NAUTILUS, INC.
Form 10-K
February 26, 2015

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2014

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	94-3002667
(State or other jurisdiction of incorporation or organization)	(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:

Title of each class	Name of each exchange on which registered
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 [x]

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 [x]

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 [x] 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 [x] 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. [x]
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 [x] 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 [x]
The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the last sales price ($11.09) 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, 2014) was $346,878,044.
The number of shares outstanding of the registrant's common stock as of February 25, 2015 was 31,365,817 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 2015 Annual Meeting of Shareholders.

NAUTILUS, INC.
2014 FORM 10-K ANNUAL REPORT

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; maintenance of appropriate inventory levels; growth in revenues and profits; leverage of operating expenses; future revenues from our licensing initiative; results of increased media investment in the Direct segment; continued improvement in operating margins; expectations for increased Research and Development expenses; the amount expected to be spent on software and equipment in 2015; 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. 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 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 United States 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®, Bowflex®, Schwinn® and Universal®.

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 United States and internationally. We also derive a portion of our revenue from the licensing of our brands and intellectual property.

Beginning in 2009, we began the divestiture of our Commercial business, which focused on the sale of commercial fitness equipment into gyms, health clubs, and fitness centers. That process was largely completed in 2011, and we reached substantial completion of asset liquidation at December 31, 2012. Results of operations from the Commercial business are presented as Discontinued Operations for all periods. There was no revenue related to the Commercial business for the years ended December 31, 2014, 2013 or 2012.

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 exclusively on consumer markets and 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 products at key price-points; 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.

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, strength and nutrition fitness products that cover a broad range of price points and features. Our products are designed for home use 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 TreadClimber® and Max Trainer® specialized cardio machines, PowerRod® and Revolution® home gyms and SelectTech® dumbbells, and nutrition supplements including Bowflex Body™.
- Our Schwinn® brand is known for its popular line of exercise bikes, including the Airdyne®, 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.

While we offer our full product assortment to our Direct customers through our Internet websites and our catalogs, we generally differentiate the product models offered in our Direct and Retail sales channels. Currently, our Bowflex TreadClimber® and Max Trainer® product lines are offered for sale primarily through our Direct sales channel.

Approximately 79% of our revenue in 2014 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 16, Segment and Geographic 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 United States, our advertising emphasis has shifted toward cardio products, especially the Bowflex TreadClimber® and Bowflex Max Trainer®, as cardio products represent the largest component of the fitness equipment market and a growing part of our business. Sales of cardio products represented 91% of our Direct channel revenues in 2014, compared to 84% in 2013 and 81% in 2012.

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 41% in 2014 from 36% in 2013 and 32% in 2012.

Retail

In our Retail business, we market and sell a comprehensive line of consumer fitness equipment under the Nautilus®, Schwinn®, Universal® and Bowflex® brands. Our products are marketed through a network of retail companies, consisting of sporting goods stores, Internet retailers, large-format and warehouse stores, and, to a lesser extent, smaller specialty retailers and independent bike dealers.

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 $7.2 million, $5.6 million and $4.2 million in 2014, 2013 and 2012, respectively, as we increased our investment in new product development resources and capabilities. We expect our research and development expenses to increase in 2015 as we continue to increase our investment in new product development.

SEASONALITY

We expect our sales 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, during the spring and summer months, consumers tend to be involved in outdoor activities, 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 2014, all of our manufacturing partners were located in Asia. Although multiple factories bid on and are able to produce most of our products, we typically select one factory to produce 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 Portland, Oregon, Obetz, Ohio, and Winnipeg, Manitoba. 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 2014 approximately 54% 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. 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 and American Telecast. We also compete with marketers of computer-based physical activity products, such as the Nintendo Wii® and Microsoft Xbox® Kinect®, and weight management companies, such as Weight Watchers, each of which offers alternative solutions for a fit and healthy lifestyle.

EMPLOYEES

As of February 25, 2015, we had approximately 340 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®, Bowflex®, PowerRod®, Bowflex Revolution®, TreadClimber®, Bowflex Max Trainer®, SelectTech®, Trimline®, Airdyne®, Bowflex Boost®, Bowflex Body™ and Universal®.

Nautilus is the exclusive licensee under the Schwinn® 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, and exercise bikes. Nautilus is also the licensee of patents that cover the Bowflex Revolution® home gyms. 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.

Additionally, we maintain a portfolio of patents related to our TreadClimber® specialized cardio machines, which are sold primarily in our Direct segment. The portfolio includes approximately 24 issued U.S. patents covering various product features and other technologies associated with our TreadClimber® products.

A patent covering certain aspects of our TreadClimber® products expired in 2013. Additional individual patents covering elements of our TreadClimber® products have expiration dates ranging from 2021 to 2031. Expiration or invalidity of patents within our TreadClimber® portfolio could trigger the introduction of similar products by our competitors. Although we view each of the patents within our portfolio as very valuable, we do not view any single patent as critical to our success or ability to differentiate our TreadClimber® 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 vigorously and take prompt, reasonable actions to prevent counterfeit or products and other infringement on our intellectual property.

BACKLOG

We define our customer order backlog to include firm orders for future shipment to our Retail customers, whether or not subject to cancellation, as well as unfulfilled consumer orders within the Direct segment. In our past reports we calculated our customer order backlog to include only sales of backordered products that were not expected to be available for shipment within typical delivery timeframes.

