015</b>   | (16)  | —   | (1,311)                                  | (1,327)                                       |
| Current period other comprehensive income (loss) before reclassifications | 8   | (450)   | 126                                      | (316)   |
| Reclassification of amounts to earnings                                   | —   | 426   | —  | 426   |
| Net other comprehensive income (loss) during period                       | 8   | (24)  | 126                                      | 110   |
| <b>Balance, December 31, 2016</b>   | <u>\$ (8)</u>   | <u>\$ (24)</u>                                    | <u>\$ (1,185)</u>                        | <u>\$ (1,217)</u>                             |

## (16) STOCK-BASED COMPENSATION

### *2015 Long-Term Incentive Plan*

On April 28, 2015, Nautilus shareholders approved our 2015 Long-Term Incentive Plan (the “2015 Plan”), which replaced our 2005 Long-Term Incentive Plan that expired in 2015. The 2015 Plan is administered by the Compensation Committee of the Board of Directors and authorizes us to grant various types of stock-based awards including: stock options, stock appreciation rights, RSAs, RSUs and PSUs. Stock options granted under the 2015 Plan shall not have an exercise price less than the fair market value of our common stock on the date of the grant. The exercise price of a stock option or stock appreciation right may not be reduced without shareholder approval. Stock options generally vest over periods of three or four years of continuous service, commencing on the date of grant. Stock options granted under the 2015 Plan have a seven -year contractual term.

Upon adoption, there were approximately 4.8 million shares available for issuance under the 2015 Plan. The number of shares available for issuance upon adoption of the 2015 Plan included new shares approved plus any shares of common stock which were previously reserved for issuance under our preceding plan, and were not subject to grant as of April 28, 2015 or as to which the stock-based compensation award is forfeited on or after April 28, 2015. The number of shares available for issuance is reduced by (i) two shares for each share delivered in settlement of any stock appreciation rights, for each share of RSA, RSU or PSU award, and (ii) one share for each share delivered in settlement of a stock option award. In no event shall more than 1.0 million aggregate shares of common stock subject to stock options, stock appreciation rights, RSA, RSU or PSU awards be granted to any one participant in any one year under the 2015 Plan. At December 31, 2016, we had 4.4 million shares available for future grant under our 2015 Plan, and a total of 5.2 million shares of our common stock are reserved for future issuance pursuant to the 2015 Plan and our previous plan combined.

### *Stock Option Activity*

Stock option activity was as follows (shares in thousands):

|   | <b>Options<br/>Outstanding</b> | <b>Weighted-<br/>Average<br/>Exercise<br/>Price</b> |
|---|--------------------------------|---|
| <b>Outstanding at December 31, 2015</b> | 520                            | \$ 5.01   |
| Forfeited, canceled or expired          | (8)                            | 9.42  |
| Exercised                               | (79)                           | 4.49  |
| <b>Outstanding at December 31, 2016</b> | <u>433</u>                     | <u>\$ 5.03</u>                                      |

Certain information regarding options outstanding at December 31, 2016 was as follows:

|  | <b>Options<br/>Outstanding</b> | <b>Options<br/>Exercisable</b> | <b>Options Vested<br/>and Expected to<br/>Vest</b> |
|--|--------------------------------|--------------------------------|--|
| Number (in thousands)                                  | 433                            | 373                            | 433  |
| Weighted-average exercise price                        | \$ 5.03                        | \$ 4.27                        | \$ 5.03  |
| Aggregate intrinsic value (in thousands)               | \$ 5,838                       | \$ 5,311                       | \$ 5,838   |
| Weighted average remaining contractual term (in years) | 2.8                            | 2.6                            | 2.8  |

**RSA Activity**

Compensation expense for RSAs is recognized over the estimated vesting period. Following is a summary of RSA activity (shares in thousands):

|   | <b>RSAs Outstanding</b> | <b>Weighted-Average<br/>Grant Date Fair Value<br/>per Share</b> |
|---|-------------------------|---|
| <b>Outstanding at December 31, 2015</b> | 30                      | \$ 15.54  |
| Granted                                 | 14                      | 17.91   |
| <b>Outstanding at December 31, 2016</b> | 44                      | \$ 16.31  |

**RSU Activity**

Compensation expense for RSUs is recognized over the estimated vesting period. Following is a summary of RSU activity (shares in thousands):

|   | <b>RSUs Outstanding</b> | <b>Weighted-Average<br/>Grant Date Fair Value<br/>per Share</b> |
|---|-------------------------|---|
| <b>Outstanding at December 31, 2015</b> | 110                     | \$ 13.73  |
| Granted                                 | 62                      | 18.68   |
| Forfeited, canceled or expired          | (2)                     | 18.07   |
| Vested                                  | (61)                    | 17.68   |
| <b>Outstanding at December 31, 2016</b> | 109                     | \$ 18.17  |

**PSU Activity**

Compensation expense for PSUs is recognized over the estimated requisite service period based on the number of PSUs ultimately expected to vest.

In May 2013, we granted PSU awards to certain of our executive officers covering a total of 24,500 shares of our common stock. The PSUs vest based on achievement of certain operating income and return on asset goals established for a three-year performance period. The number of shares vesting under the PSU awards following conclusion of the performance period will be determined based on the level at which the financial goals are achieved. The number of shares vesting can range from 60% of the PSU awards if minimum thresholds are achieved to a maximum of 150%. These awards vested in full at the 150% maximum achievement, net of forfeitures, for a total of 30,300 shares.

In February 2014, we granted PSU awards to certain of our executive officers covering a total of 82,494 shares of our common stock. The PSUs vest based on achievement of goals established for operating income and revenue growth for a three-year performance period. The number of shares vesting under the PSU awards following conclusion of the performance period will be determined based on the level at which the financial goals are achieved. The number of shares vesting can range from 60% of the PSU awards if minimum thresholds are achieved to a maximum of 150%. These awards are expected to vest in full at the 150% maximum achievement, with the exception of any forfeitures.

In April and September 2015, we granted PSU awards to certain of our executive officers and management team covering a total of 56,820 shares of our common stock. The PSUs vest based on achievement of goals established for certain operating income and return on asset criteria for a three-year performance period. The number of shares vesting under the PSU awards following conclusion of the performance period will be determined based on the level at which the financial goals are achieved. The number of shares vesting can range from 60% of the PSU awards if minimum thresholds are achieved to a maximum of 150%.

In December 2015, we granted PSU awards to a certain executive officer and management team personnel covering a total of 117,230 shares of our common stock. The PSUs vest based on achievement of certain operating income and operating margin goals for a three-year performance period. The number of shares vesting under the PSU awards following conclusion of the performance period will be determined based on the level at which the financial goals are achieved. As of December 31, 2016, 72,234 PSU shares remained, net of actual forfeitures to date.

In February 2016, we granted PSU awards to certain of our executive officers and management team covering a total of 54,818 shares of our common stock. The PSUs vest based on achievement of goals established for growth in operating income as a percentage of net revenue and return on invested capital over a three-year performance period. The number of shares that ultimately vest following conclusion of the performance period will be determined based on the level at which the financial goals are achieved. The number of shares vesting can range from 60% of the PSU awards if minimum thresholds are achieved to a maximum of 150% .

Following is a summary of PSU activity (shares in thousands):

|  | PSUs Outstanding | Weighted-Average Grant Date Fair Value per Share |
|--|------------------|--|
| <b>Outstanding at December 31, 2015</b>    | 277              | \$ 13.67   |
| Granted and additional goal shares awarded | 84               | 16.81  |
| Forfeited, canceled or expired             | (65)             | 16.93  |
| Vested                                     | (32)             | 7.13   |
| <b>Outstanding at December 31, 2016</b>    | <b>264</b>       | <b>\$ 14.66</b>                                  |

### **Stock-Based Compensation**

We receive income tax deductions as a result of the exercise of certain stock options and vesting of RSAs, RSUs and PSUs. Stock-based compensation expense, primarily included in general and administrative expense, was as follows (in thousands):

|               | Year Ended December 31, |                 |                 |
|---------------|-------------------------|-----------------|-----------------|
|               | 2016                    | 2015            | 2014            |
| Stock options | \$ 389                  | \$ 327          | \$ 592          |
| RSAs          | 168                     | —               | —               |
| RSUs          | 734                     | 544             | 121             |
| PSUs          | 1,211                   | 575             | 353             |
| ESPP          | 111                     | 38              | —               |
|               | <b>\$ 2,613</b>         | <b>\$ 1,484</b> | <b>\$ 1,066</b> |

Certain other information regarding our stock-based compensation was as follows (in thousands, except per share amounts):

|   | Year Ended December 31, |         |         |
|---|-------------------------|---------|---------|
|   | 2016                    | 2015    | 2014    |
| Weighted average grant-date per share fair value of stock options granted | \$ —                    | \$ 8.94 | \$ 5.36 |
| Total intrinsic value of stock options exercised                          | 1,221                   | 4,142   | 736     |
| Fair value of RSUs vested   | 311                     | 673     | 872     |
| Fair value of PSUs vested   | 574                     | 1,454   | —       |

As of December 31, 2016 , unrecognized compensation expense for outstanding, but unvested stock-based awards was \$2.7 million , which is expected to be recognized over a weighted average period of 0.3 to 1.4 years.

