MGIC INVESTMENT CORP
Form DEF 14A
May 24, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

Filed by the Registrant x
Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement
o Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
x Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to §240.14a-12

MGIC INVESTMENT CORPORATION
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.
o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

Persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

MGIC Investment Corporation

May 24, 2013

Notice of Special Meeting of Shareholders and Proxy Statement

Dear Shareholder:

It is my pleasure to invite you to attend a Special Meeting of Shareholders to be held on June 27, 2013, at 9:00 a.m. in the Bradley Pavilion of the Marcus Center for the Performing Arts in Milwaukee, Wisconsin.

At the Special Meeting, we will ask shareholders to approve an amendment to our Articles of Incorporation to increase our authorized Common Stock from 680,000,000 shares to 1,000,000,000 shares.

Your vote is important. Even if you plan to attend the meeting, we encourage you to vote as soon as possible. You may vote by telephone, over the Internet or by mail. Please read our proxy statement for more information about our meeting and the voting process.

Sincerely,

Curt S. Culver
Chairman and
Chief Executive Officer

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE SPECIAL MEETING OF SHAREHOLDERS TO BE HELD ON JUNE 27, 2013:

Our proxy statement is available free of charge at http://mtg.mgic.com/proxyinfo.

MGIC INVESTMENT CORPORATION

NOTICE OF SPECIAL MEETING OF SHAREHOLDERS
June 27, 2013

To Our Shareholders:

A Special Meeting of Shareholders of MGIC Investment Corporation will be held in the Bradley Pavilion of the Marcus Center for the Performing Arts, 929 North Water Street, Milwaukee, Wisconsin, on June 27, 2013, at 9:00 a.m., to vote on the approval of an amendment to our Articles of Incorporation to increase our authorized Common Stock from 680,000,000 shares to 1,000,000,000 shares.

Only shareholders of record at the close of business on May 20, 2013, will be entitled to vote at the Special Meeting and any postponement or adjournment of the meeting.

By Order of the Board of Directors

Jeffrey H. Lane, Secretary
May 24, 2013

YOUR VOTE IS IMPORTANT

PLEASE PROMPTLY VOTE VIA TOLL-FREE TELEPHONE NUMBER, OVER THE INTERNET OR BY COMPLETING, SIGNING, DATING AND RETURNING YOUR PROXY CARD OR VOTING INSTRUCTION FORM

MGIC Investment Corporation
P.O. Box 488
MGIC Plaza, 250 East Kilbourn Avenue
Milwaukee, WI 53201

Proxy Statement

Our Board of Directors is soliciting proxies for the Special Meeting of Shareholders to be held at 9:00 a.m., June 27, 2013, in the Bradley Pavilion of the Marcus Center for the Performing Arts, 929 North Water Street, Milwaukee, Wisconsin, and at any postponement or adjournment of the meeting. In this proxy statement we sometimes refer to MGIC Investment Corporation as “the Company,” “we” or “us.” This proxy statement and the enclosed form of proxy are being mailed to shareholders beginning on May 24, 2013. If you have any questions about attending our Special Meeting, you can call our Investor Relations personnel at (414) 347-6480.

ABOUT THE MEETING AND PROXY MATERIALS

What is the purpose of the Special Meeting?

At our Special Meeting, shareholders will act on the approval of an amendment to our Articles of Incorporation to increase our authorized Common Stock from 680,000,000 shares to 1,000,000,000 shares.

Who is entitled to vote at the meeting?

Only shareholders of record at the close of business on May 20, 2013, the record date for the meeting, are entitled to receive notice of and to participate in the Special Meeting. For each share of Common Stock that you held on that date, you are entitled to one vote on the matter considered at the meeting. On the record date, 337,758,169 shares of Common Stock were outstanding and entitled to vote.

What is a proxy?

A proxy is another person you legally designate to vote your shares. If you designate someone as your proxy in a written document, that document is also called a proxy or a proxy card.

How do I vote my shares?

If you are a shareholder of record, meaning your shares are registered directly in your name with Wells Fargo Bank Minnesota, N.A., our stock transfer agent, you may vote your shares in one of three ways:

- By Telephone — Shareholders of record who live in the United States or Canada may submit proxies by telephone by calling 1-800-560-1965 and following the instructions. Shareholders of record must have the control number that appears on their proxy card available when voting.

- By Internet — Shareholders may submit proxies over the Internet by following the instructions on the proxy card.

- By Mail — Shareholders may submit proxies by completing, signing and dating their proxy card and mailing it in the accompanying pre-addressed envelope.

If you attend the meeting, you may withdraw your proxy and vote your shares in person.

If you hold your shares in "street name," meaning your shares are held in a stock brokerage account or by a bank or other nominee, your broker or nominee has enclosed or provided a voting instruction form for you to use to direct the broker or nominee how to vote your shares. Certain of these institutions offer telephone and Internet voting.

If you hold shares as a participant in our Profit Sharing and Savings Plan, you may instruct the plan trustee how to vote those shares in any one of three ways:

- By Telephone — If you live in the United States or Canada, you may submit a proxy by telephone by calling 1-800-560-1965 and following the instructions. You must have the control number that appears on your proxy card available when voting.

- By Internet — You may submit a proxy over the Internet by following the instructions on the proxy card.

- By Mail — You may submit a proxy by completing, signing and dating your proxy card and mailing it in the accompanying pre-addressed envelope.

The plan trustee will vote shares held in your account in accordance with your instructions and the plan terms. The plan trustee may vote the shares for you if your instructions are not received at least five days before the Special Meeting date.

Please contact our Investor Relations personnel at (414) 347-6480 if you would like directions on attending the Special Meeting and voting in person. At our meeting, you will be asked to show some form of identification (such as your driving license).

Can I change my vote after I return my proxy card?

Yes. If you are a shareholder of record, you can revoke your proxy at any time before your shares are voted by advising our corporate Secretary in writing, by granting a new proxy with a later date, or by voting in person at the meeting. If your shares are held in street name by a broker, bank or nominee, or in our Profit Sharing and Savings Plan, you must follow the instructions of the broker, bank, nominee or plan trustee on how to change your vote.

How are the votes counted?

A quorum is necessary to hold the meeting and will exist if a majority of the 337,758,169 shares of Common Stock outstanding on the record date are represented, in person or by proxy, at the meeting. Votes cast by proxy or in person at the meeting will be counted by Wells Fargo Bank Minnesota, N.A., which has been appointed by our Board to act as inspector of election for the meeting.

Shares represented by proxy cards marked “Abstain” will be counted to determine the presence of a quorum, but will not be counted as votes for or against that matter. “Broker non-votes,” which occur when a broker or other nominee does not vote on a particular matter because the broker or other nominee does not have authority to vote without instructions from the beneficial owner of the shares and has not received such instructions, will be counted for quorum purposes but will not be counted as votes for or against any matter. Brokers and other nominees have discretionary authority to vote shares without instructions from the beneficial owner of the shares only for matters considered routine. Nominees will not have discretionary authority to vote shares on the approval of the amendment to our Articles of Incorporation to increase our authorized Common Stock from 680,000,000 shares to 1,000,000,000 shares without instructions from the beneficial owner.

What is the Board’s recommendation?

Our Board of Directors recommends a vote FOR approval of an amendment to our Articles of Incorporation to increase our authorized Common Stock from 680,000,000 shares to 1,000,000,000 shares. If you sign and return a proxy card or voting instruction form without specifying how you want your shares voted, the named proxies will vote your shares in accordance with the recommendation of the Board.

Will any other items be acted upon at the Special Meeting?

No other items will be voted on at the Special Meeting.

What are the deadlines for submission of shareholder proposals for the next Annual Meeting?

Shareholders may submit proposals on matters appropriate for shareholder action at future Annual Meetings by following the SEC's rules. Proposals intended for inclusion in next year's proxy materials must be received by our Secretary no later than November 25, 2013.

Under our Amended and Restated Bylaws ("Bylaws"), a shareholder who wants to bring business before the Annual Meeting that has not been included in the proxy materials for the meeting, or who wants to nominate directors at the meeting, must be eligible to vote at the meeting and give written notice of the proposal to our corporate Secretary in accordance with the procedures contained in our Bylaws. Our Bylaws require that shareholders give notice to our Secretary at least 45 and not more than 70 days before the first anniversary of the date set forth in our proxy statement for the prior Annual Meeting as the date on which we first mailed such proxy materials to shareholders. For the 2014 Annual Meeting, the notice must be received by the Secretary no later than February 8, 2014, and no earlier than January 14, 2014. For director nominations, the notice must comply with our Bylaws and provide the information required to be included in the proxy statement for individuals nominated by our Board. For any other proposals, the notice must describe the proposal and why it should be approved, identify any material interest of the shareholder in the matter, and include other information required by our Bylaws.

Who pays to prepare, mail and solicit the proxies?

We will pay the cost of soliciting proxies. In addition to soliciting proxies by mail, our employees may solicit proxies by telephone, email, facsimile or personal interview. We have also engaged D.F. King & Co., Inc. to provide proxy solicitation services for a fee of $14,000, plus expenses such as charges by brokers, banks and other nominees to forward proxy materials to the beneficial owners of our Common Stock.