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, 2014 and 2013 was approximately $21.1 million and $11.1 million, respectively. The increase in the overall backlog as of December 31, 2014 resulted from delays in receipt of merchandise due to the west coast port slow down.

SIGNIFICANT CUSTOMERS

In 2014, 2013 and 2012, Amazon.com accounted for 11.3%, 11.2% and 11.7%, 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 United States, 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 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.

Intense competition or loss of one or more of our large Retail customers could negatively impact our sales and operating results.

Our products are sold in highly competitive markets with limited barriers to entry. As a result, introduction by competitors of lower-priced or more innovative products could result in a significant decline in our revenues and have a material adverse effect on our operating results, financial position and cash flows.

Additionally, we derive a significant portion of our revenue from a small number of Retail customers. 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 flow.

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

Sales of cardio products, especially Bowflex TreadClimber® and Bowflex Max Trainer® products, represent a substantial portion of our Direct segment revenues. 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 sales 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 likely would 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 sales 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.

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, 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. If we are unable to successfully adapt our media strategies to new television viewing and media consumption habits, 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.

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 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.

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

All of our products are produced by third-party manufacturers, substantially all of which are located in Asia, primarily China. 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 sales 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.

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 countries in which our products are produced or sold may adjust or impose new quotas, duties, tariffs or other restrictions. Further, 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 at various ports create significant risks for our business, particularly if these disputes result in work slowdowns, lockouts, strikes or other disruptions 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 the Chinese Renminbi exchange rate 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. Currency rate fluctuations could make our products more expensive for foreign consumers and reduce our sales, 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.

A patent covering aspects of our TreadClimber® products expired during 2013. Although we own a number of other patents covering aspects of our TreadClimber® products, the introduction of comparable products designed to compete with our TreadClimber® line of specialized cardio machines may increase in the future as a result of these patent expirations. Sales of cardio products, including Bowflex TreadClimber® 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 sales 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 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 of breach of license. 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 also 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 $2.5 million and other intangible assets of $10.6 million as of December 31, 2014. 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 limited 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 affect 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 sales, 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, 2014:

Location	Primary Function(s)	Owned or

		Leased
Washington	Corporate headquarters, customer call center and R&D facility	Leased
Oregon	Warehouse and distribution	Leased
Ohio	Warehouse and distribution	Leased
Canada	Warehouse and distribution	Leased
China	Quality assurance office	Leased

Our properties are used by both our Direct and Retail segments. 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

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 United States 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 United States 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, and no decision has yet been issued. We do not believe that our use of heart rate monitors utilized or purchased from third parties, and otherwise, infringe the BioSig patents.

In August 2014, we initiated an arbitration proceeding under a 1999 license agreement pursuant to which we had licensed certain rights relating to our TreadClimber® products. We believe that our obligation to pay royalties under the license agreement ceased in the fourth quarter of 2013. The licensor disputes this and issued a notice under the contract claiming breach of the license agreement and asserting various remedies. We are seeking a declaratory ruling in the arbitration that we have performed all our obligations under the license agreement, and that there is no continuing obligation to pay royalties. The licensor has asserted various counterclaims in the arbitration, including contract and intellectual property claims, and asserted various remedies, including termination of the license agreement. The Company has replied to the counterclaim, denying the allegations and demanded remedies and asserting defenses. The arbitration is being administered by the American Arbitration Association (AAA) and is in its preliminary stages. An arbitrator has been selected, however, a stay of the arbitration proceedings has been issued.

In addition to the matters described above, from time to time we are subject to litigation, claims and assessments that arise in the ordinary course of business, including disputes that may arise from intellectual property related matters. Management believes that any liability resulting from such additional matters will not have a material adverse effect on our financial position, results of operations or cash flows.

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 25, 2015, there were 49 holders of record of our common stock and approximately 7,000 beneficial shareholders. The following table sets forth the high and low sales prices of our common stock for each period presented:

	High	Low
2014:		
Quarter 1	$9.66	$7.71
Quarter 2	$11.99	$7.94
Quarter 3	$13.31	$9.75
Quarter 4	$15.48	$10.72
2013:		
Quarter 1	$7.66	$3.48
Quarter 2	$8.75	$6.34
Quarter 3	$9.87	$6.15
Quarter 4	$8.49	$6.76

We did not pay any dividends on our common stock in 2014 or 2013, 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, 2014:

Period	(a) Total Number of Shares (or Units) Purchased [1]	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs [2]	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs [2]
October 1 to October 31, 2014	2,307	$13.38	—	$—
November 1 to November 30, 2014	4,467	$12.83	—	$15,000,000
December 1 to December 31, 2014	4,467	$15.18	—	$15,000,000
Total	11,241	$13.88	—	$15,000,000

(1) Consists of shares withheld from the vesting portion of a restricted stock unit award granted to Bruce M. Cazenave, our Chief Executive Officer. We will withhold from each monthly vesting portion of the award the number of shares sufficient to satisfy Mr. Cazenave's tax withholding obligation incident to such vesting, unless Mr. Cazenave should first elect to satisfy the tax obligation by cash payment to us.

(2) On November 3, 2014, our Board of Directors approved a stock repurchase program that authorizes us to repurchase up to $15 million of our outstanding common stock from time to time over a period of 24 months. The repurchase program expires November 3, 2016. To date, no shares have been repurchased pursuant to the program.

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 Growth index for the period commencing December 31, 2009 and ending on December 31, 2014. The S&P SmallCap 600 Growth 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 Growth represents a broad-based index of companies with similar market capitalization.