### **Employee Stock Purchase Plan**

On April 28, 2015, our shareholders approved our Employee Stock Purchase Plan (the “ESPP”). The ESPP is administered by the Compensation Committee of the Board of Directors and provides a means by which eligible employees may be given an opportunity to purchase shares of our common stock at a discount using payroll deductions. The ESPP authorizes the issuance of up to 0.5 million shares of our common stock, subject to adjustment as provided in the ESPP for stock splits, stock dividends, recapitalizations and other similar events.

Pursuant to the ESPP, and subject to certain limitations specified therein, eligible employees may elect to purchase shares of our common stock in one or more of a series of offerings conducted pursuant to the procedures set forth in the ESPP at a purchase price equal to 90% of the lower of the fair market value of the common stock on the first trading day of the offering period or on the last day of the offering period. Offering periods commence on May 15 and November 15 of each year and are six-months in

duration, with the exception of the first offering period in 2015, which was a four-month offering. Purchases under the ESPP may be made exclusively through payroll deductions.

Persons eligible to participate in the ESPP generally include employees who have been employed for at least 12 months prior to the applicable offering date and who, immediately upon purchasing shares under the ESPP, would own directly or indirectly, an aggregate of less than 5% of the total combined voting power or value of all outstanding shares of our common stock.

ESPP activity was as follows (shares in thousands):

|                                     | Shares Available for<br>Issuance | Weighted-<br>Average<br>Purchase Price | Weighted-Average<br>Discount per Share |
|-------------------------------------|----------------------------------|--|--|
| <b>Balance at December 31, 2015</b> | 493                              |  |  |
| Employee shares purchased           | (24)                             | \$ 15.84                               | \$ 1.75                                |
| <b>Balance at December 31, 2016</b> | 469                              |  |  |

Assumptions used in calculating the fair value of stock option grants and employee stock purchases were as follows:

|                         | Year Ended December 31, |      |         |         |
|-------------------------|-------------------------|------|---------|---------|
|                         | 2016                    | 2015 |         | 2014    |
|                         | ESPP                    | ESPP | Options | Options |
| Dividend yield          | —%                      | —%   | —%      | —%      |
| Risk-free interest rate | 0.4%                    | 0.1% | 1.6%    | 1.7%    |
| Expected life (years)   | N/A                     | N/A  | 4.28    | 4.75    |
| Expected volatility     | 56%                     | 43%  | 71%     | 80%     |

*Dividend yield* is based on our current expectation that no dividend payments will be made in future periods.

*Risk-free interest rate* is the U.S. Treasury zero-coupon rate, as of the grant date, for issues having a term approximately equal to the expected life of the stock option. For the ESPP, it is the U.S. Treasury six-month constant maturities rate, as of the offering date.

*Expected life* is the period of time over which stock options are expected to remain outstanding. We calculate expected term based on the average of the sum of the vesting periods and the full contractual term.

*Expected volatility* is the percentage amount by which the price of our common stock is expected to fluctuate annually during the estimated expected life for stock options. Expected price volatility is calculated using historical daily closing prices over a period matching the weighted-average expected life for stock options, as management believes such changes are the best indicator of future volatility. For the ESPP, expected volatility is the percentage amount by which the price of our common stock is expected to fluctuate semi-annually during the offering period.

## (17) STOCK REPURCHASE PROGRAM

On November 3, 2014, our Board of Directors approved a stock repurchase program that authorized us to repurchase up to \$15.0 million of our outstanding common stock from time to time during the ensuing period of 24 months. On May 4, 2016, our Board of Directors approved an expansion of our share repurchase program that authorized us to repurchase up to an additional \$10.0 million of our outstanding common stock from time to time during the period of 24 months following such approval. Repurchases may be made in open market transactions at prevailing market prices, in privately negotiated transactions, or by other means in accordance with federal securities laws. Share repurchases are funded with existing cash balances, and the repurchased shares are retired and returned to unissued authorized shares.

The repurchase program expired on November 3, 2016 as to the original \$15.0 million authorization. The repurchase program expires on May 4, 2018 as to the \$8.0 million available as of December 31, 2016 for repurchases under the \$10.0 million expansion.

Cumulative repurchases to date pursuant to the program are as follows:

| Quarter Ended         | Number of Shares | Repurchased Amount  | Average Price per Share |
|-----------------------|------------------|---------------------|-------------------------|
| March 31, 2015        | 133,877          | \$1,995,982         | \$14.91                 |
| September 30, 2015    | 577,831          | 9,571,545           | 16.56                   |
| December 31, 2016     | 319,805          | 5,390,355           | 16.86                   |
| <b>Totals to Date</b> | <b>1,031,513</b> | <b>\$16,957,882</b> | <b>\$16.44</b>          |

#### (18) INCOME PER SHARE

The weighted average numbers of shares outstanding used to compute income per share amounts were as follows (in thousands):

|  | Year Ended December 31, |        |        |
|--|-------------------------|--------|--------|
|  | 2016                    | 2015   | 2014   |
| Shares used for basic per share calculations           | 31,032                  | 31,288 | 31,253 |
| Dilutive effect of outstanding options, RSUs, and PSUs | 269                     | 301    | 435    |
| Shares used for diluted per share calculations         | 31,301                  | 31,589 | 31,688 |

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

|               | As of December 31, |      |      |
|---------------|--------------------|------|------|
|               | 2016               | 2015 | 2014 |
| Stock options | 8                  | 12   | 225  |

#### (19) 401(k) SAVINGS PLAN

We sponsor a 401(k) savings plan that allows eligible employees to contribute a certain percentage of their salary. Employees are automatically enrolled within the first month of employment and have the ability to opt out. As a safe harbor plan sponsor, we are subject to non-discretionary matching contributions. Currently, we match 100% of the employee's first 1% of eligible pay contributed plus 50% of eligible pay contributed on the next 5% , for a maximum employer matching of 3.5% . Employees vest in the employer matching portions at 25% after the first year of employment, and 100% after two years of employment. Our matching contributions for the savings plan were as follows (in thousands):

|                               | Year ended December 31, |        |        |
|-------------------------------|-------------------------|--------|--------|
|                               | 2016                    | 2015   | 2014   |
| 401(k) matching contributions | \$ 1,014                | \$ 746 | \$ 631 |

#### (20) SEGMENT AND ENTERPRISE-WIDE INFORMATION

In accordance with FASB ASC 280, *Segment Reporting* , Nautilus determined that it has two operating segments as of December 31, 2016 - Direct and Retail.

We evaluate performance using several factors, of which the primary financial measures are net sales and reportable segment contribution. Contribution is the measure of profit or loss, defined as net sales less product costs and directly attributable expenses. Directly attributable expenses include selling and marketing expenses, general and administrative expenses, and research and development expenses that are directly related to segment operations. Segment assets are those directly assigned to an operating segment's operations, primarily accounts receivable, inventories, goodwill and other intangible assets. Unallocated assets primarily include cash and cash equivalents, available-for-sale securities, derivative securities, shared information technology infrastructure, distribution centers, corporate headquarters, prepaids and other current assets, deferred income tax assets and other assets. Capital expenditures directly attributable to the Direct and Retail segments were not significant in any period.

The accounting policies of the reportable segments are the same as the policies described in Note 1, *Significant Accounting Policies* .

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

|  | Year Ended December 31, |                   |                   |
|--|-------------------------|-------------------|-------------------|
|  | 2016                    | 2015              | 2014              |
| <b>Net Sales:</b>  |                         |                   |                   |
| Direct   | \$ 225,057              | \$ 225,595        | \$ 175,593        |
| Retail   | 177,920                 | 106,195           | 93,223            |
| Unallocated royalty  | 3,062                   | 3,974             | 5,631             |
| Consolidated net sales   | <u>\$ 406,039</u>       | <u>\$ 335,764</u> | <u>\$ 274,447</u> |
| <b>Contribution:</b>   |                         |                   |                   |
| Direct   | \$ 43,215               | \$ 39,940         | \$ 29,345         |
| Retail   | 29,451                  | 12,850            | 13,279            |
| Unallocated royalty  | 3,018                   | 3,974             | 5,631             |
| Consolidated contribution  | <u>\$ 75,684</u>        | <u>\$ 56,764</u>  | <u>\$ 48,255</u>  |
| <b>Reconciliation of consolidated contribution to income from continuing operations:</b> |                         |                   |                   |
| Consolidated contribution  | \$ 75,684               | \$ 56,764         | \$ 48,255         |
| Amounts not directly related to segments:  |                         |                   |                   |
| Operating expenses   | (22,290)                | (16,493)          | (18,101)          |
| Other income (expense), net  | (1,813)                 | (249)             | 70                |
| Income tax expense   | 16,480                  | 13,219            | 9,841             |
| Income from continuing operations  | <u>\$ 35,101</u>        | <u>\$ 26,803</u>  | <u>\$ 20,383</u>  |
| <b>Depreciation and amortization expense:</b>  |                         |                   |                   |
| Direct   | \$ 1,944                | \$ 868            | \$ 1,913          |
| Retail   | 4,775                   | 757               | 643               |
| Unallocated corporate  | 1,155                   | 1,787             | 1,468             |
| Total depreciation and amortization expense  | <u>\$ 7,874</u>         | <u>\$ 3,412</u>   | <u>\$ 4,024</u>   |

|                       | As of December 31, |                   |
|-----------------------|--------------------|-------------------|
|                       | 2016               | 2015              |
| <b>Assets:</b>        |                    |                   |
| Direct                | \$ 37,388          | \$ 35,356         |
| Retail                | 206,580            | 202,696           |
| Unallocated corporate | 89,098             | 77,860            |
| Total assets          | <u>\$ 333,066</u>  | <u>\$ 315,912</u> |