## STOCK OWNERSHIP

As of May 10, 2013, based on information filed with the SEC pursuant to Section 13(d) or Section 13(g) of the Securities Exchange Act of 1934, there were no beneficial owners of more than 5% of our Common Stock. The following table shows the amount of our Common Stock beneficially owned by our named executive officers and directors and by our executive officers and directors as a group.

| Name | Shares Beneficially Owned (1) | Percent of Class | |
|---|---|---|---|
| James A. Abbott (2), (3), (5) | 37,978 | * | |
| Thomas M. Hagerty (3), (5) | 28,336 | * | |
| Timothy A. Holt (5) | 0 | * | |
| Kenneth M. Jastrow, II (2), (3), (5) | 32,698 | * | |
| Daniel P. Kearney (3), (5) | 86,266 | * | |
| Michael E. Lehman (3), (5) | 10,489 | * | |
| William A. McIntosh (2), (3), (5) | 56,573 | * | |
| Leslie M. Muma (2), (3), (4), (5) | 152,139 | * | |
| Donald T. Nicolaisen (3), (5) | 66,399 | * | |
| Mark M. Zandi (5) | 0 | * | |
| Curt S. Culver(6) | 1,156,583 | * | |
| J. Michael Lauer(6) | 704,307 | * | |
| Patrick Sinks(6) | 536,168 | * | |
| Jeffrey H. Lane(6) | 393,139 | * | |
| Lawrence J. Pierzchalski(6) | 288,636 | * | |
| All directors and executive officers as a group (16 persons) (6) | 3,567,160 | 1.1 | % |

*Less than 1%

(1) Ownership information is as of May 10, 2013. Unless otherwise noted, all directors and executive officers have sole voting and investment power with respect to the shares.

(2) Includes 2,000 shares held under our 1993 Restricted Stock Plan for Non-Employee Directors. The directors have sole voting power and no investment power over these shares.

(3) Includes shares underlying Restricted Stock Units ("RSUs") as follows: Mr. Abbott — 4,541; Mr. Hagerty — 20,155; Mr. Jastrow — 22,819; Mr. Kearney — 8,783; Mr. Lehman — 3,050; Mr. McIntosh — 3,050; Mr. Muma — 7,148; and Nicolaisen — 16,217. Such Units could be settled in shares of Common Stock within 60 days of the record date. Directors have neither voting nor investment power over the shares underlying any of these Units. Includes 6,733 shares that Mr. Jastrow held under the Deposit Share Program for Non-Employee Directors under our 1991 Stock Incentive Plan and 2002 Stock Incentive Plan. Mr. Jastrow has sole voting power and no investment power over these shares.

(4) Includes 9,132 shares owned by a trust of which Mr. Muma is a trustee and a beneficiary and as to which Mr. Muma disclaims beneficial ownership except to the extent of his interest in the trust.

(5) Excludes cash-settled share units held under our Deferred Compensation Plan over which the directors have neither voting nor investment power, as follows: Mr. Abbott — 36,364; Mr. Hagerty — 55,423; Mr. Holt — 36,364; Mr. Jastrow - 66,500; Mr. Kearney — 126,825; Mr. Lehman — 37,745; Mr. McIntosh — 36,364; Mr. Muma — 64,072; Mr. Nicolaise 90,771; and Dr. Zandi — 36,364.

(6) Includes shares that could be purchased on the record date or within 60 days thereafter by exercise of stock options granted to the executive officers: Mr. Culver — 80,000; Mr. Lauer — 27,000; Mr. Sinks — 40,000; Mr. Lane — 27,000; M Pierzchalski — 27,000; and all executive officers as a group — 201,000. These stock options have an exercise price of $68.20 per share. Also includes shares held in our Profit Sharing and Savings Plan by the executive officers: Mr. Culver — 12,696; Mr. Lauer — 53,275; Mr. Sinks — 11,733; and all executive officers as a group — 77,704. Exclud shares underlying RSUs that cannot be settled in Common Stock within 60 days of the record date: Mr. Culver — 768,318; Mr. Lauer — 253,084; Mr. Sinks — 466,450; Mr. Lane — 253,084; Mr. Pierzchalski — 253,084; and all executiv officers as a group — 2,091,354. Also includes shares for which voting and investment power are shared as follows: Mr. Lauer — 612,512, and all directors and executive officers as a group — 629,961.

## AMENDMENT TO OUR ARTICLES OF INCORPORATION

Our Board is recommending that shareholders approve an amendment to Article 4 of our Articles of Incorporation to increase the number of shares of our Common Stock that we are authorized to issue from 680,000,000 to 1,000,000,000. As of May 20, 2013, (a) approximately 338 million shares of Common Stock were outstanding, (b) approximately 126 million shares are issuable upon the conversion of our convertible notes and debentures at their initial conversion price, (c) approximately 8 million shares were reserved under our stock incentive plans, including for RSUs and options referred to under “Stock Ownership” and (d) approximately 47 million shares are, or, in the case of shares not yet issued, will need to be, reserved to be issued pursuant to our shareholder rights agreement (the shares referred to in (b)-(d) are hereinafter referred to as the “Reserved Shares”).

Based on the foregoing, approximately 161 million shares remain available. Of these shares, only approximately 146 million could be issued, considering that issuance of these shares would require us to reserve approximately 15 million additional shares under our shareholder rights agreement.

Our Board believes that it would be prudent for the Company to have the flexibility to issue additional shares of Common Stock in the discretion of the Board, without the delay of a special shareholders’ meeting. All available shares, including additional shares authorized by the amendment, will be available for general corporate purposes, including stock dividends, financings, mergers and acquisitions and employee benefit programs. At the date of mailing of this proxy statement, we did not have any plans to issue any additional shares of Common Stock. However, additional shares may be issued as part of the Reserved Shares.

Shareholders do not have any preemptive rights to subscribe for any shares of Common Stock, including those authorized by the amendment. Any of the authorized shares of Common Stock may be issued by action of the Board without further action by shareholders, other than as may be required by the rules of the NYSE or the Business Corporation Law of Wisconsin, our state of incorporation. (In general, the rules of the NYSE would require approval only for shares issued in certain compensation programs, and in business combinations and certain non-public offerings in which, in both cases, the shares issued equal or exceed 20% of our shares outstanding prior to the combination or offering. The Wisconsin Business Corporation Law would require approval only for shares issued in certain business combinations.) The issuance of Common Stock otherwise than on a pro rata basis to all shareholders may have the effect of diluting the ownership interest and voting power of our existing shareholders. Similarly, the shares authorized by the amendment could be used to discourage or make more difficult a non-negotiated attempt to obtain control of our company. This effect could occur through issuance of additional shares of Common Stock that would dilute the interest in the equity and voting power of a party seeking to gain control, including pursuant to our shareholder rights agreement. We are not aware of any effort to obtain control of our company.

Shareholder Vote Required

Approval of the amendment to our Articles of Incorporation requires the affirmative vote of a majority of the votes cast on this matter. Abstentions and broker non-votes will not be counted as votes cast.

YOUR BOARD OF DIRECTORS RECOMMENDS A VOTE FOR APPROVAL OF THE AMENDMENT TO OUR ARTICLES OF INCORPORATION TO INCREASE THE NUMBER OF AUTHORIZED SHARES OF COMMON STOCK. SIGNED PROXY CARDS AND VOTING INSTRUCTION FORMS WILL BE VOTED FOR THE AMENDMENT TO THE ARTICLES OF INCORPORATION UNLESS A SHAREHOLDER GIVES OTHER INSTRUCTIONS ON THE PROXY CARD OR VOTING INSTRUCTION FORM.

## HOUSEHOLDING

The broker, bank or other nominee for any shareholder who holds shares in "street name" and is not a shareholder of record may deliver only one copy of this proxy statement to multiple shareholders who share the same address, unless that broker, bank or other nominee has received contrary instructions from one or more of the shareholders. We will deliver promptly, upon written or oral request, a separate copy of this proxy statement to a shareholder at a shared address to which a single copy of the document was delivered. A shareholder who wishes to receive a separate copy of the proxy statement now or in the future (including the Annual Report to Shareholders, when appropriate), should submit a request to MGIC by telephone at (414) 347-6480 or by submitting a written request to Investor Relations, MGIC Investment Corporation, P.O. Box 488, MGIC Plaza, Milwaukee, WI 53201. Beneficial owners sharing an address who are receiving multiple copies of the proxy statement (including the Annual Report to Shareholders, when appropriate) and wish to receive a single copy of such materials in the future will need to contact their broker, bank or other nominee to request that only a single copy be mailed to all shareholders at the shared address in the future.

MGIC Investment Corporation
MGIC Plaza, Milwaukee, Wisconsin 53202 • http://mtg.mgic.com

Shareowner Services
P.O. Box 64945
St. Paul, MN 55164-9045

COMPANY
#

Vote by Internet, Telephone or Mail
24 Hours a Day, 7 Days a Week

Your phone or Internet vote authorizes the named proxies to vote your shares in the same manner as if you
marked, signed and returned your proxy card.

: INTERNET/MOBILE – www.eproxy.com/mtg
Use the Internet to vote your proxy until 11:59 p.m. (CT) on June 26, 2013.

( PHONE – 1-800-560-1965
Use a touch-tone telephone to vote your proxy until 11:59 p.m. (CT) on June 26, 2013.

* MAIL – Mark, sign and date your proxy card and return it in the postage-paid envelope provided.

If you vote your proxy by Internet or by Telephone, you do NOT need to mail back your Proxy Card.

