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NAUTILUS, INC.

Form 10-K

February 27, 2019

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

**FORM 10-K**

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission file number: 001-31321

**NAUTILUS,  
INC.**

(Exact name of  
Registrant as  
specified in its  
charter)

**Washington 94-3002667**  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

**17750 S.E. 6th Way**

**Vancouver, Washington 98683**

(Address of principal executive offices, including zip code)

**(360) 859-2900**

(Registrant's telephone number, including area code)

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

Title of each class Name of each exchange on which registered

**Common Stock, no par value New York Stock Exchange**

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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



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The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the last sales price (\$15.70) as reported on the New York Stock Exchange as of the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2018) was \$398,346,492.

The number of shares outstanding of the registrant's common stock as of February 22, 2019 was 29,590,022 shares.

### **Documents Incorporated by Reference**

The registrant has incorporated by reference into Part III of this Form 10-K portions of its Proxy Statement for its 2019 Annual Meeting of Shareholders.

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**NAUTILUS, INC.**  
**2018 FORM 10-K ANNUAL REPORT**

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**PART I**

***Forward-Looking Statements***

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

**Item 1. Business**

**OVERVIEW**

Founded in 1986, Nautilus, Inc. and subsidiaries (collectively, "Nautilus" or the "Company") is a consumer fitness products company headquartered in Vancouver, Washington and incorporated in the State of Washington in January 1993. We are committed to providing innovative, quality solutions to help people achieve their fitness goals through a fit and healthy lifestyle. Our principal business activities include designing, developing, sourcing and marketing high-quality cardio and strength fitness products and related accessories for consumer and commercial use, primarily in the U.S. and Canada, but also in international markets outside North America. Our products are sold under some of the most-recognized brand names in the fitness industry: Nautilus®, 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, the Internet and catalogs. Our *Retail* business offers our products through a network of independent companies to reach consumers in both the home use, as well as commercial use, markets in the U.S. and internationally. We also derive a portion of our revenue from the licensing of our brands and intellectual property.

**BUSINESS STRATEGY**

We are focused on developing and marketing consumer fitness equipment and related products to help people enjoy healthier lives. Our products are targeted to meet the needs of a broad range of consumers, including fitness enthusiasts and individuals who are seeking the benefits of regular exercise. We have diversified our business by

expanding our portfolio of high quality fitness equipment into multiple product lines utilizing our well-recognized brand names. We are focused on consumer markets and specialty and commercial distribution channels, and view the continual innovation of our product offerings as a key aspect of our business strategy. We regularly refresh our existing product lines with new technologies and finishes, and focus significant effort and resources on the development or acquisition of innovative new fitness products and technologies for introduction to the marketplace at periodic intervals.

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

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

Our long-term strategy involves:

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

## **PRODUCTS**

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

• **Nautilus**<sup>®</sup> is our corporate umbrella brand and is also used to differentiate certain specialized cardio, treadmills, ellipticals and bike products.

• Our **Bowflex**<sup>®</sup> brand represents a highly-regarded line of fitness equipment comprised of both cardio and strength products, including the Max Trainer<sup>®</sup>, TreadClimber<sup>®</sup>, HVT<sup>®</sup> and LateralX<sup>®</sup> specialized cardio machines, PowerRod<sup>®</sup> and Revolution<sup>®</sup> home gyms and SelectTech<sup>®</sup> dumbbells.

• Our **Octane Fitness**<sup>®</sup> brand is known for its innovation around low-impact cardio products, including the perfection of the traditional elliptical machine, along with the creation of new categories of exercise, including the xRide<sup>®</sup> recumbent elliptical, the LateralX<sup>®</sup> elliptical, and the Zero Runner<sup>®</sup>.

• Our **Schwinn**<sup>®</sup> brand is known for its popular line of exercise bikes, including the Airdyne<sup>®</sup>, as well as Schwinn-branded treadmills and ellipticals.

• Our **Universal**<sup>®</sup> brand, one of the oldest and most recognized names in the fitness industry, currently offers a line of weight benches.

We generally differentiate the product models offered in our Direct and Retail sales channels. We typically introduce innovative products in our Direct sales channel and build awareness through our traditional and digital media spending, and then look to cascade these into the Retail channels. We also have specific products targeted for commercial-grade requirements.

Approximately 82% of our revenue in 2018 was derived from sales of consumer cardio products. While we continue to be a leader in the consumer strength product category, we believe the much larger market for cardio products offers us greater opportunity for growth.