Net sales by geographic area were as follows:

|           | Year Ended December 31, |                   |                   |
|-----------|-------------------------|-------------------|-------------------|
|           | 2016                    | 2015              | 2014              |
| U.S.      | \$ 353,893              | \$ 295,366        | \$ 231,230        |
| Canada    | 26,005                  | 33,230            | 35,367            |
| All other | 26,141                  | 7,168             | 7,850             |
|           | <u>\$ 406,039</u>       | <u>\$ 335,764</u> | <u>\$ 274,447</u> |

There are no material long-lived assets held outside of the U.S.

In 2016 , 2015 and 2014 , Amazon.com accounted for 11.3% , 11.1% and 11.3% , respectively, of our net sales.



## (21) COMMITMENTS AND CONTINGENCIES

### *Operating Leases*

We lease property and equipment under non-cancellable operating leases which, in the aggregate, extend through 2025. Many of these leases contain renewal options and provide for rent escalations and payment of real estate taxes, maintenance, insurance and certain other operating expenses of the properties. Rent expense under all operating leases was as follows (in thousands):

|              | Year Ended December 31, |          |          |
|--------------|-------------------------|----------|----------|
|              | 2016                    | 2015     | 2014     |
| Rent expense | \$ 6,561                | \$ 5,033 | \$ 3,625 |

As of December 31, 2016 , future minimum lease payments under non-cancellable leases, reduced for sublease income, were as follows (in thousands):

|            |                  |
|------------|------------------|
| 2017       | \$ 4,608         |
| 2018       | 4,973            |
| 2019       | 4,995            |
| 2020       | 4,978            |
| 2021       | 4,015            |
| Thereafter | 7,051            |
|            | <u>\$ 30,620</u> |

### *Guarantees, Commitments and Off-Balance Sheet Arrangements*

As of December 31, 2016 , we had approximately \$0.5 million in letters of credit with certain vendors with expiration dates through April 2017 .

We have long lead times for inventory purchases and, therefore, must secure factory capacity from our vendors in advance. As of December 31, 2016 , we had approximately \$17.6 million in non-cancelable market-based purchase obligations, primarily for inventory purchases expected to be received within the next twelve months. Purchase obligations can vary from quarter-to-quarter and versus the same period in prior years due to a number of factors, including the amount of products that are shipped directly to Retail customer warehouses versus through Nautilus warehouses.

In the ordinary course of business, we enter into agreements that require us to indemnify counterparties against third-party claims. These may include: agreements with vendors and suppliers, under which we may indemnify them against claims arising from use of their products or services; agreements with customers, under which we may indemnify them against claims arising from their use or sale of our products; real estate and equipment leases, under which we may indemnify lessors against third-party claims relating to the use of their property; agreements with licensees or licensors, under which we may indemnify the licensee or licensor against claims arising from their use of our intellectual property or our use of their intellectual property; and agreements with parties to debt arrangements, under which we may indemnify them against claims relating to their participation in the transactions.

The nature and terms of these indemnification obligations vary from contract to contract, and generally a maximum obligation is not stated within the agreements. We hold insurance policies that mitigate potential losses arising from certain types of indemnification obligations. Management does not deem these obligations to be significant to our financial position, results of operations or cash flows and, therefore, no related liabilities were recorded as of December 31, 2016 .

### *Legal Matters*

In 2004, we were sued in the Southern District of New York by BioSig Instruments, Inc. for alleged patent infringement in connection with our incorporation of heart rate monitors into certain cardio products. No significant activity in the litigation occurred until 2008. In 2012, the U.S. District Court granted summary judgment to us on grounds that BioSig's patents were invalid as a matter of law. BioSig appealed the grant of summary judgment and, in April 2013, the U.S. Court of Appeals for the Federal Circuit reversed the District Court's decision on summary judgment and remanded the case to the District Court for further proceedings. On January 10, 2014, the U. S. Supreme Court granted our petition for a writ of certiorari to address the legal standard applied by the Federal Circuit in determining whether the patents may be valid under applicable law. The case was argued before the Supreme Court on April 28, 2014. By decision dated June 2, 2014, the Supreme Court unanimously reversed the Federal Circuit, holding that its standard of when a patent may be "indefinite" was incorrect and remanding to the Federal Circuit for reconsideration under the correct standard. The remand hearing in the Federal Circuit was held on October 29, 2014. By decision dated April 27, 2015, the same panel of the Federal Circuit affirmed its earlier reversal of the District Court's decision on summary

judgment. On May 27, 2015, we filed a petition for a rehearing en banc in the Federal Circuit, which was denied on August 4, 2015 and a Petition for Review by the U. S. Supreme Court which was also denied. The case has been returned to the District Court, and the parties are currently engaged in discovery and other pre-trial motion practice. We do not believe that our use of heart rate monitors utilized or purchased from third parties, and otherwise, infringes the BioSig patents.

In addition to the matter described above, from time to time, we may be involved in various claims, lawsuits and other proceedings. These legal and tax proceedings involve uncertainty as to the eventual outcomes and losses which may be realized when one or more future events occur or fail to occur.

Litigation and jury verdicts are, to some degree, inherently unpredictable, and although we have determined that a loss is not probable in connection with any current legal proceeding, it is reasonably possible that a loss may be incurred in connection with proceedings to which we are a party. Assessment of whether incurrence of a loss is probable, or a reasonable possibility, in connection with a particular proceeding, and estimation of the loss, or a range of loss, involves complex judgments and numerous uncertainties. Management is unable to estimate a range of reasonably possible losses related to litigation in which the damages sought are indeterminate, or the legal and factual basis for the relevant claims have not been developed with specificity. As such, zero liability is recorded as of December 31, 2016 .

We regularly monitor our estimated exposure to these contingencies and, as additional information becomes known, may change our estimates accordingly. We evaluate, on a quarterly basis, developments in legal proceedings, investigations or claims that could affect the amount of any accrual, as well as any developments that would make a loss probable or reasonably possible, and whether the amount of a probable or reasonably possible loss is estimable. Among other factors, we evaluate the advice of internal and external counsel, the outcomes from similar litigation, current status of the lawsuits (including settlement initiatives), legislative developments and other factors. Due to the numerous variables associated with these judgments and assumptions, both the precision and reliability of the resulting estimates of the related loss contingencies are subject to substantial uncertainties.

**(22) SUPPLEMENTARY INFORMATION - QUARTERLY RESULTS OF OPERATIONS (unaudited)**

The following table summarizes our unaudited quarterly financial data for 2016 and 2015 (in thousands, except per share amounts):

|  | Quarter Ended |           |              |             | Total      |
|--|---------------|-----------|--------------|-------------|------------|
|  | March 31      | June 30   | September 30 | December 31 |            |
| <b>2016</b>                                |               |           |              |             |            |
| Net sales                                  | \$ 120,928    | \$ 78,529 | \$ 80,818    | \$ 125,764  | \$ 406,039 |
| Gross profit                               | 66,344        | 41,862    | 39,217       | 64,102      | 211,525    |
| Operating income                           | 19,300        | 6,573     | 8,211        | 19,310      | 53,394     |
| Income from continuing operations          | 11,586        | 3,696     | 7,845        | 11,974      | 35,101     |
| Loss from discontinued operations          | (142)         | (166)     | (251)        | (364)       | (923)      |
| Net income <sup>(1)</sup>                  | 11,444        | 3,530     | 7,594        | 11,610      | 34,178     |
| Net income per share:                      |               |           |              |             |            |
| Basic                                      | \$ 0.37       | \$ 0.11   | \$ 0.24      | \$ 0.38     | \$ 1.10    |
| Diluted                                    | 0.37          | 0.11      | 0.24         | 0.37        | 1.09       |
| <b>2015</b>                                |               |           |              |             |            |
| Net sales                                  | \$ 96,239     | \$ 59,695 | \$ 70,690    | \$ 109,140  | \$ 335,764 |
| Gross profit                               | 53,889        | 30,656    | 36,209       | 52,480      | 173,234    |
| Operating income                           | 17,605        | 3,932     | 6,389        | 12,345      | 40,271     |
| Income from continuing operations          | 10,859        | 2,219     | 3,873        | 9,852       | 26,803     |
| Income (loss) from discontinued operations | (127)         | 205       | (145)        | (134)       | (201)      |
| Net income <sup>(2),(3)</sup>              | 10,732        | 2,424     | 3,728        | 9,718       | 26,602     |
| Net income per share:                      |               |           |              |             |            |
| Basic                                      | \$ 0.34       | \$ 0.08   | \$ 0.12      | \$ 0.31     | \$ 0.85    |
| Diluted                                    | 0.34          | 0.08      | 0.12         | 0.31        | 0.84       |

<sup>(1)</sup> Net income for the quarter ended September 30, 2016 included a non-recurring tax benefit of \$2.7 million related to the release of previously unrecognized tax benefits associated with certain non-U.S. filing positions, which resulted from completing the deregistration of a certain foreign entity.