THIS PROXY WHEN SIGNED AND RETURNED WILL BE VOTED AS DIRECTED OR, IF NO DIRECTION IS GIVEN,
WILL BE VOTED AS THE BOARD RECOMMENDS.–

The Board of Directors Recommends a Vote FOR Item 1.

| | | | | | |
|---|---|---|---|---|---|
| 1. | Proposal to amend the Articles of Incorporation to increase the authorized Common Stock from 680,000,000 to 1,000,000,000 shares | o For | 9,621 | 10,710 | |
| Income from continuing operations | 7,845 | | 3,873 | 23,127 | 16,951 |
| Discontinued operations: | | | | | |
| Loss from discontinued operations before | (308 | ) | (159 ) | (612 ) | (472 ) |

| | | | | | |
|---|---|---|---|---|---|
| income taxes | | | | | |
| Income tax benefit from discontinued operations | (57 | ) | (14 ) | (53 ) | (405 ) |
| Loss from discontinued operations | (251 | ) | (145 ) | (559 ) | (67 ) |
| Net income | $ | 7,594 | $3,728 | $22,568 | $16,884 |
| | | | | | |
| Basic income per share from continuing operations | $ | 0.25 | $0.12 | $0.74 | $0.54 |
| Basic loss per share from discontinued operations | (0.01 | ) | — | (0.02 ) | — |
| Basic net income per share[1] | $ | 0.24 | $0.12 | $0.73 | $0.54 |
| | | | | | |
| Diluted income per share from continuing operations | $ | 0.25 | $0.12 | $0.74 | $0.53 |
| Diluted loss per share from discontinued operations | (0.01 | ) | — | (0.02 ) | — |
| Diluted net income per share | $ | 0.24 | $0.12 | $0.72 | $0.53 |
| Shares used in per share calculations: | | | | | |
| Basic | 31,118 | | 31,272 | 31,069 | 31,386 |
| Diluted | 31,385 | | 31,527 | 31,340 | 31,702 |

[1] May not add due to rounding.

See accompanying Notes to Condensed Consolidated Financial Statements.

2

NAUTILUS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited and in thousands)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Net income | $7,594 | $3,728 | $22,568 | $16,884 |
| Other comprehensive income (loss): | | | | |
| Unrealized gain on available-for-sale securities, net of income tax expense of $0, $9, $16 and $14 | — | 10 | 26 | 23 |
| Income (loss) on derivative securities, effective portion, net of income tax benefit (expense) of $(150), $0, $326 and $0 | 248 | — | (539) | — |
| Foreign currency translation, net of income tax (benefit) expense of $(1), $5, $(6) and $9 | (45) | (451) | 397 | (803) |
| Other comprehensive income (loss) | 203 | (441) | (116) | (780) |
| Comprehensive income | $7,797 | $3,287 | $22,452 | $16,104 |

See accompanying Notes to Condensed Consolidated Financial Statements.

3

NAUTILUS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited and in thousands)

| | Nine Months Ended September 30, 2016 | 2015 |
|---|---|---|
| Cash flows from operating activities: | | |
| Income from continuing operations | $23,127 | $16,951 |
| Loss from discontinued operations | (559) | (67) |
| Net income | 22,568 | 16,884 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 5,748 | 2,511 |
| Provision for (benefit from) allowance for doubtful accounts | 183 | (118) |
| Inventory lower-of-cost-or-market adjustments | 72 | 136 |
| Stock-based compensation expense | 2,045 | 1,073 |
| Loss on asset dispositions | 107 | 289 |
| Deferred income taxes, net of valuation allowance | 5,707 | 9,503 |
| Excess tax (benefit) deficiency related to stock-based awards | (1,852) | 1 |
| Other | 6 | — |
| Changes in operating assets and liabilities: | | |
| Trade receivables | 13,633 | 7,514 |
| Inventories | (4,716) | (10,748) |
| Prepaids and other current assets | (413) | 1,205 |
| Income taxes receivable | (5,397) | (82) |
| Trade payables | (15,475) | (9,030) |
| Accrued liabilities, including warranty obligations | (7,286) | (630) |
| Net cash provided by operating activities | 14,930 | 18,508 |
| Cash flows from investing activities: | | |
| Purchases of available-for-sale securities | (22,972) | (55,230) |
| Proceeds from maturities of available-for-sale securities | 24,818 | 33,186 |
| Proceeds from sales of available-for-sale securities | 71 | 3,381 |
| Acquisition of business, net of cash acquired | (3,468) | — |
| Purchases of property, plant and equipment | (3,237) | (3,604) |
| Net cash used in investing activities | (4,788) | (22,267) |
| Cash flows from financing activities: | | |
| Payments on long-term debt | (12,000) | — |
| Payments for stock repurchases | — | (11,568) |
| Proceeds from exercise of stock options and employee stock plan purchases | 531 | 1,001 |
| Tax payments related to stock award issuances | (221) | (775) |
| Excess tax benefit (deficiency) related to stock-based awards | 1,852 | (1) |
| Net cash used in financing activities | (9,838) | (11,343) |
| Effect of exchange rate changes on cash and cash equivalents | 87 | (1,083) |
| Increase (decrease) in cash and cash equivalents | 391 | (16,185) |
| Cash and cash equivalents: | | |
| Beginning of period | 30,778 | 45,206 |
| End of period | $31,169 | $29,021 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | $(1,462) | $(17) |
| Cash paid for income taxes, net | (11,331) | (917) |

| | | |
|---|---|---|
| Supplemental disclosure of non-cash investing activities: | | |
| Capital expenditures incurred but not yet paid | $922 | $602 |

See accompanying Notes to Condensed Consolidated Financial Statements.

NAUTILUS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) GENERAL INFORMATION

Basis of Consolidation and Presentation

The accompanying condensed consolidated financial statements present the financial position, results of operations and cash flows of Nautilus, Inc. and its subsidiaries, all of which are wholly owned. Intercompany transactions and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements have not been audited. We have condensed or omitted certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). Management believes the disclosures contained herein are adequate to make the information presented not misleading. However, these condensed consolidated financial statements should be read in conjunction with our consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015 (the “2015 Form 10-K”).

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Further information regarding significant estimates can be found in our 2015 Form 10-K.

In the opinion of management, the accompanying condensed consolidated financial statements reflect all adjustments necessary to present fairly our financial position as of September 30, 2016 and December 31, 2015, and our results of operations and comprehensive income for the three and nine months ended September 30, 2016 and 2015, and cash flows for the nine months ended September 30, 2016 and 2015. Interim results are not necessarily indicative of results for a full year. Our revenues typically vary seasonally and this seasonality can have a significant effect on operating results, inventory levels and working capital needs.

Unless indicated otherwise, all information regarding our operating results pertain to our continuing operations.

New Accounting Pronouncements

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

ASU 2016-13
In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments." The amendments in ASU 2016-13 replace the incurred loss impairment

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

ASU 2016-12

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

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

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

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

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

ASU 2015-16

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

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

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

ASU 2014-12
In June 2014, the FASB issued ASU No. 2014-12, "Compensation - Stock Compensation (Topic 718)." ASU No. 2014-12 addresses accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. ASU 2014-12 indicates that, in such situations, the performance target should be treated as a performance condition and, accordingly, the performance target should not be reflected in estimating the grant-date fair value of the award. Instead, compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved. ASU 2014-12 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Our adoption of ASU 2014-12 in January 2016 did not have a material effect on our financial position, results of operations or cash flows.

ASU 2014-09
In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." ASU 2014-09 clarifies the principles for recognizing revenue and develops a common revenue standard for U.S. GAAP and the International Accounting Standards Board that:
• removes inconsistencies and weaknesses in revenue requirements;
• provides a more robust framework for addressing revenue issues;
• improves comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets;
• provides more useful information to users of financial statements through improved disclosure requirements; and
• simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer.

ASU 2014-09 is effective, as amended, for annual and interim periods beginning on or after December 15, 2017. While we do not expect the adoption of ASU 2014-09 to have a material effect on our business, we are still evaluating any potential impact that adoption of ASU 2014-09 may have on our financial position, results of operations or cash flows.

(2) BUSINESS ACQUISITION

On December 31, 2015, we acquired all of the outstanding capital stock of OF Holdings, Inc., sole parent of Octane Fitness, LLC ("Octane"), for an aggregate base purchase price of $115.0 million, plus net adjustments for working capital and cash acquired on the closing date. We funded the acquisition through an $80.0 million term loan and cash on hand.

For the three and nine months ended September 30, 2016, Octane contributed net sales of $16.2 million and $40.9 million, respectively. Octane contributed net income of $1.1 million for the third quarter of 2016 and $0.3 million for the first nine months of 2016. Operating results for the current three-month and year-to-date periods included amortization of acquired assets of $0.8 million and $2.3 million, respectively, and purchase accounting related inventory step-up charges of $0.1 million and $1.1 million, respectively. Working capital and other measurement period adjustments as of September 30, 2016 totaled $0.7 million and are detailed in the preliminary valuation table shown below.

Total acquisition costs incurred for the nine months ended September 30, 2016 were $0.3 million, and cumulative-to-date costs total $0.9 million. These charges were expensed as incurred in general and administrative costs.

Purchase Price Allocation

Acquired assets and liabilities were recorded at estimated fair value as of the acquisition date. The excess of the purchase price over the estimated fair value of identifiable net assets resulted in the recognition of goodwill of $58.3 million, all of which was assigned to the Retail segment, and is attributed primarily to Octane's intellectual property base, benefits of access to different markets and customers, and employee workforce. The goodwill is not expected to be deductible for income tax purposes.