## **BUSINESS SEGMENTS AND GEOGRAPHIC INFORMATION**

We conduct our business in two segments, Direct and Retail. For further information regarding our segments and geographic information, see Note 21, *Segment and Enterprise-Wide Information*, to our consolidated financial

statements in Part II, Item 8 of this report.

## **SALES AND MARKETING**

### ***Direct***

In our Direct business, we market and sell our products, principally Bowflex® cardio and strength products, directly to consumers. While we are, and plan to continue to be, a large direct marketer of strength products in the U.S., our advertising emphasis has shifted toward cardio products, especially the Max Trainer®, HVT® and LateralX®, as cardio products represent the largest component of the fitness equipment market and a majority of our business. Sales of cardio products represented 87% of our Direct channel revenues in 2018, compared to 90% and 93% in 2017 and 2016, respectively.

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

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continuously based on sales inquiries generated, cost-per-lead, conversion rates, return on investment and other performance metrics and we strive to optimize the efficiency of our marketing and media expenditures based on this data. Almost all of our Direct customer orders are received either on our Internet websites or through company-owned and third-party call centers.

In order to facilitate consumer sales, we partner with several third-party credit providers. Credit approval rates are an important variable in the number of Direct products we sell in a given period. Combined consumer credit approvals by our primary and secondary U.S. third-party financing providers increased to 55% in 2018 from 54% in 2017 and 51% in 2016. The year-over-year increase in approval rates for 2018 compared to 2017 reflects a continued strong consumer credit environment. The increase in approval rates for 2017 versus 2016 was due to expansion of credit approval standards, primarily by our Tier 1 third-party credit provider.

### ***Retail***

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

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

## **PRODUCT DESIGN AND INNOVATION**

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

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

Our research and development expenses were \$16.8 million, \$15.4 million and \$13.9 million in 2018, 2017 and 2016, respectively, as we increased our investment in new product development resources and capabilities. We expect our research and development expenses to increase in 2019 as we continue to supplement our investment in new product development, technology initiatives, and engineering capabilities.

## **SEASONALITY**

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

**MERCHANDISE SOURCING**

All of our products are produced by third-party manufacturers, and, in 2018, our manufacturing partners were primarily located in Asia. Although multiple factories bid on and are able to produce most of our products, we typically select one factory to be the primary supplier of any given product. Lead times for inventory purchases from our Asian suppliers, from order placement to receipt of goods, generally range from approximately two to three months, of which transit time represents three-to-four weeks. The length of our lead times requires us to place advance manufacturing orders based on management forecasts of future demand



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for our products. We attempt to compensate for our long replenishment lead times by maintaining adequate levels of inventory at our warehousing facilities.

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

## **LOGISTICS**

Our warehousing and distribution facilities are located in Oregon and Ohio. In addition to Company-operated distribution centers, we utilize third-party warehouses and logistics providers to fulfill orders.

In our Direct business we strive to maintain inventory levels that will allow us to ship our products shortly after receiving a customer's order. We use common carriers for substantially all of our merchandise shipments to Direct customers.

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

In 2018, approximately 58% of our Retail customers' orders were shipped by our contract manufacturers in Asia directly to our Retail customers locations, typically in container loads. The use of such direct shipments allows us to maintain lower levels of inventory in our warehouses, resulting in lower storage, handling, freight, insurance and other costs, with much of the savings being passed on to our customers. We use various commercial truck lines for our merchandise shipments to Retail customers.

## **COMPETITION**

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

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

Our principal competitors include: ICON Health & Fitness, Johnson Health Tech, Peloton, Beach Body, American Telecast, Life Fitness, Precor and Technogym. We also compete with marketers of mobile device applications focused on fitness training and coaching on both iOS® and Android™ platforms, such as Workout: Gym exercise planner and NIKE® Training Club. Additional marketers of competitive products include the following: activity trackers and content-driven physical activity products, such as Fitbit® and Garmin vivofit®; computer-based recreation products, such as the Microsoft Xbox®; weight management companies, such as Weight Watchers® and Nutrisystem®; group fitness, such as cross-fit classes; and gym memberships, each of which offers alternative solutions for a fit and healthy

lifestyle.

## **EMPLOYEES**

As of February 22, 2019, we had approximately 460 employees, substantially all of whom were full-time. None of our employees are subject to collective bargaining agreements. We have not experienced a material interruption of our operations due to labor disputes.