<sup>(2)</sup> Net income for the quarter ended December 31, 2015 included a \$2.4 million credit related to the reversal of a portion of our deferred tax asset valuation allowance.

<sup>(3)</sup> Net income for the quarter ended December 31, 2015 also included \$4.5 million of unusual items including the following: settlement expense related to a licensing arbitration; write-off of nutrition inventory; unrecorded current period royalty revenue and reversal of prior period royalty revenue related to a dispute with the licensee; an accounts receivable reserve related to potentially uncollectible balances from a large sporting goods retailer; and transaction expenses related to the acquisition of Octane.

## **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

### **Item 9A. Controls and Procedures**

#### ***Disclosure Controls and Procedures***

As of December 31, 2016, we conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended (“Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of December 31, 2016 that our disclosure controls and procedures were effective.

#### ***Management’s Report On Internal Control Over Financial Reporting***

Management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Rule 13a-15(f) under the Exchange Act. This rule defines internal control over financial reporting as a process designed by, or under the supervision of, our Principal Executive Officer and Principal Financial Officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP. Our internal control over financial reporting includes those policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

#### ***Management’s Assessment***

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our internal control over financial reporting based on the criteria established in *Internal Control - Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment, management concluded that our internal control over financial reporting was effective as of December 31, 2016.

Our independent registered public accounting firm has issued an attestation report on the effectiveness of our internal control over financial reporting as of December 31, 2016, which is included herein.

#### ***Changes In Internal Control Over Financial Reporting***

There were no changes in our internal control over financial reporting that occurred during the three-month period ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of  
Nautilus, Inc.  
Vancouver, Washington

We have audited the internal control over financial reporting of Nautilus, Inc. and subsidiaries (the "Company") as of December 31, 2016, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2016 of the Company and our report dated February 27, 2017 expressed an unqualified opinion on those consolidated financial statements.

/s/ Deloitte & Touche LLP

Portland, Oregon  
February 27, 2017

## Item 9B. Other Information

None.

## PART III

### Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item will be set forth under the captions *Election of Directors*, *Section 16(a) Beneficial Ownership Reporting Compliance*, *Executive Officers*, *Information Concerning the Board of Directors* and *Code of Ethics* in our Proxy Statement for our 2017 Annual Meeting of Shareholders to be filed with the SEC by May 1, 2017 (the "2017 Proxy Statement"). If the 2017 Proxy Statement is not filed with the SEC by May 1, 2017, such information will be included in an amendment to this Annual Report on Form 10-K filed by May 1, 2017.

### Item 11. Executive Compensation

The information required by this item will be set forth under the captions *Executive Compensation* and *Director Compensation* in our 2017 Proxy Statement. If the 2017 Proxy Statement is not filed with the SEC by May 1, 2017, such information will be included in an amendment to this Annual Report on Form 10-K filed by May 1, 2017.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

#### *Equity Compensation Plan Information*

The following table provides information about our equity compensation plan as of December 31, 2016 (shares in thousands):

| <u>Plan Category</u>                                       | <u>Number of securities to be issued upon exercise of outstanding options, warrants and rights <sup>(1),(2),(3)</sup></u><br>(a) | <u>Weighted average exercise price of outstanding options, warrants and rights <sup>(4)</sup></u><br>(b) | <u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</u><br>(c) |
|--|--|--|---|
| Equity compensation plans approved by security holders     | 697  | \$ 5.03  | 4,364   |
| Equity compensation plans not approved by security holders | —  | —  | —   |
| Total  | 697  | \$ 5.03  | 4,364   |

(1) Includes 192 PSU awards granted to certain executive officers and management team. The awards vest based on service requirements along with achievement of certain financial goals established for a three-year performance period, and can range from 60% of the PSU awards if minimum thresholds are achieved to a maximum of 150%. Of the 192 PSU shares, 82 are calculated at 150% of the target award while the remaining 110 are calculated at 100% of target.

(2) Includes 72 PSU awards granted to certain management personnel pursuant to the acquisition of Octane (see Note 2 of Notes to Consolidated Financial Statements). The awards vest based on service requirements along with achievement of certain financial goals established for a three-year performance period. The 72 PSU shares are currently calculated at 0% of the target award, and plans to modify or cancel and replace the existing awards are being considered by our Board of Directors.

(3) Excludes 153 RSA and RSU awards outstanding at December 31, 2016, of which 44 RSA shares are subject to vesting and release, and 109 RSU shares are subject to forfeiture.

(4) Weighted average exercise price shown in column (b) does not take into account the PSU awards included in column (a) of the table.

For further information regarding our equity compensation plan, refer to Note 16, *Stock-Based Compensation*, to our consolidated financial statements in Part II, Item 8 of this report.

#### *Beneficial Ownership*

The information required by this item is included under the caption *Security Ownership of Certain Beneficial Owners and Management* in our 2017 Proxy Statement. If the 2017 Proxy Statement is not filed with the SEC by May 1, 2017, such information will be included in an amendment to this Annual Report on Form 10-K filed by May 1, 2017.

### Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is included under the caption *Information Concerning the Board of Directors* in our 2017 Proxy Statement. If the 2017 Proxy Statement is not filed with the SEC by May 1, 2017, such information will be included in an amendment to this Annual Report on Form 10-K filed by May 1, 2017.

### Item 14. Principal Accounting Fees and Services

The information required by this item is included under the caption *Ratification of Appointment of Independent Registered Public Accounting Firm for 2017* in our 2017 Proxy Statement. If the 2017 Proxy Statement is not filed with the SEC by May 1, 2017, such information will be included in an amendment to this Annual Report on Form 10-K filed by May 1, 2017.

## PART IV

### Item 15. Exhibits and Financial Statement Schedules

#### *Financial Statements and Schedules*

The consolidated financial statements, together with the report thereon of Deloitte & Touche LLP, are included on the pages indicated below:

|  | <u>Page</u>        |
|--|--------------------|
| Report of Independent Registered Public Accounting Firm  | <a href="#">30</a> |
| Consolidated Balance Sheets as of December 31, 2016 and 2015   | <a href="#">31</a> |
| Consolidated Statements of Operations for the years ended December 31, 2016, 2015 and 2014           | <a href="#">32</a> |
| Consolidated Statements of Comprehensive Income for the years ended December 31, 2016, 2015 and 2014 | <a href="#">33</a> |
| Consolidated Statements of Shareholders' Equity for the years ended December 31, 2016, 2015 and 2014 | <a href="#">34</a> |
| Consolidated Statements of Cash Flows for the years ended December 31, 2016, 2015 and 2014           | <a href="#">35</a> |
| Notes to Consolidated Financial Statements   | <a href="#">36</a> |

Financial statement schedules have been omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

#### *Exhibits*

The following exhibits are filed herewith and this list is intended to constitute the exhibit index.

| <u>Exhibit No.</u> | <u>Description</u>   |
|--------------------|--|
| 3.1                | Amended and Restated Articles of Incorporation - Incorporated by reference to Exhibit A to Schedule 14A, as filed with the Commission on April 22, 2008.   |
| 3.2                | Amended and Restated Bylaws - Incorporated by reference to Exhibit 3.1 of our Current Report on Form 8-K, as filed with the Commission on April 5, 2005.   |
| 3.3                | Amendment to Amended and Restated Bylaws of the Company - Incorporated by reference to Exhibit 3.1 of our Current Report on Form 8-K, as filed with the Commission on January 31, 2007.  |
| 10.1*              | Company 2005 Long-Term Incentive Plan - Incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K, as filed with the Commission on June 10, 2005.  |
| 10.2*              | First Amendment to Company 2005 Long-Term Incentive Plan - Incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q for the three months ended September 30, 2006, as filed with the Commission on November 9, 2006. |
| 10.3*              | Form of Nonstatutory Stock Option Agreement - Incorporated by reference to Exhibit 10 of our Current Report on Form 8-K, as filed with the Commission on July 29, 2005.  |
| 10.4*              | Form of Non-Employee Director Nonstatutory Stock Option Agreement - Incorporated by reference to Exhibit 10 of our Current Report on Form 8-K, as filed with the Commission on August 19, 2005.  |
| 10.5*              | Form of Performance Unit Agreement - Incorporated by reference to Exhibit 10.3 to our Quarterly Report on Form 10-Q for the three months ended June 30, 2006, as filed with the Commission on August 9, 2006.                              |