The graph assumes $100 was invested, on December 31, 2009, 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 2014, 2013 and 2012, and the selected consolidated balance sheets data as of December 31, 2014 and 2013 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 2011 and 2010 and the consolidated balance sheets data as of December 31, 2012, 2011 and 2010 are derived from audited consolidated financial statements which are not included in this Form 10-K.

	For the Year Ended December 31,				
(In thousands, except per share amounts)	2014	2013	2012	2011	2010
Consolidated Statements of Operations Data					
Net sales	$274,447	$218,803	$193,926	$180,412	$168,450
Cost of sales	133,872	112,326	102,889	101,953	91,704
Gross profit	140,575	106,477	91,037	78,459	76,746
Operating expenses:					
Selling and marketing	81,059	66,486	58,617	54,494	64,039
General and administrative	22,131	18,705	17,669	17,143	19,371
Research and development	7,231	5,562	4,163	3,223	2,905
Total operating expenses	110,421	90,753	80,449	74,860	86,315
Operating income (loss)	30,154	15,724	10,588	3,599	(9,569)
Other income (expense):					
Interest income	63	14	18	65	15
Interest expense	(25)	(36)	56	(466)	(140)
Other	32	337	(246)	(11)	464
Total other income (expense)	70	315	(172)	(412)	339
Income (loss) from continuing operations before income taxes	30,224	16,039	10,416	3,187	(9,230)
Income tax provision (benefit)[1]	9,841	(32,085)	(226)	686	588
Income (loss) from continuing operations	20,383	48,124	10,642	2,501	(9,818)
Income (loss) from discontinued operations	(1,588)	(170)	6,241	(1,081)	(13,023)
Net income (loss)	$18,795	$47,954	$16,883	$1,420	$(22,841)
Basic income (loss) per share from continuing operations	$0.65	$1.55	$0.34	$0.08	$(0.32)
Basic income (loss) per share from discontinued operations	(0.05)	(0.01)	0.21	(0.03)	(0.42)
Basic net income (loss) per share	$0.60	$1.54	$0.55	$0.05	$(0.74)
Diluted income (loss) per share from continuing operations	$0.64	$1.53	$0.34	$0.08	$(0.32)
Diluted income (loss) per share from discontinued operations	(0.05)	(0.01)	0.21	(0.03)	(0.42)
Diluted net income (loss) per share	$0.59	$1.52	$0.55	$0.05	$(0.74)

Shares used in per share calculations:					
Basic	31,253	31,072	30,851	30,746	30,744
Diluted	31,688	31,457	30,974	30,776	30,744

	As of December 31,				
Consolidated Balance Sheets Data	2014	2013	2012	2011	2010
Cash and investments	$72,190	$40,979	$23,207	$17,427	$14,296
Working capital	83,080	45,662	25,410	19,439	15,316
Total assets	175,654	143,567	94,311	82,813	78,367
Long-term notes payable	—	—	—	5,598	5,141
Other long-term liabilities	4,911	4,077	6,508	6,614	6,148
Total shareholders' equity	111,072	91,565	43,326	31,953	30,799

(1) Income tax benefit in 2013 includes a $38.9 million credit related to the reversal of our deferred tax asset valuation allowance.

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 United States 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 United States and Canada. Our products are sold under some of the most-recognized brand names in the fitness industry: Nautilus®, Bowflex®, Schwinn® and Universal®.

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 United States and internationally. We also derive a portion of our revenue from the licensing of our brands and intellectual property.

Our Net Sales in 2014 were $274.4 million, an increase of $55.6 million, or 25.4%, compared to Net Sales of $218.8 million in 2013. Net Sales of our Direct segment increased $38.9 million, or 28.5%, compared to 2013, primarily due to increased consumer demand for our cardio products, especially the Bowflex Max Trainer®. Net Sales of our Retail segment increased by $16.4 million, or 21.4% in 2014, compared to 2013, primarily due to growth in recently launched cardio products.

Income from Continuing Operations was $20.4 million, or $0.64 per diluted share, in 2014, compared to $48.1 million, or $1.53 per diluted share, in 2013. Income from Continuing Operations in 2014 and 2013 included a $1.2 million and a $38.9 million credit related to the reversal of our deferred tax asset valuation allowance, respectively. Without consideration of the reversal of our deferred tax asset valuation allowance, the improvement in our results from continuing operations in 2014, compared to 2013, was driven primarily by higher sales and increased operating income in both our Direct and Retail segments.

Net Income was $18.8 million, or $0.59 per diluted share, in 2014, compared to $48.0 million, or $1.52 per diluted share, in 2013. Net Income in 2014 and 2013 included a $1.2 million and a $38.9 million credit related to the reversal of our deferred tax asset valuation allowance, respectively.

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. Income from Discontinued Operations of $6.2 million in 2012 primarily represents a currency translation adjustment gain related to the liquidation of European subsidiaries. Although there was no revenue related to the Commercial business in 2014, 2013 or 2012, 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.

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.

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 inventory 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. Finite-lived intangible assets, including patents and patent rights, and 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

2014, 2013 or 2012.

Our impairment loss calculations 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 business segments. 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 limited 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, for example, in the second quarter of 2013, we concluded that a majority of the existing valuation allowance on our domestic deferred income tax assets was no longer required. Further, in the fourth quarter of 2014, after re-evaluating the potential realization of the remainder of our deferred income tax assets, we concluded that, as of December 31, 2014, 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.