## **INTELLECTUAL PROPERTY**

Trademarks, patents and other forms of intellectual property are vital to the success of our business and are an essential factor in maintaining our competitive position in the health and fitness industry. We regularly monitor commercial activity in our industry to identify potential infringement of our intellectual property. We protect our proprietary rights and take prompt, reasonable actions to prevent counterfeit products and other infringement on our intellectual property.

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### ***Trademarks***

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

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

### ***Patents and Designs***

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

We own or license patents and design registrations covering a variety of technologies, some of which are utilized in our selectorized dumbbells, treadmills, exercise bikes, and elliptical machines. Patent and design protection for these technologies, which are utilized in products sold in both the Direct and Retail segments, extends as far as 2034.

We maintain a portfolio of patents related to our TreadClimber® specialized cardio machines, which are sold primarily in our Direct segment. The portfolio includes patents with expiration dates ranging from 2021 to 2027.

We maintain a portfolio of patents and patent applications related to our MaxTrainer® specialized cardio machines, which are sold in our Direct and Retail segments. The portfolio includes issued patents with expiration dates ranging from 2024 to 2034, and additional pending patent applications.

Nautilus is also the licensee of patents related to the Bowflex Revolution® home gyms. These patents have expiration dates ranging from 2022 to 2025. Through its Octane Fitness subsidiary, Nautilus owns and licenses certain patents related to Octane's LateralX®, xRide® and Zero Runner® products. These patents have expiration dates ranging from 2022 to 2034.

## **BACKLOG**

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

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

Our customer order backlog as of December 31, 2018 and 2017 was approximately \$2.9 million and \$6.0 million, respectively.

## **SIGNIFICANT CUSTOMERS**

In 2018, 2017 and 2016, Amazon.com and Dick's Sporting Goods accounted for more than 10% of total net sales as follows:

	<b>2018</b>	<b>2017</b>	<b>2016</b>
Amazon.com	11.5%	11.9%	11.4%
Dick's Sporting Goods	13.8%	*	*

\*Less than 10% of total net sales.

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**ENVIRONMENTAL AND OTHER REGULATORY MATTERS**

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

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

Our digital platforms may receive, process, transmit and store personal health and fitness information relating to identifiable individuals. Consumer demand for personalized fitness experiences, through mobile applications or wearable fitness trackers and our focus on digital fitness solutions for our products may increase the volume of identifiable individual information we receive on our platforms and through our products. We also receive, process, transmit and store information relating to identifiable individuals in our capacity as an employer. As a result, we may be subject to numerous United States (both federal and state) and foreign jurisdiction laws and regulations designed to protect both individually identifiable information as well as personal health information, including the Health Insurance Portability and Accountability Act of 1996, as amended (“HIPAA”) and the European Union’s General Data Protection Regulation (“GDPR”), each of which governs, among other things, the privacy, security and electronic transmission of individually identifiable health information. The GDPR includes, and a growing number of legislative and regulatory bodies elsewhere in the world have adopted, consumer notification requirements in the event of unauthorized access to or acquisition of certain types of personal data. These breach notification laws continue to evolve and include jurisdiction-specific obligations.

We believe that we comply with such laws and regulations in all material respects and our controls in place are adequate for our continued compliance.

**AVAILABLE INFORMATION**

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

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

We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, and other information as filed with the SEC, available free of charge on the investor relations page of our corporate website. In addition to our SEC filings, we also webcast our earnings calls and certain events we participate in with members of the investment community on our investor relations page. Further, we use our investor relations page to make presentations and other materials regarding our business and financial performance available, along with our Code of Business Conduct and Ethics, corporate governance policies, and the charters of our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee. The contents of our websites are not incorporated by reference into this Annual Report on Form 10-K or in any other report or document we file with the SEC, and any references to our websites are intended to be inactive textual references only.

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**Item 1A. Risk Factors**

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

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

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

- Introduction and market acceptance of new products and sales trends affecting specific existing products;
- Variations in product selling prices and costs and the mix of products sold;
- Size and timing of Retail customer orders, which, in turn, often depend upon the success of our customers' businesses or specific products;
- Changes in the market conditions for consumer fitness equipment;
- Changes in macroeconomic factors;
- Availability of consumer credit;
- Timing and availability of products coming from our offshore contract manufacturing suppliers;
- Seasonality of markets, which vary from quarter-to-quarter and are influenced by outside factors such as overall consumer confidence and the availability and cost of television advertising time;
- Effectiveness of our media and advertising programs;
- Customer consolidation in our Retail segment, or the bankruptcy of any of our larger Retail customers;
- Restructuring charges;
- Goodwill and other intangible asset impairment charges; and
- Legal and contract settlement charges.