| Exhibit No. | Description  |
|-------------|--|
| 10.6        | Trademark License Agreement, dated September 20, 2001, by and between Pacific Direct, LLC and Nautilus, Inc. - Incorporated by reference to Exhibit 2.1 of our Quarterly Report on Form 10-Q for the three months ended September 30, 2001, as filed with the Commission on November 14, 2001.   |
| 10.7        | License Agreement dated as of December 29, 2009 between Nautilus, Inc. and Fit Dragon International, Inc. - Incorporated by reference to Exhibit 10.24 of our Form 10-K for the fiscal year ended December 31, 2009 as filed with the Commission on March 8, 2010.   |
| 10.8        | Technology Transfer and License Agreement dated as of December 29, 2009 between Nautilus, Inc. and Fit Dragon International, Inc. - Incorporated by reference to Exhibit 10.26 of our Form 10-K for the fiscal year ended December 31, 2009 as filed with the Commission on March 8, 2010.   |
| 10.9        | Private Label Consumer Credit Card Program Agreement, dated June 15, 2010, by and between Nautilus, Inc. and GE Money Bank - Incorporated by reference to Exhibit 10.1 of our Form 10-Q for the three months ended June 30, 2010 as filed with the Commission on August 16, 2010. [Confidential treatment has been granted with respect to a portion of this Exhibit]          |
| 10.10       | HELPCard Merchant Agreement, dated June 14, 2010, effective as of June 11, 2010, by and between Nautilus, Inc. and Dent-A-Med, Inc. - Incorporated by reference to Exhibit 10.2 of our Form 10-Q for the three months ended June 30, 2010 as filed with the Commission on August 16, 2010. [Confidential treatment has been granted with respect to a portion of this Exhibit] |
| 10.11       | First Amendment dated November 6, 2010 to Private Label Consumer Credit Card Program Agreement, dated June 15, 2010, by and between the Company and GE Money Bank - Incorporated by reference to Exhibit 10.27 of our Form 10-K for the fiscal year ended December 31, 2012 as filed with the Commission on March 7, 2013.   |
| 10.12       | Merchant Agreement dated December 15, 2010, between the Company and Hy Cite Corporation - Incorporated by reference to Exhibit 10.28 of our Form 10-K for the fiscal year ended December 31, 2012 as filed with the Commission on March 7, 2013. [Confidential treatment has been granted with respect to a portion of this Exhibit]   |
| 10.13*      | Executive Employment Agreement, dated September 21, 2007, between the Company and Wayne M. Bolio - Incorporated by reference to Exhibit 10.33 of our Form 10-K for the fiscal year ended December 31, 2010 as filed with the Commission on March 8, 2011.  |
| 10.14*      | Severance and Employment Agreement, dated April 23, 2012, between the Company and Robert O. Murdock - Incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K as filed with the Commission on March 20, 2013.  |
| 10.15*      | Severance and Employment Agreement, dated March 30, 2011, between the Company and William B. McMahon - Incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K as filed with the Commission on March 31, 2011.   |
| 10.16       | Office Lease Agreement dated as of July 25, 2011, by and between Nautilus, Inc. and Columbia Tech Center, L.L.C. - Incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K as filed with the Commission on July 29, 2011.  |
| 10.17*      | Executive Employment Agreement dated as of May 30, 2011, between Nautilus, Inc. and Bruce M. Cazenave - Incorporated by reference to Exhibit 10.1 of our Form 10-Q for the three months ended June 30, 2011 as filed with the Commission on August 11, 2011.   |
| 10.18*      | Form of Restricted Stock Unit Agreement - Incorporated by reference to Exhibit 10.2 of our Form 10-Q for the three months ended June 30, 2011 as filed with the Commission on August 11, 2011.   |
| 10.19*      | Form of Restricted Stock Unit Agreement - Incorporated by reference to Exhibit 10.3 of our Form 10-Q for the three months ended June 30, 2011 as filed with the Commission on August 11, 2011.   |
| 10.20*      | Form of Non-Employee Director Nonstatutory Stock Option Agreement - Incorporated by reference to Exhibit 10.2 of our Form 10-Q for the three months ended March 31, 2012 as filed with the Commission on May 9, 2012.  |
| 10.21       | Program Agreement between Nautilus, Inc. and Genesis Bankcard Services, Inc. - Incorporated by reference to Exhibit 10.1 of our Form 10-Q for the three months ended June 30, 2013 as filed with the Commission on August 8, 2013. [Confidential Treatment has been granted with respect to portions of this exhibit]  |
| 10.22*      | Form of Non-Employee Director Restricted Stock Unit Award Agreement - Incorporated by reference to Exhibit 10.2 of our Form 10-Q for the three months ended June 30, 2013 as filed with the Commission on August 8, 2013.  |



| Exhibit No. | Description   |
|-------------|---|
| 10.23*      | Executive Employment Agreement dated as of February 10, 2014, by and between Nautilus, Inc. and Sidharth Nayar - Incorporated by reference to Exhibit 10.1 of our Form 10-Q for the three months ended March 31, 2014 as filed with the Commission on May 8, 2014.  |
| 10.24*      | Stock Unit Award Agreement dated as of February 28, 2014, by and between Nautilus, Inc. and Sidharth Nayar - Incorporated by reference to Exhibit 10.2 of our Form 10-Q for the three months ended March 31, 2014 as filed with the Commission on May 8, 2014.  |
| 10.25*      | Offer Letter, dated July 26, 2013, between the Company and Jeffery Collins - Incorporated by reference to Exhibit 10.3 of our Form 10-Q for the three months ended March 31, 2014 as filed with the Commission on May 8, 2014.  |
| 10.26       | First Lease Modification Agreement, dated as of June 19, 2014, to the Office Lease by and between Nautilus, Inc. and Columbia Tech Ceter, L.L.C. dated July 25, 2011 - Incorporated by reference to Exhibit 10.1 of our Form 10-Q for the three months ended June 30, 2014 as filed with the Commission on August 7, 2014.  |
| 10.27       | Credit Agreement dated December 5, 2014 between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.1 of our Form 8-K dated December 5, 2014 as filed with the Commission on December 8, 2014.   |
| 10.28       | Continuing Security Agreement dated December 5, 2014 between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.2 of our Form 8-K dated December 5, 2014 as filed with the Commission on December 8, 2014.  |
| 10.29       | Line of Credit Note dated December 5, 2014 between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.3 of our Form 8-K dated December 5, 2014 as filed with the Commission on December 8, 2014.  |
| 10.30       | Consent and Amendment to Loan Documents dated December 31, 2015 between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.30 of our Form 10-K for the year ended December 31, 2015 as filed with the Commission on February 25, 2016.  |
| 10.31       | Term Note dated December 31, 2015 between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.31 of our Form 10-K for the year ended December 31, 2015 as filed with the Commission on February 25, 2016.  |
| 10.32*      | Nautilus, Inc. 2015 Long-Term Incentive Plan - Incorporated by reference to Exhibit 10.1 of our Form 8-K dated April 28, 2015 as filed with the Commission on May 4, 2015.  |
| 10.33       | Nautilus, Inc. Employee Stock Purchase Plan - Incorporated by reference to Exhibit 10.2 of our Form 8-K dated April 28, 2015 as filed with the Commission on May 4, 2015.   |
| 10.34*      | Employment Agreement dated December 28, 2016, by and between Nautilus, Inc. and Brian Pope  |
| 10.35*      | Employment Agreement dated January 1, 2017, by and between Nautilus, Inc. and Ryan Simat  |
| 21          | Subsidiaries of the Company.  |
| 23          | Consent of Independent Registered Public Accounting Firm.   |
| 31.1        | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.   |
| 31.2        | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.   |
| 32.1        | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 101         | The following financial statements from Nautilus, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2016, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Shareholders' Equity, (v) Consolidated Statements of Cash Flows, and (vi) Notes to Consolidated Financial Statements. |

\* Indicates management contract, compensatory agreement or arrangement, in which our directors or executive officers may participate.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

NAUTILUS, INC.  
(Registrant)

February 27, 2017  
\_\_\_\_\_

Date

By: \_\_\_\_\_ /s/ Bruce M. Cazenave

**Bruce M. Cazenave**  
Chief Executive Officer  
(Principal Executive Officer)

NAUTILUS, INC.  
(Registrant)

February 27, 2017  
\_\_\_\_\_

Date

By: \_\_\_\_\_ /s/ Sidharth Nayar

**Sidharth Nayar**  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

**POWER OF ATTORNEY**

Each person whose individual signature appears below hereby authorizes and appoints Bruce M. Cazenave, Sidharth Nayar and Wayne M. Bolio, and each of them, with full power of substitution and resubstitution and full power to act without the other, as his true and lawful attorney-in-fact and agent to act in his name, place and stead and to execute in the name and on behalf of each person, individually and in each capacity stated below, and to file any and all amendments to this report, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing, ratifying and confirming all that said attorneys-in-fact and agents or any of them or their or his substitute or substitutes may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 27, 2017 .