As of December 31, 2014, we have a valuation allowance against net deferred income tax assets of $6.2 million. If our assumptions change and we determine we will be able to realize these 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 was 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,			
	2014	2013	Change	% Change
Net sales	$274,447	$218,803	$55,644	25.4 %
Cost of sales	133,872	112,326	21,546	19.2 %
Gross profit	140,575	106,477	34,098	32.0 %
Operating expenses:				
Selling and marketing	81,059	66,486	14,573	21.9 %
General and administrative	22,131	18,705	3,426	18.3 %
Research and development	7,231	5,562	1,669	30.0 %
Total operating expenses	110,421	90,753	19,668	21.7 %
Operating income	30,154	15,724	14,430	91.8 %
Other income (expense):				
Interest income	63	14	49	
Interest expense	(25)	(36)	11	
Other	32	337	(305)	
Total other income (expense), net	70	315	(245)	
Income before income taxes	30,224	16,039	14,185	
Income tax provision (benefit)	9,841	(32,085)	41,926	
Income from continuing operations	20,383	48,124	(27,741)	
Loss from discontinued operations, net of income taxes	(1,588)	(170)	(1,418)	
Net income	$18,795	$47,954	$(29,159)	

	Year Ended December 31,			
	2013	2012	Change	% Change
Net sales	$218,803	$193,926	$24,877	12.8 %
Cost of sales	112,326	102,889	9,437	9.2 %
Gross profit	106,477	91,037	15,440	17.0 %
Operating expenses:				
Selling and marketing	66,486	58,617	7,869	13.4 %
General and administrative	18,705	17,669	1,036	5.9 %
Research and development	5,562	4,163	1,399	33.6 %
Total operating expenses	90,753	80,449	10,304	12.8 %
Operating income	15,724	10,588	5,136	48.5 %
Other income (expense):				
Interest income	14	18	(4)	
Interest expense	(36)	56	(92)	
Other	337	(246)	583	
Total other income (expense), net	315	(172)	487	
Income before income taxes	16,039	10,416	5,623	
Income tax benefit	(32,085)	(226)	(31,859)	

Income from continuing operations	48,124	10,642	37,482
Income (loss) from discontinued operations, net of income taxes	(170)	6,241	(6,411)
Net income	$47,954	$16,883	$31,071

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

	Year Ended December 31,						
	2014		2013		Change	% Change	
Net sales:							
Direct	$175,593		$136,663		$38,930	28.5	%
Retail	93,223		76,775		16,448	21.4	%
Royalty income	5,631		5,365		266	5.0	%
	$274,447		$218,803		$55,644	25.4	%
Cost of sales:							
Direct	$64,362		$55,008		$9,354	17.0	%
Retail	69,510		57,318		12,192	21.3	%
Royalty income	—		—		—		
	$133,872		$112,326		$21,546	19.2	%
Gross profit:							
Direct	$111,231		$81,655		$29,576	36.2	%
Retail	23,713		19,457		4,256	21.9	%
Royalty income	5,631		5,365		266	5.0	%
	$140,575		$106,477		$34,098	32.0	%
Gross margin:							
Direct	63.3	%	59.7	%	360	basis points	
Retail	25.4	%	25.3	%	10	basis points	

	Year Ended December 31,						
	2013		2012		Change	% Change	
Net sales:							
Direct	$136,663		$124,978		$11,685	9.3	%
Retail	76,775		63,891		12,884	20.2	%
Royalty income	5,365		5,057		308	6.1	%
	$218,803		$193,926		$24,877	12.8	%
Cost of sales:							
Direct	$55,008		$53,349		$1,659	3.1	%
Retail	57,318		49,540		7,778	15.7	%
Royalty income	—		—		—		
	$112,326		$102,889		$9,437	9.2	%
Gross profit:							
Direct	$81,655		$71,629		$10,026	14.0	%
Retail	19,457		14,351		5,106	35.6	%
Royalty income	5,365		5,057		308	6.1	%
	$106,477		$91,037		$15,440	17.0	%
Gross margin:							
Direct	59.7	%	57.3	%	240	basis points	
Retail	25.3	%	22.5	%	280	basis points	

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

	Year Ended December 31,			
	2014	2013	Change	% Change
Direct net sales:				
Cardio products[1]	$160,249	$114,846	$45,403	39.5 %
Strength products[2]	15,344	21,817	(6,473)	(29.7)%
	175,593	136,663	38,930	28.5 %
Retail net sales:				
Cardio products[1]	56,262	36,692	19,570	53.3 %
Strength products[2]	36,961	40,083	(3,122)	(7.8)%
	93,223	76,775	16,448	21.4 %
Royalty income	5,631	5,365	266	5.0 %
	$274,447	$218,803	$55,644	25.4 %

(1) Cardio products include: TreadClimber®, Max Trainer®, treadmills, exercise bikes, ellipticals, Bowflex Boost®, Bowflex Body™ and DVDs.
(2) Strength products include: home gyms, selectorized dumbbells, kettlebell weights, UpperCut™ and accessories.

	Year Ended December 31,			
	2013	2012	Change	% Change
Direct net sales:				
Cardio products[1]	$114,846	$100,677	$14,169	14.1 %
Strength products[2]	21,817	24,301	(2,484)	(10.2)%
	136,663	124,978	11,685	9.3 %
Retail net sales:				
Cardio products[1]	36,692	36,209	483	1.3 %
Strength products[2]	40,083	27,682	12,401	44.8 %
	76,775	63,891	12,884	20.2 %
Royalty income	5,365	5,057	308	6.1 %
	$218,803	$193,926	$24,877	12.8 %

(1) Cardio products include: TreadClimber®, Max Trainer®, treadmills, exercise bikes, ellipticals, Bowflex Boost®, Bowflex Body™ and DVDs.
(2) Strength products include: home gyms, selectorized dumbbells, kettlebell weights, UpperCut™ and accessories.