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

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

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

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

Sales of cardio products, especially Max Trainer® products, represent a substantial portion of our Direct segment revenues. Our products are sold in highly competitive markets with limited barriers to entry. Introduction by competitors of comparable products at lower price-points, a maturing product lifecycle or other factors could result in

a decline in our revenues derived from this product line. A significant decline in our revenue from this product line would have a material adverse effect on our operating results, financial position and cash flows.

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

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



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

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

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

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

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

As of December 31, 2018, we had goodwill of \$63.5 million and other intangible assets of \$55.2 million. Any future impairment charges, if significant, could materially and adversely affect our operating results. An unexpected decline in revenue, changes in market conditions, changes in competitive products or technologies or a change in management's intentions regarding utilization of intangible assets could lead to future impairment charges.

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

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

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

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

cash flows.

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

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

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

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

**We are subject to laws of the United States and foreign jurisdictions relating to individually identifiable information and personal health information, and failure to comply with those laws, whether or not inadvertent, could subject us to legal actions and could materially adversely affect our business, financial condition and results of operations.**

Our digital platforms may receive, process, transmit and store personal health and fitness information relating to identifiable individuals. Consumer demand for personalized fitness experiences, through mobile applications or wearable fitness trackers, and our strategy to focus on digital fitness solutions for our products may increase the volume of identifiable individual information we receive on our platforms and through our products. We also receive, process, transmit and store information relating to identifiable individuals in our capacity as an employer. As a result, we may be subject to United States (both federal and state) and foreign jurisdiction laws and regulations designed to protect both individually identifiable information and personal health information, including HIPAA and its regulations, and the GDPR, which became effective in May 2018. The GDPR includes, and a growing number of legislative and regulatory bodies elsewhere in the world have adopted, consumer notification requirements in the event of unauthorized access to or acquisition of certain types of personal data. These breach notification laws continue to evolve and include jurisdiction-specific obligations. Complying with these obligations could cause us to incur substantial costs and could increase negative publicity surrounding any incident that compromises personal data.

These and other related laws have been subject to frequent changes, and new legislation in this area may be enacted at any time. Changes to existing laws, introduction of new laws in this area or failure to comply with existing laws that are applicable to us may subject us to, among other things, additional costs or changes to our business practices, liability for monetary damages, fines and/or criminal prosecution, unfavorable publicity, restrictions on our ability to obtain and process information and allegations by our customers and consumers that we have not performed our contractual obligations, any of which could materially adversely affect our business, financial condition and results of operations.

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

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

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

New television technologies and services, such as video-on-demand, digital video recorders and Internet streaming services are changing traditional patterns of television viewing. Additionally, consumer attention is increasingly fragmented across a variety of games, apps, the Internet and other digital media, the balance of which may shift at any time in response to media coverage of current events and the advancement of new technologies. We believe that

consumer attention to media coverage of major events, such as the Olympics and the U.S. presidential election, have, in the past, impacted the effectiveness of our media advertising. Future events that draw significant media coverage may similarly impact our ability to engage consumers with our media advertising. If we are unable to successfully adapt our media strategies to new television viewing and media consumption habits, or if consumer attention is focused on other events, the effectiveness and efficiency of our media placements could be adversely affected, and our operating results may be negatively impacted.

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

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

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

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

- Consolidating research and development, logistics, product sourcing, human resources, information technology and other aspects of the combined operations, where appropriate;
- Coordinating sales, distribution and marketing functions and strategies across new and existing channels of trade;
- Establishing or expanding manufacturing, research and development, sales, distribution and marketing functions in order to accommodate newly-acquired businesses or product lines or rationalizing these functions to take advantage of synergies;
- Minimizing the diversion of management's attention from ongoing business concerns;
- Potential loss of key employees of the acquired business;
- Coordinating geographically separate operations; and
- Regulatory and legal issues relating to the integration of legacy and newly-acquired businesses.