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

| | Preliminary valuation at December 31, 2015 | Measurement period adjustments | Adjusted preliminary valuation at September 30, 2016 |
|---|---|---|---|
| Cash | $ 7,759 | $ — | $ 7,759 |
| Accounts receivable | 12,507 | — | 12,507 |
| Inventories | 12,168 | 1,515 | 13,683 |
| Prepaid expenses | 1,028 | (143 ) | 885 |
| Deferred tax assets | 1,287 | (527 ) | 760 |
| Property, plant and equipment | 3,240 | 132 | 3,372 |
| Intangible assets | 63,100 | — | 63,100 |
| Total assets acquired | 101,089 | 977 | 102,066 |
| | | | |
| Accounts payable | 6,215 | 282 | 6,497 |
| Accrued liabilities | 1,614 | (8 ) | 1,606 |
| Warranty obligations | 5,550 | — | 5,550 |
| Deferred tax liabilities, non-current | 20,914 | 98 | 21,012 |
| Other non-current liabilities | 519 | (129 ) | 390 |
| Total liabilities assumed | 34,812 | 243 | 35,055 |
| | | | |
| Net identifiable assets acquired | 66,277 | 734 | 67,011 |
| Goodwill | 58,357 | (63 ) | 58,294 |
| Net assets acquired | $ 124,634 | $ 671 | $ 125,305 |

The allocation of the purchase price is preliminary and is based upon valuation information available and estimates and assumptions made as of September 30, 2016. We are still in the process of verifying data and finalizing information including valuation and recording of the assets acquired and liabilities assumed, and the resulting amount of recognized goodwill.

The following table sets forth the components of identifiable intangible assets and their estimated fair values and useful lives as of December 31, 2015, the acquisition date (dollars in thousands):

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

Summary of Unaudited Pro Forma Information

The following table reflects the unaudited pro forma consolidated results of operations for the periods presented, as though the acquisition of Octane had occurred on January 1, 2015 (in thousands, except per share amounts):

| | (unaudited) Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Net sales | $80,818 | $83,931 | $280,275 | $268,422 |
| Net income | 7,308 | 3,691 | 23,682 | 17,053 |
| Net income per share: | | | | |
| Basic | $0.23 | $0.12 | $0.76 | $0.54 |
| Diluted | 0.23 | 0.12 | 0.76 | 0.54 |

The unaudited pro forma financial information is presented for illustrative purposes only and is not indicative of the results of operations that would have been realized if the acquisition had been completed on the date indicated, nor is it indicative of future operating results.

(3) DISCONTINUED OPERATIONS

There was no revenue related to discontinued operations for the nine months ended September 30, 2016 or the year ended December 31, 2015. However, we continue to have legal and accounting expenses as we work with authorities on final deregistration of certain foreign entities and product liability expenses associated with product previously sold into the Commercial channel.

The following table summarizes liabilities for exit costs related to discontinued operations, included in accrued liabilities in our Condensed Consolidated Balance Sheets (in thousands):

| | Facilities Leases |
|---|---|
| Balance, December 31, 2015 | $ 300 |
| Payments | (225 ) |
| Balance, September 30, 2016 | $ 75 |

We expect the lease obligations to be paid out through 2016.

(4) FAIR VALUE MEASUREMENTS

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

- Level 1 - observable inputs such as quoted prices (unadjusted) in active liquid markets for identical securities as of the reporting date;
- Level 2 - other significant directly or indirectly observable inputs, including quoted prices for similar securities, interest rates, prepayment speeds and credit risk; or observable market prices in markets with insufficient volume and/or infrequent transactions; and
- 

Level 3 - significant inputs that are generally unobservable inputs for which there is little or no market data available, including our own assumptions in determining fair value.

Assets and liabilities measured at fair value on a recurring basis as of September 30, 2016 and December 31, 2015 were as follows (in thousands):

| | September 30, 2016 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Cash Equivalents | | | | |
| Money market funds | $3,474 | $— | $ — | $3,474 |
| Commercial paper | — | 1,999 | — | 1,999 |
| Total cash equivalents | 3,474 | 1,999 | — | 5,473 |
| Available-for-Sale Securities | | | | |
| Certificates of deposit[1] | — | 25,048 | — | 25,048 |
| Corporate bonds | — | 1,027 | — | 1,027 |
| U.S. government bonds | — | 2,006 | — | 2,006 |
| Total available-for-sale securities | — | 28,081 | — | 28,081 |
| Total assets measured at fair value | $3,474 | $30,080 | $ — | $33,554 |
| Liabilities: | | | | |
| Derivatives | | | | |
| Interest rate swap contract | $— | $(865) | $ — | $(865) |
| Total liabilities measured at fair value | $— | $(865) | $ — | $(865) |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Cash Equivalents | | | | |
| Money market funds | $1 | $— | $ — | $1 |
| Corporate bonds | — | 733 | — | 733 |
| Total cash equivalents | 1 | 733 | — | 734 |
| Available-for-Sale Securities | | | | |
| Certificates of deposit[1] | — | 25,234 | — | 25,234 |
| Corporate bonds | — | 4,764 | — | 4,764 |
| Total available-for-sale securities | — | 29,998 | — | 29,998 |
| Total assets measured at fair value | $1 | $30,731 | $ — | $30,732 |

[1] All certificates of deposit are within current FDIC insurance limits.

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

For our assets measured at fair value on a recurring basis, we recognize transfers between levels at the actual date of the event or change in circumstance that caused the transfer. There were no transfers between levels during the three and nine months ended September 30, 2016, nor for the year ended December 31, 2015.

We did not have any changes to our valuation techniques during the three and nine months ended September 30, 2016, nor for the year ended December 31, 2015.

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

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

We recognize or disclose the fair value of certain assets, such as non-financial assets, primarily property, plant and equipment, goodwill, other intangible assets and certain other long-lived assets in connection with impairment evaluations. All of our nonrecurring valuations use significant unobservable inputs and therefore fall under Level 3 of the fair value hierarchy. We did not perform any valuations on assets or liabilities that are valued at fair value on a nonrecurring basis during the first nine months of 2016. During the fourth quarter of 2015, we performed our annual goodwill and indefinite-lived trade names impairment analyses effective as of October 1, 2015. During the nine months ended September 30, 2016 and the year ended December 31, 2015, we did not record any other-than-temporary impairments on our financial assets required to be measured at fair value on a nonrecurring basis.

(5) DERIVATIVES

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

As of September 30, 2016, we had a $68.0 million interest rate swap outstanding with JPMorgan Chase Bank, N.A. This interest rate swap matures on December 31, 2020 and has a fixed rate of 1.42% per annum. The variable rate on the interest rate swap is the one-month LIBOR benchmark. At September 30, 2016, the one-month LIBOR rate was 0.52%.

We typically designate all interest rate swaps as cash flow hedges and, accordingly, record the change in fair value for the effective portion of these interest rate swaps in accumulated other comprehensive income rather than current period earnings until the underlying hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. For the three and nine months ended September 30, 2016, there was no ineffectiveness. As of September 30, 2016, we expect to reclassify a loss of $0.6 million from accumulated other comprehensive loss to earnings within the next twelve months.

The fair value of our derivative instruments was included in our Condensed Consolidated Balance Sheets as follows (in thousands):

| | Balance Sheet Classification | As of September 30, 2016 | December 31, 2015 |
|---|---|---|---|
| Derivatives instruments designated as cash flow hedges: | | | |
| Interest rate swap contract | Accrued liabilities | $ 550 | $ — |
| | Other long-term liabilities | 315 | — |
| | | $ 865 | $ — |

The effect of derivative instruments on our Condensed Consolidated Statements of Operations was as follows (in thousands):

| | Statement of Operations Classification | Three Months Ended September 30, 2016 | 2015 | Nine Months Ended September 30, 2016 | 2015 |
|---|---|---|---|---|---|
| Derivatives instruments designated as cash flow hedges: | | | | | |
| Gain (loss) recognized in other comprehensive income before reclassifications | --- | $ 84 | $ — | $ (896 ) | $ — |
| Loss reclassified from accumulated other comprehensive income to earnings for the effective portion | Interest expense | $ (167 ) | $ — | $ (480 ) | $ — |
| Related tax effect | Income tax benefit | $ 3 | $ — | $ 123 | $ — |

(6) INVENTORIES

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

| | As of September 30, 2016 | December 31, 2015 |
|---|---|---|
| Finished goods | $45,593 | $ 39,115 |
| Parts and components | 3,645 | 3,614 |
| Total inventories | $49,238 | $ 42,729 |

(7) PROPERTY, PLANT AND EQUIPMENT

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

| | Estimated Useful Life (in years) | As of September 30, 2016 | December 31, 2015 |
|---|---|---|---|
| Automobiles | 5 to 6 | $139 | $ 139 |
| Leasehold improvements | 4 to 20 | 3,256 | 3,397 |
| Computer software and equipment | 3 to 7 | 25,706 | 23,991 |
| Machinery and equipment | 3 to 5 | 12,540 | 10,867 |
| Furniture and fixtures | 5 to 20 | 2,062 | 1,605 |
| Work in progress(1) | N/A | 1,308 | 1,655 |
| Total cost | | 45,011 | 41,654 |
| Accumulated depreciation | | (26,965 ) | (24,890 ) |
| Total property, plant and equipment, net | | $18,046 | $ 16,764 |

(1) Work in progress includes production tooling and equipment, and internal use software development.