Net Sales and Cost of Sales

Direct

The 28.5% increase in Direct Net Sales in 2014 compared to 2013 was primarily related to a 39.5% increase in Direct sales of our cardio products that was due primarily to growth of the Bowflex Max Trainer®, which started shipping in January 2014, partially offset by a decline in the Bowflex TreadClimber®. The business also benefited from higher U.S. consumer credit approval rates.

The 9.3% increase in Direct Net Sales in 2013 compared to 2012 was primarily related to a 14.1% increase in sales of our cardio products, reflecting strong consumer demand, especially for our Bowflex TreadClimber®, which we believe was driven by increased advertising effectiveness, improved call center effectiveness and higher U.S. consumer credit approval rates.

The increases in Direct Net Sales of cardio products in 2014 compared to 2013, and in 2013 compared to 2012, were partially offset by a 29.7% and a 10.2% decline, respectively, in Direct Net Sales of strength products, primarily rod-based home gyms. The declines in sales of rod-based home gyms were attributable, in part, to the reduction of advertising for these products over time, as management determined that television advertising spending on this mature product category was generating suboptimal returns. We continue to market and sell rod-based home gyms through more cost efficient online media and through the Retail channel.

Combined consumer credit approvals by our primary and secondary U.S. third-party financing providers were 41.4% in 2014 compared to 36.1% in 2013 and 31.6% in 2012.

The increase in Cost of Sales in our Direct business in 2014 compared to 2013 , and in 2013 compared to 2012, was almost entirely related to the growth in Direct Net Sales.

The 360 basis point increase in the gross margin of our Direct business for 2014 compared to 2013 was primarily driven by improvements in product mix coupled with lower product costs related to expired royalty expenses.

The 240 basis point increase in the gross margin of our Direct business for 2013 compared to 2012 was primarily due to greater absorption of fixed supply chain costs resulting from the higher sales volume.

Retail

The 21.4% increase in Retail Net Sales in 2014 compared to 2013 was driven primarily by increased sales of our cardio products. Net Sales of strength products in the Retail business decreased 7.8% in 2014 compared to 2013, primarily driven by lower sales of home gyms. The 53.3% increase in Retail cardio sales for 2014 compared to 2013 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.

The 20.2% increase in Retail Net Sales in 2013 compared to 2012 was primarily driven by increased sales of our strength products, which increased 44.8%, primarily due to higher sales of selectorized dumbbells and home gyms. The 1.3% increase in sales of Retail cardio products, including indoor bikes and ellipticals, was primarily due to the introduction of our new line of cardio products in the third quarter of 2013.

The increase in Retail Cost of Sales for both 2014 compared to 2013, and 2013 compared to 2012, was due to the increase in Retail Net Sales.

The 10 basis point improvement in Retail gross margin in 2014 compared to 2013 was primarily due to greater absorption of fixed supply chain costs due to higher sales volume, partially offset by higher allowances related to discontinued inventory and a less favorable product mix.

Gross margins in our Retail business increased by 280 basis points in 2013 compared to 2012, as a result of the Retail price increase we implemented in the third quarter of 2012 and greater absorption of fixed supply chain costs due to higher sales volume.

Selling and Marketing

Dollars in thousands	Year Ended December 31,		Change	
	2014	2013	$	%
Selling and Marketing	$81,059	$66,486	$14,573	21.9%
As % of Net Sales	29.5%	30.4%		

Dollars in thousands	Year Ended December 31,		Change	
	2013	2012	$	%
Selling and Marketing	$66,486	$58,617	$7,869	13.4%
As % of Net Sales	30.4%	30.2%		

The increases in Selling and Marketing in 2014 compared to 2013, and in 2013 compared to 2012, were primarily due to increases in media advertising of $6.8 million and $4.9 million, respectively, as well as increased incremental variable sales expenses and program costs of $4.8 million and $2.6 million, respectively. In addition, production costs for creative media increased $1.6 million in 2014 compared to 2013.

Selling and Marketing as a percentage of Net Sales is affected by the mix of Direct sales compared to Retail sales. Selling and Marketing expenses are generally higher as a percentage of Net Sales in the Direct segment and lower as a percentage of Net Sales in the Retail segment. These costs as a percentage of Net Sales declined in 2014 compared to 2013 as a result of the year-over-year revenue growth in both segments.

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	
	2014	2013	$	%
Media advertising	$42,643	$35,819	$6,824	19.1%

Dollars in thousands	Year Ended December 31,		Change	
	2013	2012	$	%
Media advertising	$35,819	$30,903	$4,916	15.9%

We made strategic increased investments in media and creative advertising in 2014 to further support Bowflex TreadClimber® and the launch of Bowflex Max Trainer®.

General and Administrative

Dollars in thousands	Year Ended December 31,		Change	
	2014	2013	$	%
General and Administrative	$22,131	$18,705	$3,426	18.3%
As % of Net Sales	8.1%	8.5%		

Dollars in thousands	Year Ended December 31,		Change	
	2013	2012	$	%
General and Administrative	$18,705	$17,669	$1,036	5.9%
As % of Net Sales	8.5%	9.1%		

The increase in General and Administrative in 2014 compared to 2013 was due to increased employee-related costs of $0.9 million, higher spending on intellectual property registration and legal fees for patent enforcement of $0.8 million, product liability and other legal costs of $0.8 million, increased technology and facilities infrastructure costs of $0.6 million, and higher general insurance and business taxes expenses of $0.3 million.