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

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

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

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

- Unexpected increases in manufacturing and repair costs;
- Interruptions in shipments if our contract manufacturer is unable to complete production;

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

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

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

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

All of our products are produced by third-party manufacturers, substantially all of which are located in Asia, primarily in China and Taiwan. Additionally, we make significant sales to customers worldwide, in particular to customers in Canada. Most of our imported products are subject to duties or tariffs that affect the cost and quantity of various types of goods imported into the U.S. or our other markets. The current U.S. presidential administration has indicated that it may seek changes to or withdraw the United States from various international treaties and trade arrangements. While we have not been impacted by any tariff changes to date, uncertainty regarding policies affecting global trade may make it difficult for our management to accurately forecast our business, and increases in the duties, tariffs and other charges imposed on our products by the United States or other countries in which our products are manufactured or sold, or other restraints on international trade, could negatively affect our business and the results of our operations.

### **Our business, financial condition and results of operations depend on our ability to attract and retain adequate skilled labor and on the successful implementation of succession plans for key personnel.**

Our future success depends on, among other factors, our ability to attract and retain qualified personnel, including executives and skilled labor. Availability of skilled workers is critical to our operations. We may experience difficulty maintaining desired staffing levels with unemployment rates at low levels in many of the geographic areas in which we manufacture or distribute goods. The loss of qualified personnel, our inability to attract new qualified employees or adequately train employees or a delay in hiring key personnel, could materially adversely affect our business, financial condition and results of operations.

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

All of our products are produced by third-party manufacturers, substantially all of which are located in Asia, primarily China and Taiwan. Lead times for inventory purchases from our Asian suppliers, from order placement to receipt of goods, generally range from approximately two to three months, of which transit time represents three to four weeks. The length of our lead times requires us to place advance manufacturing orders based on management forecasts of future demand for our products. Due to the length of our lead times, our revenue and cash flows may be negatively impacted if we do not have sufficient inventory on hand to meet customer demand for such items. In addition, our liquidity and cash flows may be negatively affected, and inventory obsolescence may increase, if the quantity of products we order exceeds customer demand for such items.

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

Our business depends on our ability to source and distribute products in a timely manner. As a result, we rely on the free flow of goods through open and operational ports worldwide. Labor disputes or other disruptions at ports create

significant risks for our business, particularly if work slowdowns, lockouts, strikes or other disruptions occur during our peak importing seasons. Any of these factors could result in reduced sales, canceled sales orders and unanticipated inventory accumulation and have a material adverse effect on our operating results, financial position and cash flows.

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

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



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and regulations in effect in each country. Changes in any of the above factors could have a material adverse effect on our operating results, financial position and cash flows.

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

Sales of cardio products, especially Max Trainer® products, represent a substantial portion of our Direct segment revenues. Introduction by competitors of comparable products, a maturing product lifecycle or other factors could result in a decline in our revenues derived from this product line. A significant decline in our revenue from this product line, without offsetting sales gains, would have a material adverse effect on our operating results, financial position and cash flows.

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

Protecting our intellectual property is an essential factor in maintaining our competitive position in the health and fitness industry. Failure to maximize or to successfully assert our intellectual property rights could impact our competitiveness. We rely on trademark, trade secret, patent and copyright laws to protect our intellectual property rights. Many factors bear upon the exclusive ownership and right to exploit intellectual properties, including, without limitation, prior rights of third parties and nonuse and/or nonenforcement by us and/or related entities. While we make efforts to develop and protect our intellectual property, the validity, enforceability and commercial value of our intellectual property rights may be reduced or eliminated. We cannot be sure that our intellectual property rights will be maximized or that they can be successfully asserted. There is a risk that we will not be able to obtain and perfect our own intellectual property rights or, where appropriate, license intellectual property rights necessary to compete successfully within the marketplace for our products. We cannot be sure that these rights, if obtained, will not be invalidated, circumvented or challenged in the future. If we do not, or are unable to, adequately protect our intellectual property, then we may face difficulty in differentiating our products from those of our competitors and our business, operating results and financial condition may be adversely affected.

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

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

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

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

From time to time, we may be a defendant in lawsuits and regulatory actions relating to our business or the former operations of our discontinued Commercial business segment. Due to the inherent uncertainties of litigation and regulatory proceedings, we cannot accurately predict the ultimate outcome of any such proceedings. An unfavorable

outcome could have a material adverse effect on our business, financial condition and results of operations. In addition, any significant litigation in the future, regardless of its merits, could divert management's attention from our operations and may result in substantial legal costs.