(Remainder of page is blank.)

| <u>Signature</u>   | <u>Title</u>  |
|--|---|
| /s/ Bruce M. Cazenave<br>_____<br><b>Bruce M. Cazenave</b>                           | Chief Executive Officer<br>(Principal Executive Officer)                |
| /s/ Sidharth Nayar<br>_____<br><b>Sidharth Nayar</b>                                 | Chief Financial Officer<br>(Principal Financial and Accounting Officer) |
| *<br>_____<br><b>M. Carl Johnson, III</b>  | Chairman  |
| *<br>_____<br><b>Ronald P. Badie</b>   | Director  |
| *<br>_____<br><b>Richard A. Horn</b>   | Director  |
| *<br>_____<br><b>Anne G. Saunders</b>  | Director  |
| *<br>_____<br><b>Marvin G. Siegert</b>   | Director  |
| *By: /s/ Wayne M. Bolio<br>_____<br><b>Wayne M. Bolio</b><br><i>Attorney-In-Fact</i> | February 27, 2017   |

## EMPLOYMENT AGREEMENT

This Employment Agreement (this "Agreement") is entered into as of December 28, 2016, by and between Nautilus Inc., a Washington corporation (the "Company" or "Employer"), and Brian Pope ("Employee"). In consideration of the premises and the mutual covenants and agreements hereinafter set forth, the Company and Employee hereby agree as follows:

**1. Employment.** Employee is being hired the position of Vice President/General Manager, Direct effective December 28, 2016. Employee shall (a) devote his professional entire time, attention, and energies to his position, (b) use his best efforts to promote the interests of Employer; (c) perform faithfully and efficiently his responsibilities and duties, and (d) refrain from any endeavor outside of employment which interferes with his ability to perform his obligations hereunder. Employee shall report to the Chief Operating Officer, and perform his job duties subject to his general supervision, orders, advice and direction. Employee shall perform the duties normally associated with the position and/or such duties as delegated and assigned by the Company.

Employee additionally agrees to abide by any pre-employment hiring procedures, general employment guidelines or policies adopted by Employer such as those detailed in an employer's handbook, as such guidelines or policies may be implemented and/or amended from time to time.

**2. Salary.** As compensation for services to be rendered hereunder, the Company shall pay Employee an initial annual salary in the gross amount of Two hundred forty thousand dollars (\$240,000). Said salary will be paid in accordance with the Company's existing payroll policies, and shall be subject to normal and/or authorized deductions and withholdings. Employee will be eligible to receive an annual bonus targeted at fifty-percent (50%) of Employee's base salary earned in the applicable year in accordance with the Short Term Incentive Plan. The amount of such bonus (if any) is determined at the discretion of the Company and the Board of Directors based on the accomplishment of corporate and individual performance goals. In addition, you will be provided a one-time signing bonus of \$20,000 upon the beginning of employment. The bonus will vest in 1/12 increments beginning in your first month of employment and over the next 12 months. Should you resign from the Company or be terminated for cause before 12 months of employment you agree to re-pay a pro rata amount of that bonus for any remaining time that you are not employed.

**3. Restricted Share Units and Stock Options.** Pursuant to the Company's current 2015 Long Term Incentive Plan (the "Plan"), Employee will receive an initial grant of 10,000 Restricted Stock Units. The terms of the option grant shall be governed by the Plan and a Stock Grant Agreement (the "Grant Agreement"). Employee will be eligible for additional annual grants on the same basis as other members of the executive team.

**4. Expenses.** The Company will reimburse Employee for all necessary and reasonable travel, entertainment and other business expenses incurred by him in the performance of his duties hereunder, upon receipt of signed itemized lists of such expenditures with appropriate back-up documentation, and/or in accordance with such other reasonable procedures as the Company may adopt generally from time to time.



5. **Health and Welfare Benefits.** Upon satisfaction of eligibility criteria, the Employee shall be eligible to receive employee benefits, if any, generally provided to its employees by Employer, including, if provided, medical, dental, and life insurance and Paid-Time Off. Such benefits may be amended or discontinued by Employer at any time. Employee shall also be entitled to four (4) weeks of Paid Time Off in accordance with the Company's policies.

6. **Termination.** The parties acknowledge that Employee's employment with the Company is "at-will" and may be terminated by either party with or without cause. No one other than the President and Chief Executive Officer of the Company or the Board of Directors has the power to change the at-will character of the employment relationship. As discussed below, however, the various possible ways in which Employee's employment with the Company may be terminated will determine the payments that may be due to Employee under this Agreement. As used in this Agreement, the following terms have the following meanings:

(a) **Cause.** As used in this Agreement, Cause means (i) Employee's indictment or conviction in a court of law for any crime or offense that in Employer's reasonable judgment makes Employee unfit for continued employment, prevents Employee from performing Employee's duties or other obligations or adversely affects the reputation of Employer; (ii) dishonesty by Employee related to his employment; (iii) violation of a key Employer policy or this Agreement by Employee (including, but not limited to, acts of harassment or discrimination, use of unlawful drugs or drunkenness on Employer's premises during normal work hours); (iv) insubordination (i.e. conduct such as refusal to follow direct orders of the President or other individuals(s) to whom Employee reports); (v) dereliction of duty by Employee (e.g., failure to perform minimum duties after warning and reasonable opportunity to correct); (vi) Employee's competition with Employer, diversion of any corporate opportunity or other similarly serious conflict of interest or self-dealing incurring to Employee's direct or indirect benefit and Employer's detriment; (vii) intentional or grossly negligent conduct by Employee that is significantly injurious to Employer or its affiliates; (viii) Employee's failure to meet the minimum goals of his position if such are provided in writing to Employee, and as such goals may be amended from time to time; and (ix) Employee's death or disability (i.e., Employee's inability to perform the essential job functions of the position with or without a reasonable accommodation).

(b) **At-Will.** At-will termination shall mean a termination by the Company where it does not seek to establish Cause or by Employee for any reason. If Employee exercises his right to terminate his employment, the Employee agrees to provide the Company with 21 days' prior written notice of the termination of his employment (Notice of Termination). After receiving such Notice from the Employee, the Company retains the right to accept Employee's resignation, and hence, terminate the employment relationship without the need for further payments, at an earlier date than provided in the Employee's Notice of Termination.

7. **Severance Upon Termination.** (a) Upon termination of Employee's employment under this Agreement by the Company without Cause, then, in lieu of any further salary, bonus, or other payments for periods subsequent to the Date of Termination, the Company shall pay to the Employee severance equal to four months average monthly annual base salary at the rate then in

effect<sup>1</sup>. Such severance payment shall be made according to the Company's normal payroll process spread out equally over the severance period. Company will also continue, at its cost, the Company portion of the current medical and dental coverage elected by Employee as of the date of termination for the duration of the severance period. Employee will be required to timely sign up and elect COBRA benefits in order to be eligible for continued coverage under this Agreement and to pay any employee portion of the coverage. Violation of this Agreement or the Business Protection Agreement and/or failure to sign the Release and Waiver Agreement shall immediately relieve the Company from its payment obligation under this paragraph and entitle it to recover any amounts paid under this paragraph. This Section 7 shall be read in conjunction with Section 6, and entitles the Employee to a maximum of four *months'* salary and benefits under this Agreement.

(b) If the Company terminates the Employee's employment during the term of this Agreement for Cause or if the Employee terminates her employment for any reason, then the Company shall have no further payment obligations to Employee.

(c) Except as it relates to the receipt of severance (which shall be solely granted under the terms of this Agreement), this Agreement shall not affect any payments due to Employee under applicable law as a result of the termination of his employment (such as payment of earned wages).

(d) The severance amounts in Section 7(a) will immediately cease in the event that Employee becomes employed at any time during the severance period at a monthly base salary rate equal to or greater than the monthly base salary rate paid by the Company as of the date of termination. In the event the Employee is employed during that severance period at a monthly base salary rate less than the monthly base salary rate previously paid by the Company, Employee will be provided a maximum severance benefit in the amount of the difference between the 4 months average monthly annual base salary paid by the Company and the 4 months average monthly annual base salary paid, or to be paid, by the subsequent Employer over the severance period. In either event continued health care benefits will cease if Employee accepts employment during the severance period following termination with Company. Following termination by the Company and during the severance period, Employee will exercise reasonable efforts to seek, obtain, and accept comparable employment.

**8. Relocation Assistance.** You will be provided a one-time payment of \$35,000 as well as the movement of your household goods paid by Nautilus up to a maximum of billed amount of \$25,000. In addition, the Company will provide temporary lodging for up to 60 days after you begin employment as well as two house hunting trips for you and your family.