12

(8) GOODWILL AND OTHER INTANGIBLE ASSETS

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

| | Direct | Retail | Total |
|---|---|---|---|
| Balance, January 1, 2015 | $2,520 | $— | $2,520 |
| Currency exchange rate adjustment | (407) | — | (407) |
| Business acquisition (Note 2) | — | 58,357 | 58,357 |
| Balance, December 31, 2015 | 2,113 | 58,357 | 60,470 |
| Currency exchange rate adjustment | 117 | (8) | 109 |
| Business acquisition (Note 2) - measurement period adjustments | — | (63) | (63) |
| Balance, September 30, 2016 | $2,230 | $58,286 | $60,516 |

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

| | Estimated Useful Life (in years) | As of September 30, 2016 | December 31, 2015 |
|---|---|---|---|
| Indefinite-lived trademarks | N/A | $32,052 | $ 32,052 |
| Definite-lived trademarks | 10 to 15 | 2,600 | 2,600 |
| Patents | 8 to 24 | 31,487 | 31,487 |
| Customer relationships | 10 to 15 | 24,700 | 24,700 |
| | | 90,839 | 90,839 |
| Accumulated amortization - definite-lived intangible assets | | (20,223) | (17,485) |
| Other intangible assets, net | | $70,616 | $ 73,354 |

Amortization expense was as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Amortization expense | $817 | $188 | $2,738 | $657 |

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

| | |
|---|---|
| Remainder of 2016 | $816 |
| 2017 | 3,256 |
| 2018 | 3,164 |
| 2019 | 3,134 |
| 2020 | 3,108 |
| Thereafter | 25,086 |
| | $38,564 |

(9) ACCRUED LIABILITIES

Accrued liabilities consisted of the following (in thousands):

| | As of September 30, 2016 | December 31, 2015 |
|---|---|---|
| Payroll and related liabilities | $3,282 | $ 6,556 |
| Other | 6,097 | 6,471 |
| Total accrued liabilities | $9,379 | $ 13,027 |

(10) PRODUCT WARRANTIES

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

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

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2016 | 2015 |
| Balance, beginning of period | $8,545 | $2,246 |
| Accruals | 2,132 | 1,845 |
| Payments | (2,857 ) | (1,433 ) |
| Balance, end of period | $7,820 | $2,658 |

(11) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

| | Unrealized Gain on Available-for-Sale Securities | Gain (Loss) on Derivative Securities (Effective Portion) | Foreign Currency Translation Adjustments | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|---|
| Balance, June 30, 2016 | $ 10 | $ (787 ) | $ (869 ) | $ (1,646 ) |
| Current period other comprehensive income (loss) before reclassifications | — | 84 | (45 ) | 39 |
| Reclassification of amounts to earnings | — | 164 | — | 164 |
| Net other comprehensive income (loss) during period | — | 248 | (45 ) | 203 |
| Balance, September 30, 2016 | $ 10 | $ (539 ) | $ (914 ) | $ (1,443 ) |

| | Unrealized Gain (Loss) on Available-for-Sale Securities | Loss on Derivative Securities (Effective Portion) | Foreign Currency Translation Adjustments | Accumulated Other Comprehensive Loss |
|---|---|---|---|---|
| Balance, December 31, 2015 | $ (16 ) | $ — | $ (1,311 ) | $ (1,327 ) |
| Current period other comprehensive income (loss) before reclassifications | 26 | (896 ) | 397 | (473 ) |
| Reclassification of amounts to earnings | — | 357 | — | 357 |
| Net other comprehensive income (loss) during period | 26 | (539 ) | 397 | (116 ) |
| Balance, September 30, 2016 | $ 10 | $ (539 ) | $ (914 ) | $ (1,443 ) |

| | Unrealized Gain (Loss) on Available-for-Sale Securities | Foreign Currency Translation Adjustments | Accumulated Other Comprehensive Loss |
|---|---|---|---|
| Balance, June 30, 2015 | $ (5 ) | $ (642 ) | $ (647 ) |
| Current period other comprehensive income (loss) | 10 | (451 ) | (441 ) |
| Balance, September 30, 2015 | $ 5 | $ (1,093 ) | $ (1,088 ) |

| | Unrealized Gain (Loss) on Available-for-Sale Securities | Foreign Currency Translation Adjustments | Accumulated Other Comprehensive Loss |
|---|---|---|---|
| Balance, December 31, 2014 | $ (18 ) | $ (290 ) | $ (308 ) |
| Current period other comprehensive income (loss) | 23 | (803 ) | (780 ) |
| Balance, September 30, 2015 | $ 5 | $ (1,093 ) | $ (1,088 ) |

(12) STOCK REPURCHASE PROGRAM

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

As of September 30, 2016, a total of $13.4 million remained available for future repurchases. The repurchase program expires on November 3, 2016 as to the approximately $3.4 million remaining available for repurchases under the original $15.0 million authorization. The repurchase program expires on May 4, 2018 as to the $10.0 million available for repurchases under the $10.0 million expansion.

There were no repurchases during the three and nine months ended September 30, 2016. Repurchases pursuant to the program were as follows:

| Quarter Ended | Number of Shares | Repurchased Amount | Average Price Per Share |
|---|---|---|---|
| March 31, 2015 | 133,877 | $1,995,982 | $14.91 |
| September 30, 2015 | 577,831 | 9,571,545 | 16.56 |
| Totals to Date | 711,708 | $11,567,527 | $16.25 |

(13) INCOME PER SHARE

Basic per share amounts were computed using the weighted average number of common shares outstanding. Diluted per share amounts were calculated using the number of basic weighted average shares outstanding increased by dilutive potential common shares related to stock-based awards, as determined by the treasury stock method. The weighted average numbers of shares outstanding used to compute income per share were as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Shares used to calculate basic income per share | 31,118 | 31,272 | 31,069 | 31,386 |
| Dilutive effect of outstanding stock options, performance stock units and restricted stock units | 267 | 255 | 271 | 316 |
| Shares used to calculate diluted income per share | 31,385 | 31,527 | 31,340 | 31,702 |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Stock options | 4 | 7 | 11 | 10 |

(14) SEGMENT AND ENTERPRISE-WIDE INFORMATION

We operate in three segments - Direct, Retail, and Commercial and Specialty. Based on the aggregation criteria of ASC 280-10, we determined that two of the operating segments (Retail and Commercial and Specialty) can be aggregated due to these segments having similar economic and other characteristics. As a result, we have two reportable segments - Direct and Retail. This financial reporting structure was effective as of December 31, 2015, the date on which we acquired Octane.

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

16

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Net sales: | | | | |
| Direct | $33,710 | $42,876 | $159,884 | $158,595 |
| Retail | 46,223 | 25,730 | 117,939 | 64,424 |
| Royalty | 885 | 2,084 | 2,452 | 3,605 |
| Consolidated net sales | $80,818 | $70,690 | $280,275 | $226,624 |
| Contribution: | | | | |
| Direct | $2,584 | $5,394 | $31,253 | $30,071 |
| Retail | 9,164 | 3,224 | 17,225 | 5,900 |
| Royalty | 871 | 2,084 | 2,419 | 3,605 |
| Consolidated contribution | $12,619 | $10,702 | $50,897 | $39,576 |
| | | | | |
| Reconciliation of consolidated contribution to income from continuing operations: | | | | |
| Consolidated contribution | $12,619 | $10,702 | $50,897 | $39,576 |
| Amounts not directly related to segments: | | | | |
| Operating expenses | (4,408) | (4,313) | (16,813) | (11,650) |
| Other income (expense), net | (218) | 40 | (1,336) | (265) |
| Income tax expense | (148) | (2,556) | (9,621) | (10,710) |
| Income from continuing operations | $7,845 | $3,873 | $23,127 | $16,951 |

There was no material change in the allocation of assets by segment during the first nine months of 2016 and, accordingly, assets by segment are not presented.

For the three and nine months ended September 30, 2016, Amazon.com accounted for 17.2% and 12.1%, respectively, of total net sales. For the third quarter of 2015, Amazon.com represented 13.6% of our total net sales, and no customer represented 10.0% or more of total net sales for the first nine months of 2015.

(15) COMMITMENTS AND CONTINGENCIES

Guarantees, Commitments and Off-Balance Sheet Arrangements
As of September 30, 2016, we had approximately $0.6 million in standby letters of credit with certain vendors expiring April 2017.

We have long lead times for inventory purchases and, therefore, must secure factory capacity from our vendors in advance. As of September 30, 2016, we had approximately $35.0 million in noncancelable market-based purchase obligations, primarily for inventory purchases expected to be received within the next twelve months. Purchase obligations can vary from quarter-to-quarter and versus the same period in prior years due to a number of factors, including the amount of products that are shipped directly to Retail customer warehouses versus through Nautilus warehouses.

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

The nature and terms of these indemnification obligations vary from contract to contract, and generally a maximum obligation is not stated within the agreements. We hold insurance policies that mitigate potential losses arising from certain types of indemnification obligations. Management does not deem these obligations to be significant to our financial position, results of operations or cash flows and, therefore, no related liabilities were recorded as of September 30, 2016.

Legal Matters

In 2004, we were sued in the Southern District of New York by BioSig Instruments, Inc. for alleged patent infringement in connection with our incorporation of heart rate monitors into certain cardio products. No significant activity in the litigation occurred until 2008. In 2012, the 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. By decision dated April 27, 2015, the same panel of the Federal Circuit affirmed its earlier reversal of the District Court's decision on summary judgment. On May 27, 2015, we filed a petition for a rehearing en banc in the Federal Circuit, which was denied on August 4, 2015 and a Petition for Review by the U. S. Supreme Court which was also denied. The case has been returned to the District Court, and the parties are currently engaged in discovery and other pre-trial motion practice. We do not believe that our use of heart rate monitors utilized or purchased from third parties, and otherwise, infringes the BioSig patents.