**Our business is exposed to potential false advertising and other related claims, which could adversely affect our financial condition and performance.**

The global nature of our business involves a risk of exposure under U.S. (both federal and state) and foreign laws and regulations related to false advertising. A false advertising claim or related judgment against us could result in substantial and unexpected expenditures, affect consumer or customer confidence in our products and services, and divert management's time and attention from other responsibilities. Although we maintain product and general liability insurance, there can be no assurance that the type or level of coverage we have is adequate (or will apply to the claim at hand) or that we will be able to continue to maintain our

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existing insurance or obtain comparable insurance at a reasonable cost, if at all. A false advertising or other judgment against us and related negative publicity could have a material adverse effect on our reputation, results of operations and financial condition.

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

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

System failures or service interruptions may occur as the result of a number of factors, including: computer viruses; hacking or other unlawful activities by third parties; disasters; equipment, hardware or software failures; ineffective design or implementation of new systems or systems upgrades; cable outages, extended power failures, or our inability or failure to properly protect, repair or maintain our communication and information systems. To mitigate the risk of business interruption, we have in place a disaster recovery program that targets our most critical operational systems. If our disaster recovery system is ineffective, in whole or in part, or efforts conducted by us or third-parties to prevent or respond to system interruptions in a timely manner are ineffective, our ability to conduct operations would be significantly affected. If we do not consider the potential impact of critical decisions related to systems or process design and implementation, this could lead to operational challenges and increased costs. Any of the aforementioned factors could have a material adverse effect on our operating results, financial position and cash flows.

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

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

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

**Item 1B. Unresolved Staff Comments**

None.

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Following is a summary of each of our properties as of December 31, 2018:

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

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

**Item 3. Legal Proceedings**

From time to time, in the ordinary course of business, we may be involved in various claims, lawsuits and other proceedings. These legal 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.

As of the date of filing of this Annual Report on Form 10-K, we were not involved in any material legal proceedings.

**Item 4. Mine Safety Disclosures**

Not applicable.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*****Market for our Common Stock***

Our common stock is listed on the New York Stock Exchange (the "NYSE") and trades under the symbol "NLS." As of February 22, 2019, there were 42 holders of record of our common stock and approximately 9,370 beneficial shareholders.

We did not pay any dividends on our common stock in 2018 or 2017. Payment of any future dividends, in accordance with our borrowing arrangements, is at the discretion of our Board of Directors, which considers various factors such as our financial condition, operating results, current and anticipated cash needs and future expansion plans.

***Equity Compensation Plans***

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

***Issuer Purchases of Equity Securities***

The following table provides information about our repurchases of our equity securities during the fourth quarter ended December 31, 2018. See Note 18 of Notes to Consolidated Financial Statements for information regarding our public share repurchase programs.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(1),(2)</sup>	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(1),(2)</sup>
October 1 - October 31	428,895	\$13.03	428,895	\$16,408,009
November 1 - November 30	185,290	13.04	185,290	13,991,344
December 1 - December 31	—	—	—	13,991,344
<b>Total</b>	<b>614,185</b>	<b>\$13.04</b>	<b>614,185</b>	<b>\$13,991,344</b>

<sup>(1)</sup> On April 25, 2017, our Board of Directors authorized a \$15.0 million repurchase of our outstanding common stock from time to time through April 25, 2019. As of November 2018, the stock repurchases under this program were completed in full and the program expired.

<sup>(2)</sup> On February 21, 2018, our Board of Directors authorized a \$15.0 million repurchase of our outstanding common stock from time to time through February 21, 2020.

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***Stock Performance Graph***

The graph below compares the cumulative total stockholder return of our common stock with the cumulative total return of the *NYSE Composite Index* and the *S&P SmallCap 600* index for the period commencing December 31, 2013 and ending on December 31, 2018. The *S&P SmallCap 600* was chosen because we do not believe we can reasonably identify an industry index or specific peer issuer that would offer a meaningful comparison. The *S&P SmallCap 600* represents a broad-based index of companies with similar market capitalization.

The graph assumes \$100 was invested, on December 31, 2013, in our common stock and each index presented. The comparisons in the table below are not intended to forecast or be indicative of future performance of our common stock.

**Item 6. Selected Financial Data**

The following selected consolidated financial data should be read in connection with our audited consolidated financial statements and related notes thereto and with Management's Discussion and Analysis of Financial Condition and Results of Operations, which are included elsewhere in this Form 10-K. The consolidated statements of operations data for fiscal years 2018, 2017 and 2016, and the selected consolidated balance sheets data as of December 31, 2018 and 2017 are derived from, and are qualified by reference to, the audited consolidated financial statements which are included in this Form 10-K. The consolidated statements of operations data for fiscal 2015 and 2014 and the consolidated balance sheets data as of December 31, 2016, 2015 and 2014 are derived from audited consolidated financial statements which are not included in this Form 10-K.