The increase in General and Administrative in 2013 compared to 2012 was primarily due to a $0.4 million increase in infrastructure costs and a $0.8 million increase in employee-related costs, partially offset by a $0.3 million one-time charge in 2012 for lease write-off costs.

The decreases in General and Administrative as a percentage of Net Sales in 2014 compared to 2013 and in 2013 compared to 2012 were primarily due to higher Net Sales.

Research and Development

Dollars in thousands	Year Ended December 31,		Change	
	2014	2013	$	%
Research and Development	$7,231	$5,562	$1,669	30.0%
As % of Net Sales	2.6%	2.5%		

Dollars in thousands	Year Ended December 31,		Change	
	2013	2012	$	%
Research and Development	$5,562	$4,163	$1,399	33.6%
As % of Net Sales	2.5%	2.1%		

The increases in Research and Development in 2014 compared to 2013 and in 2013 compared to 2012 were primarily due to our continued investment in additional engineering and product development headcount. We expect Research and Development expense to increase in 2015 compared to 2014, as we continue to invest in new product development resources.

Interest Expense

Interest expense in both 2014 and 2013 was less than $0.1 million each year, and was for financing costs associated with capital equipment lease payments. Negative interest expense of $0.1 million in 2012 arose from the early repayment in March 2012 of our Increasing-Rate Senior Discount Notes. Early repayment of the notes resulted in a lower average effective interest rate over the term of the notes than would have applied if the notes had been held to maturity. In prior periods, we used the average effective interest rate as if the notes were held to maturity in determining the amount of interest expense incurred.

Other Income (Expense)

Other Income (Expense) primarily relates to the effect of exchange rate fluctuations between the U.S. and Canada. However, 2014 and 2013 also included gains of $0.1 million and $0.3 million, respectively, related to refunds of state sales taxes previously paid by us.

Income Tax Expense (Benefit)

Dollars in thousands	Year Ended December 31,		Change	
	2014	2013	$	%
Income Tax Expense (Benefit)	$9,841	$(32,085)	$41,926	n/m
Dollars in thousands	Year Ended December 31,		Change	
	2013	2012	$	%
Income Tax Benefit	$(32,085)	$(226)	$(31,859)	n/m

n/m - Not meaningful.

Our income tax expense in 2014 was primarily attributable to the income generated domestically and in Canada, partially offset by a $1.2 million release of our domestic valuation allowance. Income tax benefit for 2013 included a $38.9 million release of our domestic valuation allowance. Income tax benefit for 2012 was primarily related to the expiration of statutes of limitation applicable to our liabilities for uncertain tax positions in certain jurisdictions. Generally, we did not recognize U.S. income tax expense associated with our income from continuing operations for 2013 or 2012 due to the valuation allowance against the net deferred tax asset.

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 the second quarter of 2013, we concluded that a majority of the existing valuation allowance on our domestic deferred income tax assets was no longer required. Accordingly, an income tax benefit of $38.9 million related to the reduction of our existing valuation allowance was recorded during 2013. Further, in the fourth quarter of 2014, after re-evaluating the potential realization of the remainder of our deferred income tax assets, we concluded that, as of December 31, 2014, 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.

The amount of valuation allowance offsetting our deferred tax assets was $6.2 million as of December 31, 2014. Of the total remaining valuation allowance, $2.9 million primarily relates to domestic credit carryforwards as we currently do not anticipate to generate the 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, $3.3 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, 2013 and, accordingly, we maintain our existing valuation allowance on foreign deferred income tax assets in such jurisdictions at December 31, 2014.

Refer to Note 12, 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, 2014, we had $45.2 million of Cash and Cash Equivalents, compared to $41.0 million as of December 31, 2013 and $27.0 million of Available-For-Sale Securities at December 31, 2014 compared to none at December 31, 2013. Cash provided by operating activities was $34.4 million for 2014, compared to cash provided by operating activities of $21.1 million for 2013. We expect our Cash and Cash Equivalents and Available-For-Sale Securities at December 31, 2014, 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, 2014.

The increase in cash flows from operating activities for 2014, compared to 2013, was primarily due to improved operating performance and the changes in our operating assets and liabilities as discussed below.

Trade receivables increased $1.0 million to $26.3 million as of December 31, 2014, compared to $25.3 million as of December 31, 2013, due to higher revenue within our Retail business. Days sales outstanding ("DSO") at December 31, 2014 were 17.6 days compared to 19.9 days as of December 31, 2013. The decrease in DSO at December 31, 2014 compared to December 31, 2013 was due to a greater mix of Direct revenue along with improved collections. Direct sales are generally collected by credit card or funded by third party financing partners, resulting in cash receipt within a few days after product shipment.

Inventories increased $9.1 million to $24.9 million as of December 31, 2014, compared to $15.8 million as of December 31, 2013, due to higher revenue, additional products, and the opening of a new distribution center. A significant portion of this inventory was in-transit as of December 31, 2014, as the west coast port slowdown has delayed deliveries by 15-25 days. We believe our current inventory level is appropriate to meet customer requirements and to support additional growth of the business.