**9. Return of Documents.** Employee understands and agrees that all equipment, records, files, manuals, forms, materials, supplies, computer programs, and other materials furnished to the Employee by Employer or used on Employer's behalf, or generated or obtained during the course of his/her employment shall remain the property of Employer. Upon termination of this employment or at any other time upon the Company's request, Employee agrees to return all

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<sup>1</sup> The average annual monthly base salary shall be calculated using the average of the cash compensation received by Employee in the twelve months prior to the Date of Termination.



documents and property belonging to the Company in his possession including, but not limited to, customer lists, contracts, agreements, licenses, business plans, equipment, software, software programs, products, work-in-progress, source code, object code, computer disks, Confidential Information, books, notes and all copies thereof, whether in written, electronic or other form. In addition, Employee shall certify to the Company in writing as of the effective date of termination that none of the assets or business records belonging to the Company is in his/her possession, remain under his control, or have been transferred to any third person.

**10. Confidential Information/Non-Competition.** By virtue of his employment, Employee will have access to confidential, proprietary and trade secret information, the ownership and protection of which is very important to the Company. Employee hereby agrees to enter into a Business Protection Agreement with the Company concurrent with his entry into this Agreement.

**11. Release of Claims.** As a precondition to receipt of the severance provided in Section 8 of this Agreement, Employee acknowledges and understands that he must sign a Waiver and Release of Claims Agreement. Such Agreement shall be substantially similar to the Agreement attached as Exhibit A. Employee understands that he will not be entitled to receive any payments under this Agreement until he executes and delivers the Waiver and Release of Claims Agreement, and the revocation period set forth in the Waiver and Release of Claims Agreement has run.

**12. Assignment.** This Agreement is personal, and is being entered into based upon the singular skill, qualifications and experience of Employee. Employee shall not assign this Agreement or any rights hereunder without the express written consent of Employer which may be withheld with or without reason. This Agreement will bind and benefit any successor of the Employer, whether by merger, sale of assets, reorganization or other form of business acquisition, disposition or business reorganization.

**13. Notices.** Any Notice of Termination or notice of good reason shall be in writing and shall be deemed to have been given or submitted (i) upon actual receipt if delivered in person or by facsimile transmission with confirmation of transmission, (ii) upon the earlier of actual receipt or the expiration of two (2) business days after sending by express courier (such as U.P.S. or Federal Express), and (iii) upon the earlier of actual receipt or the expiration of seven (7) business days after mailing if sent by registered or certified mail, postage prepaid, to the parties at the following addresses:

To the Company:

Nautilus, Inc.  
17750 SE 6<sup>th</sup> Way  
Vancouver, WA 98683  
Attention: Senior Vice President Law and  
Human Resources

With a Copy to:

Garvey, Schubert & Barer  
1191 Second Avenue, 18<sup>th</sup> Floor  
Seattle, WA 98101-2939  
Attention: Peter Cancelmo

To Employee:

Employee: Brian Pope

At the last address and fax number  
Shown on the records of the Company

Employee shall be responsible for providing the Company with a current address. Either party may change its address (and facsimile number) for purposes of notices under this Agreement by providing notice to the other party in the manner set forth above within ten business days.

14. **Effect of Waiver.** The waiver by either party of a breach of any provision of this Agreement shall not operate or be construed as a waiver of any subsequent breach hereof. No waiver shall be valid unless in writing.

15. **Entire Agreement.** This Agreement, along with the Business Protection Agreement, sets forth the entire agreement of the parties hereto and supersedes any and all prior agreements and understandings concerning Employee's employment by the Company. This Agreement may be changed only by a written document signed by Employee and the Company.

16. **Employment Guidelines.** Employee understands that while not constituting a contract, the Employer sets certain policies and standards that it expects employees to comply with as part of general expectations of employee behavior. Employee agrees to abide by any general employment guidelines or policies adopted by the Company such as those detailed in an employee handbook, as such guidelines may be implemented and amended from time to time.


17. **Governing Law/Jurisdiction/Venue.** This Agreement shall be governed by, and construed and enforced in accordance with, the substantive and procedural laws of the State of Washington without regard to rules governing conflicts of law. For all disputes under this Agreement, the parties agree that any suit or action between them shall be instituted and commenced exclusively in the state courts in Clark County or King County Washington (U.S.A) or the United States District Court for the Western District of Washington, sitting in Seattle, Washington. Both parties waive the right to change such venue and hereby consent to the jurisdiction of such courts for all potential claims under this Agreement.

18. **Acknowledgment.** The Employee acknowledges that he has read and understands this Agreement, that he has had the opportunity to consult with an attorney regarding the terms and conditions hereof, and that he accepts and signs this Agreement as his own free act and in full and complete understanding of its present and future legal effect.



IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first written above.

Employer: NAUTILUS, INC.

By   
Its CEO

2/14/17  
Date

  
Employee

2/13/17  
Date



## EMPLOYMENT AGREEMENT

This Employment Agreement (this "Agreement") is entered into as of January 1, 2017, by and between Nautilus Inc., a Washington corporation (the "Company" or "Employer"), and Ryan Simat ("Employee"). In consideration of the premises and the mutual covenants and agreements hereinafter set forth, the Company and Employee hereby agree as follows:

1. **Employment.** Employee is being hired the position of Vice President/General Manager, Commercial and Specialty effective January 1, 2017. Employee shall (a) devote his professional entire time, attention, and energies to his position, (b) use his best efforts to promote the interests of Employer; (c) perform faithfully and efficiently his responsibilities and duties, and (d) refrain from any endeavor outside of employment which interferes with his ability to perform his obligations hereunder. Employee shall report to the Chief Operating Officer, and perform his job duties subject to his general supervision, orders, advice and direction. Employee shall perform the duties normally associated with the position and/or such duties as delegated and assigned by the Company.

Employee additionally agrees to abide by any pre-employment hiring procedures, general employment guidelines or policies adopted by Employer such as those detailed in an employer's handbook, as such guidelines or policies may be implemented and/or amended from time to time.

2. **Salary.** As compensation for services to be rendered hereunder, the Company shall pay Employee an initial annual salary in the gross amount of Two hundred fifteen thousand dollars (\$215,000). Said salary will be paid in accordance with the Company's existing payroll policies, and shall be subject to normal and/or authorized deductions and withholdings. Employee will be eligible to receive an annual bonus targeted at fifty-percent (50%) of Employee's base salary earned in the applicable year in accordance with the Short Term Incentive Plan. The amount of such bonus (if any) is determined at the discretion of the Company and the Board of Directors based on the accomplishment of corporate and individual performance goals.

3. **Restricted Share Units and Stock Options.** Pursuant to the Company's current 2015 Long Term Incentive Plan (the "Plan"), Employee will receive an initial grant of 5,000 Restricted Stock Units. The terms of the option grant shall be governed by the Plan and a Stock Grant Agreement (the "Grant Agreement"). Employee will be eligible for additional annual grants on the same basis as other members of the executive team.

5. **Expenses.** The Company will reimburse Employee for all necessary and reasonable travel, entertainment and other business expenses incurred by him in the performance of his duties hereunder, upon receipt of signed itemized lists of such expenditures with appropriate back-up documentation, and/or in accordance with such other reasonable procedures as the Company may adopt generally from time to time.

6. **Health and Welfare Benefits.** Upon satisfaction of eligibility criteria, the Employee shall be eligible to receive employee benefits, if any, generally provided to its employees by Employer, including, if provided, medical, dental, and life insurance and Paid-Time Off. Such benefits may be amended or discontinued by Employer at any time. Employee shall also be entitled to five (5) weeks of Paid Time Off in accordance with the Company's policies.

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7. **Termination.** The parties acknowledge that Employee's employment with the Company is "at-will" and may be terminated by either party with or without cause. No one other than the President and Chief Executive Officer of the Company or the Board of Directors has the power to change the at-will character of the employment relationship. As discussed below, however, the various possible ways in which Employee's employment with the Company may be terminated will determine the payments that may be due to Employee under this Agreement. As used in this Agreement, the following terms have the following meanings:

(a) **Cause.** As used in this Agreement, Cause means (i) Employee's indictment or conviction in a court of law for any crime or offense that in Employer's reasonable judgment makes Employee unfit for continued employment, prevents Employee from performing Employee's duties or other obligations or adversely affects the reputation of Employer; (ii) dishonesty by Employee related to his employment; (iii) violation of a key Employer policy or this Agreement by Employee (including, but not limited to, acts of harassment or discrimination, use of unlawful drugs or drunkenness on Employer's premises during normal work hours); (iv) insubordination (i.e. conduct such as refusal to follow direct orders of the President or other individuals(s) to whom Employee reports); (v) dereliction of duty by Employee (e.g., failure to perform minimum duties after warning and reasonable opportunity to correct); (vi) Employee's competition with Employer, diversion of any corporate opportunity or other similarly serious conflict of interest or self-dealing incurring to Employee's direct or indirect benefit and Employer's detriment; (vii) intentional or grossly negligent conduct by Employee that is significantly injurious to Employer or its affiliates; (viii) Employee's failure to meet the minimum goals of his position if such are provided in writing to Employee, and as such goals may be amended from time to time; and (ix) Employee's death or disability (i.e., Employee's inability to perform the essential job functions of the position with or without a reasonable accommodation).