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	<b>For the Year Ended December 31,</b>				
<b>(In thousands, except per share amounts)</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Consolidated Statements of Operations Data</b>					
Net sales	\$396,753	\$406,184	\$406,039	\$335,764	\$274,447
Cost of sales	215,013	202,302	194,514	162,530	133,872
Gross profit	181,740	203,882	211,525	173,234	140,575
Operating expenses:					
Selling and marketing	115,920	116,222	115,437	101,618	81,059
General and administrative	28,226	27,111	28,775	21,441	22,131
Research and development	16,825	15,446	13,919	9,904	7,231
Asset impairment charge <sup>(2)</sup>	—	8,800	—	—	—
Total operating expenses	160,971	167,579	158,131	132,963	110,421
Operating income	20,769	36,303	53,394	40,271	30,154
Other income (expense):					
Interest income	1,044	653	234	218	63
Interest expense	(1,051)	(1,552)	(1,928)	(22)	(25)
Other, net	239	301	(119)	(445)	32
Total other income (expense)	232	(598)	(1,813)	(249)	70
Income from continuing operations before income taxes	21,001	35,705	51,581	40,022	30,224
Income tax expense <sup>(3)</sup>	5,891	8,080	16,480	13,219	9,841
Income from continuing operations	15,110	27,625	35,101	26,803	20,383
Loss from discontinued operations	(452)	(1,358)	(923)	(201)	(1,588)
Net income	\$14,658	\$26,267	\$34,178	\$26,602	\$18,795
Basic income per share from continuing operations					
Basic loss per share from discontinued operations	(0.02)	(0.04)	(0.03)	(0.01)	(0.05)
Basic net income per share <sup>(1)</sup>	\$0.49	\$0.86	\$1.10	\$0.85	\$0.60
Diluted income per share from continuing operations					
Diluted loss per share from discontinued operations	(0.01)	(0.04)	(0.03)	(0.01)	(0.05)
Diluted net income per share <sup>(1)</sup>	\$0.48	\$0.85	\$1.09	\$0.84	\$0.59
Shares used in per share calculations:					
Basic	30,099	30,671	31,032	31,288	31,253
Diluted	30,355	31,010	31,301	31,589	31,688
<b>As of December 31,</b>					
<b>Consolidated Balance Sheets Data</b>					
Cash and investments <sup>(4)</sup>	\$63,517	\$85,196	\$79,617	\$60,776	\$72,190
Working capital <sup>(4)</sup>	76,621	91,118	84,951	69,373	83,080
Total assets	332,944	324,776	333,066	315,912	175,654
Long-term note payable, net of current portion <sup>(5)</sup>	15,993	31,986	47,979	63,971	—
Other long-term liabilities	19,514	16,227	25,825	29,432	4,911
Total shareholders' equity	182,596	179,189	160,857	126,991	111,072

(1) May not add due to rounding.



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- (2) Asset impairment charge in 2017 related to the Octane Fitness brand name. See Notes 1, 5, and 11 of notes to consolidated financial statements for additional information.
- (3) Income tax expense in 2017 includes a \$5.6 million benefit related to the change in U.S. tax law that resulted in a lower effective tax rate compared to prior years. See Note 15 of notes to consolidated financial statements for additional information.
- (4) The decreases in cash and investments and working capital at December 31, 2015 compared to December 31, 2014 were primarily due to our purchase of Octane on December 31, 2015.
- (5) The increase in long-term notes payable at December 31, 2015 compared to December 31, 2014 was due to our purchase of Octane on December 31, 2015.

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

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

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

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

**OVERVIEW**

We are committed to providing innovative, quality solutions to help people achieve a fit and healthy lifestyle. Our principal business activities include designing, developing, sourcing and marketing high-quality cardio and strength fitness products and related accessories for consumer use, primarily in the U.S., Canada, Europe and Asia. 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, the Internet and catalogs. Our *Retail* business offers our products through a network of independent retail companies and specialty retailers with stores and websites located in the U.S. and internationally. We also derive a portion of our revenue from the licensing of our brands and intellectual property.