Net deferred income tax assets decreased $8.3 million to $21.9 million as of December 31, 2014, compared to $30.2 million as of December 31, 2013, primarily due to the utilization of net operating loss deferred tax assets in 2014.

Trade payables increased $10.4 million to $47.6 million as of December 31, 2014, compared to $37.2 million as of December 31, 2013, primarily due to increased inventory purchases and media expense to support the growth in sales.

Accrued liabilities increased $0.8 million to $9.9 million as of December 31, 2014 compared to $9.1 million as of December 31, 2013, primarily due to increases in accrued payroll, commissions and incentive compensation.

Warranty obligations increased $0.6 million to $2.2 million as of December 31, 2014 compared to $1.6 million as of December 31, 2013, primarily due to increased year-over-year sales in both our business segments.

Cash used in investing activities of $30.2 million for 2014 was primarily related to the purchase of $37.4 million of marketable securities, offset by maturities of marketable securities of $10.5 million during the period. Additionally, $3.2 million was used for capital expenditures during 2014, primarily for implementation of new software and hardware information system upgrades. We anticipate spending $4.5 million to $5.5 million in 2015 for software, equipment and product tooling.

Financing Arrangements

On December 5, 2014, we entered into a Credit Agreement (the "Credit Agreement") with JPMorgan Chase Bank, N.A. ("Chase Bank") that provides for a $20.0 million maximum revolving secured credit line. The line of credit is available through December 5, 2017 for working capital, letters of credit and general corporate purposes. 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 each advance under the Credit Agreement is based on either Chase Bank's floating prime rate or adjusted LIBOR, plus an applicable margin. Our borrowing rate was 1.17% as of December 31, 2014. The Credit Agreement contains customary covenants, including minimum fixed charge coverage ratio and asset coverage ratio, and limitations on capital expenditures, mergers and acquisitions, indebtedness, liens, dispositions, dividends and investments. Borrowings under the Credit Agreement are collateralized by substantially all of our assets pursuant to a continuing security agreement. 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.

As of December 31, 2014, we had no outstanding borrowings and $0.6 million in letters of credit issued under the Credit Agreement with expiration dates through April 2015. As of December 31, 2014, we were in compliance with the financial covenants of the Credit Agreement and approximately $19.4 million was available for borrowing.

Commitments and Contingencies

For a description of our commitments and contingencies, refer to Note 17 to our Consolidated Financial Statements in Part II, Item 8 of this report.

Non-Cancelable Contractual Obligations

Our operating cash flows include the effect of certain non-cancelable, contractual obligations. A summary of such obligations as of December 31, 2014, including those related to our discontinued Commercial operations, is as follows (in thousands):

	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating lease obligations	$25,917	$4,050	$7,240	$4,824	$9,803
Purchase obligations(1)	21,250	21,250	—	—	—
Minimum royalty obligations	188	188	—	—	—
Total	$47,355	$25,488	$7,240	$4,824	$9,803

(1) 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, 2014, we are unable to make reasonably reliable estimates of the timing of any cash settlements with the respective taxing authorities. Therefore, approximately $4.7 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 12, 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, 2014.

SEASONALITY

We expect our sales 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, during the spring and summer months, consumers tend to be involved in outdoor activities, 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 2014, 2013 or 2012. 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 Polices, 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 and substantially all our marketable securities. As of December 31, 2014, we had cash equivalents of $24.1 million held in a combination of money market funds, certificates of deposit, commercial paper and variable rate demand notes, and marketable securities of $27.0 million, held in a combination of certificates of deposit and corporate 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.

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, 2014 and 2013, 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, 2014. 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, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, 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, 2014, 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 26, 2015 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

Portland, Oregon
February 26, 2015

NAUTILUS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands)

	As of December 31, 2014	2013
Assets		
Cash and cash equivalents	$45,206	$40,979
Available-for-sale securities	26,984	—
Trade receivables, net of allowances of $108 and $53	26,260	25,336
Inventories	24,896	15,824
Prepaids and other current assets	6,987	6,927
Income taxes receivable	50	80
Deferred income tax assets	12,368	4,441
Total current assets	142,751	93,587
Property, plant and equipment, net	9,634	8,499
Goodwill	2,520	2,740
Other intangible assets, net	10,575	12,615
Long-term deferred income tax assets	9,546	25,725
Other assets	628	401
Total assets	$175,654	$143,567
Liabilities and Shareholders' Equity		
Trade payables	$47,574	$37,192
Accrued liabilities	9,851	9,123
Warranty obligations, current portion	2,246	1,610
Total current liabilities	59,671	47,925
Warranty obligations, non-current	—	28
Income taxes payable, non-current	3,725	2,577
Other long-term liabilities	1,186	1,472
Total liabilities	64,582	52,002
Commitments and contingencies (Note 17)		
Shareholders' equity:		
Common stock - no par value, 75,000 shares authorized, 31,333 and 31,162 shares issued and outstanding	8,033	6,769
Retained earnings	103,347	84,552
Accumulated other comprehensive income (loss)	(308)	244
Total shareholders' equity	111,072	91,565
Total liabilities and shareholders' equity	$175,654	$143,567

See accompanying Notes to Consolidated Financial Statements.