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

Litigation and jury verdicts are, to some degree, inherently unpredictable, and although we have determined that a loss is not probable in connection with any current legal proceeding, it is reasonably possible that a loss may be incurred in connection with proceedings to which we are a party. Assessment of whether incurrence of a loss is probable, or a reasonable possibility, in connection with a particular proceeding, and estimation of the loss, or a range of loss, involves complex judgments and numerous uncertainties. Management is unable to estimate a range of reasonably possible losses related to litigation in which the damages sought are indeterminate, or the legal and factual basis for the relevant claims have not been developed with specificity. As such, zero liability is recorded as of September 30, 2016.

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

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

The following discussion and analysis is based upon our financial statements as of the dates and for the periods presented in this section. You should read this discussion and analysis in conjunction with the financial statements and notes thereto found in Part I, Item 1 of this Form 10-Q and our consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015 (the “2015 Form 10-K”). All references to the third quarter and first nine months of 2016 and 2015 mean the three and nine-month periods ended September 30, 2016 and 2015, respectively. Unless the context otherwise requires, “Nautilus,” “we,” “us” and “our” refer to Nautilus, Inc. and its subsidiaries. Unless indicated otherwise, all information regarding our operating results pertains to our continuing operations.

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, costs associated with acquisition or license of products and technologies, 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 of any future growth or profitability. For more information, see our discussion of risk factors located at Part I, Item 1A of our 2015 Form 10-K.

Forward-Looking Statements

This Quarterly Report on Form 10-Q 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. Forward-looking statements include any statements related to our future business and financial performance; anticipated fluctuations in net sales due to seasonality; plans and expectations regarding gross and operating margins; plans and expectations regarding research and development expenses and capital expenditures; anticipated losses from discontinued operations; the anticipated outcome of litigation to which we are a party; results of media investment in the Direct segment; plans for new product introductions and anticipated demand for our new and existing products; and statements regarding our inventory and working capital requirements and the sufficiency of our financial 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 our ability to timely acquire inventory that meets our quality control standards from sole source foreign manufacturers at acceptable costs, the effectiveness, availability and price of media time consistent with our cost and audience profile parameters, greater than anticipated costs associated with launch of new products, our ability to successfully integrate acquired businesses, a decline in consumer spending due to unfavorable economic conditions, softness in the retail marketplace, an adverse change in the availability of credit for our customers who finance their purchases, our ability to pass along vendor raw material price increases and increased shipping costs, our ability to effectively develop, market and sell future products, our ability to protect our intellectual property, the introduction of competing products, and our ability to get foreign-sourced product through customs in a timely manner. Additional assumptions, risks and uncertainties are described in Part I, Item 1A, "Risk Factors," in our 2015 Form 10-K as supplemented or modified in our quarterly reports on Form 10-Q. 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.

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, Canada and Europe. Our products are sold under some of the most-recognized brand names in the fitness industry: Nautilus®, Bowflex®, Octane Fitness®, 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 and specialty retailers 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.

Net sales for the first nine months of 2016 were $280.3 million, an increase of $53.7 million, or 23.7%, as compared to net sales of $226.6 million for the first nine months of 2015. Net sales of our Direct segment increased $1.3 million, or 0.8%, in the first nine months of 2016, compared to the first nine months of 2015, primarily due to increased consumer demand for our cardio products. Net sales of our Retail segment increased by $53.5 million, or 83.1%, in the first nine months of 2016, compared to the first nine months of 2015, primarily due to the addition of Octane sales, coupled with strong organic Retail sales growth across both cardio and strength product offerings.

Gross profit for the first nine months of 2016 was $147.4 million, or 52.6% of net sales, an increase of $26.7 million, or 22.1%, as compared to gross profit of $120.8 million, or 53.3% of net sales, for the first nine months of 2015. The increase in gross profit dollars was primarily due to the increase in net sales as well as margin improvements.

Operating expenses for the first nine months of 2016 were $113.3 million, an increase of $20.5 million, or 22.1%, as compared to operating expenses of $92.8 million for the first nine months of 2015. The growth in operating expenses was primarily related to the incremental operating expenses of the acquired Octane business.

Operating income for the first nine months of 2016 was $34.1 million, an increase of $6.2 million, or 22.1%, as compared to operating income of $27.9 million for the first nine months of 2015. The improvement in operating results for the first nine months of 2016 compared to the first nine months of 2015 was driven primarily by higher net sales and improved gross profits.

Income from continuing operations was $23.1 million for the first nine months of 2016, or $0.74 per diluted share, compared to income from continuing operations of $17.0 million, or $0.53 per diluted share, for the first nine months of 2015. The effective tax rates for the first nine months of 2016 and 2015 were 29.4% and 38.7%, respectively.

Net income for the first nine months of 2016 was $22.6 million, compared to net income of $16.9 million for the first nine months of 2015. Net income per diluted share was $0.72 for the first nine months of 2016, compared to $0.53 for the first nine months of 2015. In the third quarter of 2016, the Company recognized a non-recurring tax benefit of $2.7 million, or $0.09 per diluted share, related to the release of previously unrecognized tax benefits upon completing deregistration of a non-U.S. entity.

Discontinued Operations

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

RESULTS OF OPERATIONS

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

| | Three Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Net sales | $80,818 | $70,690 | $10,128 | 14.3 % |
| Cost of sales | 41,601 | 34,481 | 7,120 | 20.6 % |
| Gross profit | 39,217 | 36,209 | 3,008 | 8.3 % |
| Operating expenses: | | | | |
| Selling and marketing | 21,394 | 21,742 | (348) | (1.6)% |
| General and administrative | 6,177 | 5,505 | 672 | 12.2 % |
| Research and development | 3,435 | 2,573 | 862 | 33.5 % |
| Total operating expenses | 31,006 | 29,820 | 1,186 | 4.0 % |
| Operating income | 8,211 | 6,389 | 1,822 | 28.5 % |
| Other income (expense): | | | | |
| Interest income | 60 | 61 | (1) | |
| Interest expense | (489) | (6) | (483) | |
| Other, net | 211 | (15) | 226 | |
| Total other income (expense), net | (218) | 40 | (258) | |
| Income from continuing operations before income taxes | 7,993 | 6,429 | 1,564 | |
| Income tax expense | 148 | 2,556 | (2,408) | |
| Income from continuing operations | 7,845 | 3,873 | 3,972 | |
| Loss from discontinued operations, net of taxes | (251) | (145) | (106) | |
| Net income | $7,594 | $3,728 | $3,866 | |

| | Nine Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Net sales | $280,275 | $226,624 | $53,651 | 23.7% |
| Cost of sales | 132,852 | 105,870 | 26,982 | 25.5% |
| Gross profit | 147,423 | 120,754 | 26,669 | 22.1% |
| Operating expenses: | | | | |
| Selling and marketing | 81,284 | 70,193 | 11,091 | 15.8% |
| General and administrative | 21,611 | 15,376 | 6,235 | 40.6% |
| Research and development | 10,444 | 7,259 | 3,185 | 43.9% |
| Total operating expenses | 113,339 | 92,828 | 20,511 | 22.1% |
| Operating income | 34,084 | 27,926 | 6,158 | 22.1% |
| Other income (expense): | | | | |
| Interest income | 182 | 164 | 18 | |
| Interest expense | (1,469) | (17) | (1,452) | |
| Other, net | (49) | (412) | 363 | |
| Total other expense, net | (1,336) | (265) | (1,071) | |
| Income from continuing operations before income taxes | 32,748 | 27,661 | 5,087 | |
| Income tax expense | 9,621 | 10,710 | (1,089) | |
| Income from continuing operations | 23,127 | 16,951 | 6,176 | |
| Loss from discontinued operations, net of taxes | (559) | (67) | (492) | |
| Net income | $22,568 | $16,884 | $5,684 | |

21

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

| | Three Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Net sales: | | | | |
| Direct | $33,710 | $42,876 | $(9,166) | (21.4)% |
| Retail | 46,223 | 25,730 | 20,493 | 79.6 % |
| Royalty | 885 | 2,084 | (1,199) | (57.5)% |
| | $80,818 | $70,690 | $10,128 | 14.3 % |
| Cost of sales: | | | | |
| Direct | $11,579 | $15,326 | $(3,747) | (24.4)% |
| Retail | 30,008 | 19,155 | 10,853 | 56.7 % |
| Royalty | 14 | — | 14 | — % |
| | $41,601 | $34,481 | $7,120 | 20.6 % |
| Gross profit: | | | | |
| Direct | $22,131 | $27,550 | $(5,419) | (19.7)% |
| Retail | 16,215 | 6,575 | 9,640 | 146.6 % |
| Royalty | 871 | 2,084 | (1,213) | (58.2)% |
| | $39,217 | $36,209 | $3,008 | 8.3 % |
| Gross margin: | | | | |
| Direct | 65.7 % | 64.3 % | 140 | basis points |
| Retail | 35.1 % | 25.6 % | 950 | basis points |

| | Nine Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Net sales: | | | | |
| Direct | $159,884 | $158,595 | $1,289 | 0.8 % |
| Retail | 117,939 | 64,424 | 53,515 | 83.1 % |
| Royalty | 2,452 | 3,605 | (1,153) | (32.0)% |
| | $280,275 | $226,624 | $53,651 | 23.7 % |
| Cost of sales: | | | | |
| Direct | $53,732 | $56,803 | $(3,071) | (5.4)% |
| Retail | 79,087 | 49,067 | 30,020 | 61.2 % |
| Royalty | 33 | — | 33 | — % |
| | $132,852 | $105,870 | $26,982 | 25.5 % |
| Gross profit: | | | | |
| Direct | $106,152 | $101,792 | $4,360 | 4.3 % |
| Retail | 38,852 | 15,357 | 23,495 | 153.0 % |
| Royalty | 2,419 | 3,605 | (1,186) | (32.9)% |
| | $147,423 | $120,754 | $26,669 | 22.1 % |
| Gross margin: | | | | |
| Direct | 66.4 % | 64.2 % | 220 | basis points |
| Retail | 32.9 % | 23.8 % | 910 | basis points |