(b) **At-Will.** At-will termination shall mean a termination by the Company where it does not seek to establish Cause or by Employee for any reason. If Employee exercises his right to terminate his employment, the Employee agrees to provide the Company with 21 days' prior written notice of the termination of his employment (Notice of Termination). After receiving such Notice from the Employee, the Company retains the right to accept Employee's resignation, and hence, terminate the employment relationship without the need for further payments, at an earlier date than provided in the Employee's Notice of Termination.

8. **Severance Upon Termination.**

(a) Upon termination of Employee's employment under this Agreement by the Company without Cause, then, in lieu of any further salary, bonus, or other payments for periods subsequent to the Date of Termination, the Company shall pay to the Employee severance equal to four months average monthly annual base salary at the rate then in effect<sup>1</sup>. Such severance payment shall be made according to the Company's normal payroll process spread out equally over the severance period. Company will also continue, at its cost, the Company portion of the

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<sup>1</sup> The average annual monthly base salary shall be calculated using the average of the cash compensation received by Employee in the twelve months prior to the Date of Termination.

current medical and dental coverage elected by Employee as of the date of termination for the duration of the severance period. Employee will be required to timely sign up and elect COBRA benefits in order to be eligible for continued coverage under this Agreement and to pay any employee portion of the coverage. Violation of this Agreement or the Business Protection Agreement and/or failure to sign the Release and Waiver Agreement shall immediately relieve the Company from its payment obligation under this paragraph and entitle it to recover any amounts paid under this paragraph. This Section 8 shall be read in conjunction with Section 7, and entitles the Employee to a maximum of four months salary and benefits under this Agreement.

(b) If the Company terminates the Employee's employment during the term of this Agreement for Cause or if the Employee terminates her employment for any reason, then the Company shall have no further payment obligations to Employee.

(c) Except as it relates to the receipt of severance (which shall be solely granted under the terms of this Agreement), this Agreement shall not affect any payments due to Employee under applicable law as a result of the termination of his employment (such as payment of earned wages).

(d) The severance amounts in Section 8(a) will immediately cease in the event that Employee becomes employed at any time during the severance period at a monthly base salary rate equal to or greater than the monthly base salary rate paid by the Company as of the date of termination. In the event the Employee is employed during that severance period at a monthly base salary rate less than the monthly base salary rate previously paid by the Company, Employee will be provided a maximum severance benefit in the amount of the difference between the 4 months average monthly annual base salary paid by the Company and the 4 months average monthly annual base salary paid, or to be paid, by the subsequent Employer over the severance period. In either event continued health care benefits will cease if Employee accepts employment during the severance period following termination with Company. Following termination by the Company and during the severance period, Employee will exercise reasonable efforts to seek, obtain, and accept comparable employment.

**9. Return of Documents.** Employee understands and agrees that all equipment, records, files, manuals, forms, materials, supplies, computer programs, and other materials furnished to the Employee by Employer or used on Employer's behalf, or generated or obtained during the course of his/her employment shall remain the property of Employer. Upon termination of this employment or at any other time upon the Company's request, Employee agrees to return all documents and property belonging to the Company in his possession including, but not limited to, customer lists, contracts, agreements, licenses, business plans, equipment, software, software programs, products, work-in-progress, source code, object code, computer disks, Confidential Information, books, notes and all copies thereof, whether in written, electronic or other form. In addition, Employee shall certify to the Company in writing as of the effective date of termination that none of the assets or business records belonging to the Company is in his/her possession, remain under his control, or have been transferred to any third person.

**10. Confidential Information/Non-Competition.** By virtue of his employment, Employee will have access to confidential, proprietary and trade secret information, the ownership and

protection of which is very important to the Company. Employee hereby agrees to enter into a Business Protection Agreement with the Company concurrent with his entry into this Agreement.

11. **Release of Claims.** As a precondition to receipt of the severance provided in Section 8 of this Agreement, Employee acknowledges and understands that he must sign a Waiver and Release of Claims Agreement. Such Agreement shall be substantially similar to the Agreement attached as Exhibit A. Employee understands that he will not be entitled to receive any payments under this Agreement until he executes and delivers the Waiver and Release of Claims Agreement, and the revocation period set forth in the Waiver and Release of Claims Agreement has run.

12. **Assignment.** This Agreement is personal, and is being entered into based upon the singular skill, qualifications and experience of Employee. Employee shall not assign this Agreement or any rights hereunder without the express written consent of Employer which may be withheld with or without reason. This Agreement will bind and benefit any successor of the Employer, whether by merger, sale of assets, reorganization or other form of business acquisition, disposition or business reorganization.

13. **Notices.** Any Notice of Termination or notice of good reason shall be in writing and shall be deemed to have been given or submitted (i) upon actual receipt if delivered in person or by facsimile transmission with confirmation of transmission, (ii) upon the earlier of actual receipt or the expiration of two (2) business days after sending by express courier (such as U.P.S. or Federal Express), and (iii) upon the earlier of actual receipt or the expiration of seven (7) business days after mailing if sent by registered or certified mail, postage prepaid, to the parties at the following addresses:

To the Company:

Nautilus, Inc.  
17750 SE 6<sup>th</sup> Way  
Vancouver, WA 98683  
Attention: Senior Vice President Law and  
Human Resources

With a Copy to:

Garvey, Schubert & Barer  
1191 Second Avenue, 18<sup>th</sup> Floor  
Seattle, WA 98101-2939  
Attention: Peter Cancelmo

To Employee:

Employee: Ryan Simat

At the last address and fax number  
Shown on the records of the Company

Employee shall be responsible for providing the Company with a current address. Either party may change its address (and facsimile number) for purposes of notices under this Agreement by providing notice to the other party in the manner set forth above within ten business days.

**14. Effect of Waiver.** The waiver by either party of a breach of any provision of this Agreement shall not operate or be construed as a waiver of any subsequent breach hereof. No waiver shall be valid unless in writing.

**15. Entire Agreement.** This Agreement, along with the Business Protection Agreement, sets forth the entire agreement of the parties hereto and supersedes any and all prior agreements and understandings concerning Employee's employment by the Company. This Agreement may be changed only by a written document signed by Employee and the Company.

**16. Employment Guidelines.** Employee understands that while not constituting a contract, the Employer sets certain policies and standards that it expects employees to comply with as part of general expectations of employee behavior. Employee agrees to abide by any general employment guidelines or policies adopted by the Company such as those detailed in an employee handbook, as such guidelines may be implemented and amended from time to time.

**17. Governing Law/Jurisdiction/Venue.** This Agreement shall be governed by, and construed and enforced in accordance with, the substantive and procedural laws of the State of Washington without regard to rules governing conflicts of law. For all disputes under this Agreement, the parties agree that any suit or action between them shall be instituted and commenced exclusively in the state courts in Clark County or King County Washington (U.S.A) or the United States District Court for the Western District of Washington, sitting in Seattle, Washington. Both parties waive the right to change such venue and hereby consent to the jurisdiction of such courts for all potential claims under this Agreement.

**18. Acknowledgment.** The Employee acknowledges that he has read and understands this Agreement, that he has had the opportunity to consult with an attorney regarding the terms and conditions hereof, and that he accepts and signs this Agreement as his own free act and in full and complete understanding of its present and future legal effect.



IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first written above.

Employer: NAUTILUS, INC.

By   
Its 

2/14/17  
Date

  
Employee

2/13/2017  
Date





**SUBSIDIARIES OF NAUTILUS, INC.**

Nautilus, Inc., a Washington corporation

Nautilus Fitness Canada, Inc., a Canadian corporation

Nautilus (Shanghai) Fitness Co., Ltd., a Chinese corporation

Nautilus (Shanghai) Fitness Equipments Co., Ltd., a Chinese corporation

OF Holdings, Inc., a Delaware corporation

Octane Fitness, LLC, a Minnesota limited liability company

US Octane Fitness Limited, a Hong Kong corporation

Octane Fitness International, B.V., a Netherlands corporation

Octane Fitness UK Ltd, a United Kingdom corporation

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statements No. 333-204455, 333-126054, 333-79643 and 333-46936 on Form S-8 of our reports dated February 27, 2017 , relating to the consolidated financial statements of Nautilus, Inc., and the effectiveness of Nautilus, Inc.'s internal control over financial reporting, appearing in this Annual Report on Form 10-K of Nautilus, Inc. for the year ended December 31, 2016 .

*/s/ Deloitte & Touche LLP*

Portland, Oregon

February 27, 2017



**CERTIFICATION**

I, Sidharth Nayar, certify that:

1. I have reviewed this annual report on Form 10-K of Nautilus, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 27, 2017

Date

By: /s/ Sidharth Nayar

Sidharth Nayar  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

**Certification  
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  
(Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), the undersigned officers of Nautilus, Inc., a Washington corporation (the "Company"), do hereby certify that:

To our knowledge, the Annual Report on Form 10-K for the year ended December 31, 2016 (the "Form 10-K") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

February 27, 2017  
Date

By: /s/ **Bruce M. Cazenave**  
Bruce M. Cazenave  
Chief Executive Officer  
(Principal Executive Officer)

February 27, 2017  
Date

By: /s/ **Sidharth Nayar**  
Sidharth Nayar  
Chief Financial Officer  
(Principal Financial and Accounting Officer)