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

	Year Ended December 31,		
	2014	2013	2012
Net sales	$274,447	$218,803	$193,926
Cost of sales	133,872	112,326	102,889
Gross profit	140,575	106,477	91,037
Operating expenses:			
Selling and marketing	81,059	66,486	58,617
General and administrative	22,131	18,705	17,669
Research and development	7,231	5,562	4,163
Total operating expenses	110,421	90,753	80,449
Operating income	30,154	15,724	10,588
Other income (expense):			
Interest income	63	14	18
Interest expense	(25)	(36)	56
Other	32	337	(246)
Total other income (expense), net	70	315	(172)
Income from continuing operations before income taxes	30,224	16,039	10,416
Income tax provision (benefit)	9,841	(32,085)	(226)
Income from continuing operations	20,383	48,124	10,642
Discontinued operations:			
Income (loss) from discontinued operations before income taxes	(1,134)	(559)	6,007
Income tax provision (benefit) of discontinued operations	454	(389)	(234)
Income (loss) from discontinued operations	(1,588)	(170)	6,241
Net income	$18,795	$47,954	$16,883
Basic income per share from continuing operations	$0.65	$1.55	$0.34
Basic income (loss) per share from discontinued operations	(0.05)	(0.01)	0.21
Basic net income per share	$0.60	$1.54	$0.55
Diluted income per share from continuing operations	$0.64	$1.53	$0.34
Diluted income (loss) per share from discontinued operations	(0.05)	(0.01)	0.21
Diluted net income per share	$0.59	$1.52	$0.55
Shares used in per share calculations:			
Basic	31,253	31,072	30,851
Diluted	31,688	31,457	30,974

See accompanying Notes to Consolidated Financial Statements.

30

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

	Year Ended December 31,		
	2014	2013	2012
Net income	$18,795	$47,954	$16,883
Other comprehensive loss:			
Unrealized loss on marketable securities, net of income tax benefit of $(11), $0 and $0	(18)	—	—
Foreign currency translation, net of income tax provision (benefit) of $15, $20 and $(9)	(534)	(381)	(83)
Comprehensive income	$18,243	$47,573	$16,800

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			
Balances at January 1, 2012	30,747	$5,360	$19,715	$ 6,878	$31,953
Net income	—	—	16,883	—	16,883
Foreign currency translation adjustment, net of income tax benefit of $9	—	—	—	(83)	(83)
Reclassification of foreign currency translation gains to income upon substantial liquidation of subsidiaries	—	—	—	(6,170)	(6,170)
Stock-based compensation expense	—	630	—	—	630
Common stock issued under equity compensation plan	177	113	—	—	113
Balances at December 31, 2012	30,924	6,103	36,598	625	43,326
Net income	—	—	47,954	—	47,954
Foreign currency translation adjustment, net of income tax provision of $20	—	—	—	(381)	(381)
Stock-based compensation expense	—	454	—	—	454
Common stock issued under equity compensation plan	238	357	—	—	357
Tax deficiency related to stock-based awards	—	(145)	—	—	(145)
Balances at December 31, 2013	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 provision of $15	—	—	—	(534)	(534)
Stock-based compensation expense	—	1,066	—	—	1,066
Common stock issued under equity compensation plan	171	378	—	—	378
Tax deficiency related to stock-based awards		(180)	—	—	(180)
Balances at December 31, 2014	31,333	$8,033	$103,347	$ (308)	$111,072

See accompanying Notes to Consolidated Financial Statements.

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

	Year Ended December 31,		
	2014	2013	2012
Cash flows from operating activities:			
Income from continuing operations	$20,383	$48,124	$10,642
Income (loss) from discontinued operations	(1,588)	(170)	6,241
Net income	18,795	47,954	16,883
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	4,024	3,344	3,269
Bad debt expense (reduction)	104	588	(13)
Inventory lower-of-cost-or-market adjustments	457	557	402
Stock-based compensation expense	1,066	454	630
(Gain) loss on asset disposals	145	2	(30)
Deferred income taxes, net of valuation allowances	8,007	(32,814)	145
Excess tax deficiency related to stock-based awards	180	145	—
Reclassification of foreign currency translation gains to income upon substantial liquidation of subsidiaries	—	—	(6,170)
Changes in operating assets and liabilities:			
Trade receivables	(1,331)	(4,417)	1,928
Inventories	(9,560)	2,388	(7,573)
Prepaids and other current assets	(314)	(1,174)	(1,314)
Income taxes receivable	30	(91)	464
Trade payables	10,456	4,487	4,189
Accrued liabilities, including warranty obligations	2,313	(337)	3
Net cash provided by operating activities	34,372	21,086	12,813
Cash flows from investing activities:			
Proceeds from sale of discontinued operations	—	116	410
Proceeds from other asset sales	—	5	6
Purchases of property, plant and equipment	(3,181)	(3,590)	(2,442)
Purchases of available-for-sale-securities	(37,434)	—	—
Proceeds from maturities of available-for-sale securities	10,450	—	—
Net cash used in investing activities	(30,165)	(3,469)	(2,026)
Cash flows from financing activities:			
Repayment of long-term borrowings	—	—	(5,000)
Proceeds from exercise of stock options	378	357	113
Excess tax deficiency related to stock-based awards	(180)	(145)	—
Net cash provided by (used in) financing activities	198	212	(4,887)
Effect of exchange rate changes on cash and cash equivalents	(178)	(57)	(120)
Increase in cash and cash equivalents	4,227	17,772	5,780
Cash and cash equivalents, beginning of year	40,979	23,207	17,427
Cash and cash equivalents, end of year	$45,206	$40,979	$23,207
Supplemental disclosure of cash flow information:			
Cash paid for income taxes, net	$(923)	$(450)	$(277)

Cash paid for interest	$(25)	$(36