22

The following table compares the net sales of our major product lines within each business segment (dollars in thousands):

| | Three Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Direct net sales: | | | | |
| Cardio products(1) | $30,548 | $39,696 | $(9,148 ) | (23.0 )% |
| Strength products(2) | 3,162 | 3,180 | (18 ) | (0.6 )% |
| | 33,710 | 42,876 | (9,166 ) | (21.4 )% |
| Retail net sales: | | | | |
| Cardio products(1) | 33,280 | 14,670 | 18,610 | 126.9 % |
| Strength products(2) | 12,943 | 11,060 | 1,883 | 17.0 % |
| | 46,223 | 25,730 | 20,493 | 79.6 % |
| Royalty | 885 | 2,084 | (1,199 ) | (57.5 )% |
| | $80,818 | $70,690 | $10,128 | 14.3 % |

| | Nine Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Direct net sales: | | | | |
| Cardio products(1) | $149,074 | $147,579 | $1,495 | 1.0 % |
| Strength products(2) | 10,810 | 11,016 | (206 ) | (1.9 )% |
| | 159,884 | 158,595 | 1,289 | 0.8 % |
| Retail net sales: | | | | |
| Cardio products(1) | 86,739 | 37,908 | 48,831 | 128.8 % |
| Strength products(2) | 31,200 | 26,516 | 4,684 | 17.7 % |
| | 117,939 | 64,424 | 53,515 | 83.1 % |
| Royalty | 2,452 | 3,605 | (1,153 ) | (32.0 )% |
| | $280,275 | $226,624 | $53,651 | 23.7 % |

(1) Cardio products include: Max Trainer®, TreadClimber®, Zero Runner®, treadmills, exercise bikes and ellipticals.
(2) Strength products include: home gyms, selectorized dumbbells, kettlebell weights and accessories.

Direct

Direct net sales decreased 21.4% and increased 0.8%, respectively, for the three and nine month periods ended September 30, 2016 compared to the same periods of 2015. The decrease in net sales in the third quarter of 2016 was primarily related to a decline in the media response rate for cardio products, resulting in a decision to defer advertising spending during the quarter to ensure a profitable return on media investment. The increase in net sales for the nine month period ended September 30, 2016 was primarily related to an increase in net sales of our cardio products.

Combined consumer credit approvals by our primary and secondary U.S. third-party financing providers for the third quarter of 2016 was 47.9%, compared to 47.8% in the same period of 2015.

The $3.7 million decrease in cost of sales of our Direct business in the third quarter of 2016 compared to the same period of 2015 was due to lower net sales. The $3.1 million decrease in cost of sales in the nine month period ended September 30, 2016 was due to favorable product mix and lower reserve requirements partially offset by the increase in net sales.

For the three and nine month periods ended September 30, 2016, Direct gross margin increased 140 and 220 basis points, respectively, as compared to the same periods of 2015 primarily due to product mix and lower reserve requirements.

Retail

Retail net sales increased by 79.6% and 83.1%, respectively, for the three and nine month periods ended September 30, 2016 compared to the same periods of 2015. The increases were primarily driven by the acquisition of Octane, as well as organic growth across a variety of cardio and strength products.

The increases in cost of sales of our Retail business for the three and nine month periods ended September 30, 2016 compared to the same periods of 2015 were almost entirely related to the growth in Retail net sales as discussed above.

For the three and nine month periods ended September 30, 2016, Retail gross margin increased 950 and 910 basis points, respectively, compared to the same periods of 2015 due to the inclusion of Octane, which has higher margins, along with leveraging of supply chain costs and lower reserve requirements in the organic Retail business. The margin increases for the three and nine month periods of 2016 are net of purchase price accounting-related inventory step-up charges of $0.1 million and $1.1 million, respectively, that are included in cost of sales.

Selling and Marketing

| Dollars in thousands | Three Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Selling and marketing | $21,394 | $21,742 | $(348) | (1.6)% |
| As % of net sales | 26.5% | 30.8% | | |

| Dollars in thousands | Nine Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Selling and marketing | $81,284 | $70,193 | $11,091 | 15.8% |
| As % of net sales | 29.0% | 31.0% | | |

The $0.3 million decrease in selling and marketing expense in the three month period ended September 30, 2016 compared to the same period of 2015 was primarily related to lower media advertising of $1.7 million, lower variable sales expenses of $1.4 million, and partially offset by incremental selling and marketing expenses related to the inclusion of Octane of $2.5 million. For the nine months ended September 30, 2016, the year-over-year increase was primarily attributable to incremental selling and marketing expenses related to Octane and increased media spend of $7.5 million and $2.6 million, respectively.

The decreases in selling and marketing expense as a percentage of net sales in the three and nine month periods ended September 30, 2016 compared to the same periods of 2015 were primarily due to the acquisition of Octane and growth in the organic Retail business, both of which have a lower selling and marketing expense percentage than the company average.

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

| Dollars in thousands | Three Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Media advertising | $10,790 | $12,510 | $(1,720) | (13.7)% |

| Dollars in thousands | | | Change | |
|---|---|---|---|---|

| | Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Media advertising | $40,804 | $38,211 | $2,593 | 6.8% |

The decrease in media advertising in the three month period ended September 30, 2016 compared to the same period of 2015 was primarily related to a decision to defer advertising spending during the quarter to ensure a profitable return on media investment, in response to a decline in the media response rate for cardio products.

The increase in media advertising in the nine month period ended September 30, 2016 compared to the same period of 2015 was primarily to drive incremental leads and sales in the Direct business.

General and Administrative

| Dollars in thousands | Three Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| General and administrative | $6,177 | $5,505 | $672 | 12.2% |
| As % of net sales | 7.6% | 7.8% | | |

| Dollars in thousands | Nine Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| General and administrative | $21,611 | $15,376 | $6,235 | 40.6% |
| As % of net sales | 7.7% | 6.8% | | |

The increase in general and administrative in the three month period ended September 30, 2016 compared to the same period of 2015 was primarily due to the addition of Octane of $1.1 million and amortization of Octane acquired assets of $0.8 million, partially offset by lower patent and legal charges and a reduction in employee incentive compensation costs of $0.7 million and $0.6 million, respectively. For the nine months ended September 30, 2016 compared to the same period of 2015, the increase was attributable to the inclusion of the Octane business in the amount of $2.9 million, amortization of Octane acquired assets of $2.3 million, acquisition-related consulting expenses of $0.5 million, and non-recurrence of a state business tax refund of $0.5 million received in the second quarter of 2015.

The increase in general and administrative as a percentage of net sales in the nine month period ended September 30, 2016 compared to the same period of 2015 was due to the inclusion of Octane and other increased spending as discussed above.

Research and Development

| Dollars in thousands | Three Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Research and development | $3,435 | $2,573 | $862 | 33.5% |
| As % of net sales | 4.3% | 3.6% | | |

| Dollars in thousands | Nine Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Research and development | $10,444 | $7,259 | $3,185 | 43.9% |
| As % of net sales | 3.7% | 3.2% | | |

The increases in research and development in the three and nine month periods ended September 30, 2016 compared to the same periods of 2015 were primarily due to our investment in additional engineering and product development headcount as we continue to supplement our new product development resources required to innovate and broaden our product portfolio, coupled with the incremental impact of the research and development expenses related to Octane.

The increases in research and development as a percentage of net sales in the three and nine month periods of 2016 compared to the same periods of 2015 were primarily due to the increased investment discussed above.

Interest Expense

Interest expense increased $0.5 million and $1.5 million, respectively, for the three and nine month periods ended September 30, 2016 compared to the same periods of 2015 due to borrowings under our term loan in connection with the Octane acquisition on December 31, 2015.

Other, Net

Other, net relates to the effect of exchange rate fluctuations between the U.S. and our foreign subsidiaries, primarily Canada, China and Europe.

25

Income Tax Expense

| Dollars in thousands | Three Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Income tax expense | $148 | $2,556 | $(2,408) | (94.2)% |
| Effective tax rate | 1.9% | 39.8% | | |

| Dollars in thousands | Nine Months Ended September 30, | | Change | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Income tax expense | $9,621 | $10,710 | $(1,089) | (10.2)% |
| Effective tax rate | 29.4% | 38.7% | | |

The decreases in income tax expense from continuing operations for the three and nine month periods ended September 30, 2016 compared to the same periods of 2015 were primarily attributed to the release of previously unrecognized tax benefits associated with certain non-U.S. filing positions. These resulted from completion of the deregistration process of a certain foreign entity during the third quarter of 2016.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2016, we had total cash and investments of $59.3 million compared to $60.8 million as of December 31, 2015. Cash provided by operating activities was $14.9 million for the nine months ended September 30, 2016, compared to $18.5 million for the nine months ended September 30, 2015. We expect our cash, cash equivalents and available-for-sale securities at September 30, 2016, along with cash expected to be generated from operations, to be sufficient to fund our operating and capital requirements for at least twelve months from September 30, 2016.

The decrease in cash flows from operating activities for the nine months ended September 30, 2016 as compared to the same period of 2015 was primarily due to changes in our operating assets and liabilities as discussed below, partially offset by improved operating performance.

Trade receivables decreased $13.9 million to $31.3 million as of September 30, 2016, compared to $45.2 million as of December 31, 2015, due to seasonally lower net sales in the Retail business. Trade receivables as of September 30, 2016 compared to September 30, 2015 increased $12.2 million due to the acquisition of Octane.

Inventories increased $6.5 million to $49.2 million as of September 30, 2016, compared to $42.7 million as of December 31, 2015 due to seasonal preparations for the coming fourth quarter. Inventories as of September 30, 2016 compared to September 30, 2015 increased by $13.7 million, primarily due to the acquisition of Octane.

Net deferred income tax liability increased $3.9 million to $13.4 million as of September 30, 2016, compared to $9.5 million as of December 31, 2015, primarily due to the utilization of tax credit carryforwards from prior periods.

Trade payables decreased $17.0 million to $44.8 million as of September 30, 2016, compared to $61.7 million as of December 31, 2015, due to seasonality in the business. Trade payables as of September 30, 2016 compared to September 30, 2015 increased $5.9 million. The higher amount outstanding as of September 30, 2016 was primarily due to addition of the Octane business.

Accrued liabilities decreased $3.6 million to $9.4 million as of September 30, 2016, compared to $13.0 million as of December 31, 2015, due to a reduction in accrued incentive compensation in the first nine months of 2016, reflecting payout of incentive compensation during the first quarter.

Cash used in investing activities of $4.8 million for the first nine months of 2016 was primarily related to $3.5 million of payments to Octane under the December 31, 2015 stock purchase agreement, partially offset by net maturities of marketable securities of $1.9 million. In addition, $3.2 million was used for capital expenditures during the period primarily for production tooling and computer hardware and software. We anticipate spending between $5.0 million and $6.0 million in 2016 for software, equipment, and product tooling.

Cash used in financing activities of $9.8 million for the first nine months of 2016 was related to repayments on our term loan of $12.0 million, partially offset by $1.9 million of recognized excess tax benefits related to stock-based compensation.

Financing Arrangements
We have a Credit Agreement with JPMorgan Chase Bank, N.A. (“Chase Bank”) that provides for an $80.0 million term loan and a $20.0 million revolving line of credit. The term of the Credit Agreement expires on December 31, 2020 and is secured by substantially all of our assets.

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

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

The interest rate applicable to the term loan, as well as each advance under the revolving line of credit, is based on either Chase Bank's floating prime rate or adjusted LIBOR, plus an applicable margin. As of September 30, 2016 our borrowing rate for both the term loan and line of credit advances was 1.77%.

As of September 30, 2016, the balance on our term loan was $68.0 million, and we had no outstanding borrowings under the line of credit. In addition, $0.6 million in letters of credit that expire in April 2017 were outstanding under the Credit Agreement. As of September 30, 2016, we were in compliance with the financial covenants of the Credit Agreement and approximately $19.4 million was available for borrowing under the line of credit.

As of September 30, 2016, we had a $68.0 million receive-variable, pay-fixed interest rate swap outstanding with Chase Bank. The interest rate swap amortizes monthly in line with the outstanding principal balance on our term loan and is classified as a cash flow hedge. The swap matures on December 31, 2020 and has a fixed rate of 1.42% per annum. The variable rate on the interest rate swap is the one-month LIBOR benchmark. At September 30, 2016, the one-month LIBOR rate was 0.52%.

Commitments and Contingencies
For a description of our commitments and contingencies, refer to Note 15 to our Condensed Consolidated Financial Statements in Item 1 of this Form 10-Q.

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 September 30, 2016.

Stock Repurchase Program

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

As of September 30, 2016, we have repurchased 711,708 shares at an average price of $16.25 per share for a total of $11.6 million, and $13.4 million remained available for future repurchases. The repurchase program expires on November 3, 2016 as to the approximately $3.4 million remaining available for repurchases under the original $15.0 million authorization. The repurchase program expires on May 4, 2018 as to the $10.0 million available for repurchases under the $10.0 million expansion.

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.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our critical accounting policies have not changed from those discussed in our 2015 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk
Our exposure to market risk from changes in interest rates relates primarily to our cash equivalents, marketable securities, variable-rate debt obligations, and derivative liabilities. As of September 30, 2016, we had cash equivalents of $5.5 million held in a combination of money market funds and commercial paper, and marketable securities of $28.1 million, held in a combination of certificates of deposit, corporate bonds, and U.S. government bonds. Our cash equivalents mature within three months or less from the date of purchase. Marketable securities with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. We have classified our marketable securities as available-for-sale and, therefore, we may choose to sell or hold them as changes in the market occur. Because of the short-term nature of the instruments in our portfolio, a decline in interest rates would reduce our interest income over time, and an increase in interest rates may negatively affect the market price or liquidity of certain securities within the portfolio, but a change in interest rates would not have a material impact on our results of operations, financial position or cash flows.

Our negotiated credit facilities generally charge interest based on a benchmark rate such as LIBOR. Fluctuations in short-term interest rates may cause interest payments on term loan principal and drawn amounts on the revolving line to increase or decrease. As of September 30, 2016, the outstanding balances on our credit facilities totaled $68.0 million.

In January 2016, we entered into an $80.0 million receive-variable, pay-fixed interest rate swap agreement, amortizing monthly in line with the outstanding principal balance on our term loan. The swap is classified as a cash flow hedge and effectively fixes the interest rate on our variable-rate term loan. The interest rate swap matures on December 31, 2020 and has a fixed interest rate of 1.42% per annum. The variable rate on the interest rate swap is the one-month LIBOR benchmark, which was 0.52% at September 30, 2016.

The fair value of our interest rate swap agreement represents the estimated receipts or payments that would be made to terminate the agreement. The amounts related to our cash flow hedge are recorded as deferred gains or losses in our Consolidated Balance Sheets with the offset recorded in accumulated other comprehensive income, net of tax. At September 30, 2016, the fair value of our interest rate swap agreement was a liability of $0.9 million. The estimated amount expected to be reclassified into earnings within the next twelve months was $0.6 million at September 30, 2016.

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

In accordance with Rule 13a-15 of the Securities Exchange Act of 1934 (the “Exchange Act”), as of the end of the period covered by this Quarterly Report on Form 10-Q, our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rule 13a- 15(e) and Rule 15d-15(e) under the Exchange Act). Based upon their evaluation of these disclosure controls and procedures, our management, including the Chief Executive Officer and Chief Financial Officer, have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Control over Financial Reporting

At this time, we continue to evaluate the business and internal controls and processes associated with Octane and are making various changes to its operating and organizational structure based on our business plan. We are in the process of implementing our internal control structure over this acquired business. The SEC’s rules require us to include acquired entities in our assessment of the effectiveness of internal control over financial reporting no later than the annual management report following the first anniversary of the acquisition. We plan to complete the evaluation and the integration of Octane within the required time frames and report management’s assessment of our internal control over financial reporting in our first annual report in which such assessment is required for this acquisition.

There were no changes in our internal control over financial reporting that occurred during the three months ended September 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Patent Infringement Case

In 2004, we were sued in the Southern District of New York by BioSig Instruments, Inc. for alleged patent infringement in connection with our incorporation of heart rate monitors into certain cardio products. No significant activity in the litigation occurred until 2008. In 2012, the 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. By decision dated April 27, 2015, the same panel of the Federal Circuit affirmed its earlier reversal of the District Court’s decision on summary judgment. On May 27, 2015, we filed a petition for a rehearing en banc in the Federal Circuit, which was denied on August 4, 2015 and a Petition for Review by the U. S. Supreme Court which was also denied. The case has been returned to the District Court, and the parties are currently engaged in discovery and other pre-trial motion practice. We do not believe that our use of heart rate monitors utilized or purchased from third parties, and otherwise, infringes the BioSig patents.

In addition to the matter described above, from time to time we 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 1A. Risk Factors

We operate in an environment that involves a number of risks and uncertainties. The risks and uncertainties described in our 2015 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 our 2015 Form 10-K actually occur, our business, operating results and financial position could be adversely affected. There has not been a material change to the risk factors as set forth in our 2015 Form 10-K.

Item 6. Exhibits

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

| Exhibit No. | Description |
|---|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended. |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities and Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101 | The following financial statements from Nautilus, Inc.'s quarterly report on Form 10-Q for the three and nine months ended September 30, 2016 formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets (unaudited), (ii) Condensed Consolidated Statements of Operations (unaudited), (iii) Condensed Consolidated Statements of Comprehensive Income (unaudited), (iv) Condensed Consolidated Statements of Cash Flows (unaudited) and (v) Notes to Condensed Consolidated Financial Statements (unaudited). |

SIGNATURES

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

| | |
|---|---|
| | NAUTILUS, INC.<br>(Registrant) |
| November 3, 2016<br>Date | By: /S/ Bruce M. Cazenave<br>Bruce M. Cazenave<br>Chief Executive Officer<br>(Principal Executive Officer) |
| | NAUTILUS, INC.<br>(Registrant) |
| November 3, 2016<br>Date | By: /S/ Sidharth Nayar<br>Sidharth Nayar<br>Chief Financial Officer<br>(Principal Financial and Accounting Officer) |

31