Net sales in 2018 were \$396.8 million, a decrease of \$9.4 million, compared to net sales of \$406.2 million in 2017. Net sales of our Direct segment decreased \$34.5 million, or 15.7%, compared to 2017, primarily due to decreased consumer demand for our Bowflex Max Trainer® cardio products, partially offset by the introduction of the Bowflex LateralX® product line. Net sales of our Retail segment increased by \$24.2 million, or 13.2% in 2018, compared to 2017, reflecting sales increases across a variety of product offerings in the mass and specialty retail channels.

Income from continuing operations was \$15.1 million, or \$0.50 per diluted share, in 2018, compared to \$27.6 million, or \$0.89 per diluted share, in 2017. Income from continuing operations in 2017 included a non-cash intangible asset impairment charge of \$8.8 million, and a one-time tax benefit of \$5.6 million related to the change in United States tax law that resulted in the reassessment of certain deferred tax assets and liabilities.

Net income was \$14.7 million, or \$0.48 per diluted share, in 2018, compared to \$26.3 million, or \$0.85 per diluted share, in 2017.

## **BUSINESS ACQUISITION**

On December 6, 2018, we acquired certain assets of Paofit Holdings Pte Limited, its subsidiaries and related companies (collectively, "Paofit") for an aggregate purchase price of \$2.8 million. The acquisition was funded with cash on hand. Based primarily in Singapore, the Paofit business is focused on developing and distributing software applications known as RunSocial®

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and RideSocial™. The acquisition of Paofit's assets is expected to broaden our digital platform applications and deepen our talent pool.

**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 2018, 2017 or 2016, we continue to incur product liability expenses associated with product previously sold into the Commercial channel, and accrued interest associated with an uncertain tax position on discontinued international operations.

During 2017, our litigation with Biosig Instruments, Inc. ("Biosig") was settled. The litigation began in 2004 and alleged patent infringement in connection with our incorporation of heart rate monitors into certain cardio products of our former Commercial business. We paid Biosig \$1.2 million under the settlement, and the matter was dismissed with prejudice. The settlement was expensed in discontinued operations.

**CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements in conformity with generally accepted accounting principles requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements. An accounting estimate is considered to be critical if it meets both of the following criteria: (i) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change, and (b) the impact of the estimate on financial condition or operating performance is material. Our critical accounting estimates are discussed below.

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

We evaluate our indefinite-lived intangible assets and goodwill for potential impairment annually or when events or circumstances indicate their carrying value may be impaired. Definite-lived intangible assets, including acquired trade names, customer relationships, patents and patent rights, and other long-lived assets, primarily property, plant and equipment, are evaluated for impairment when events or circumstances indicate the carrying value may be impaired. In 2017, we recognized a non-cash intangible asset impairment charge of \$8.8 million related to the indefinite-lived Octane Fitness brand name. No goodwill or other long-term asset impairment charges were recognized in 2018 or 2016.

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

Table of Contents**RESULTS OF OPERATIONS**

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

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

	<b>Year Ended December</b>			
	<b>2018</b>	<b>2017</b>	<b>Change</b>	<b>% Change</b>
Net sales	\$396,753	\$406,184	\$(9,431 )	(2.3 )%
Cost of sales	215,013	202,302	12,711	6.3 %
Gross profit	181,740	203,882	(22,142 )	(10.9 )%
Operating expenses:				
Selling and marketing	115,920	116,222	(302 )	(0.3 )%
General and administrative	28,226	27,111	1,115	4.1 %
Research and development	16,825	15,446	1,379	8.9 %
Asset impairment charge	—	8,800	(8,800 )	— %
Total operating expenses	160,971	167,579	(6,608 )	(3.9 )%
Operating income	20,769	36,303	(15,534 )	(42.8 )%
Other income (expense):				
Interest income	1,044	653	391	
Interest expense	(1,051 )	(1,552 )	501	
Other, net	239	301	(62 )	
Total other income (expense), net	232	(598 )	830	
Income before income taxes	21,001	35,705	(14,704 )	
Income tax expense	5,891	8,080	(2,189 )	
Income from continuing operations	15,110	27,625	(12,515 )	
Loss from discontinued operations, net of income taxes	(452 )	(1,358 )	906	
Net income	\$14,658	\$26,267	\$(11,609)	

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	Year Ended December 31,			
	2017	2016	Change	% Change
Net sales	\$406,184	\$406,039	\$145	— %
Cost of sales	202,302	194,514	7,788	4.0 %
Gross profit	203,882	211,525	(7,643 )	(3.6 )%
Operating expenses:				
Selling and marketing	116,222	115,437	785	0.7 %
General and administrative	27,111	28,775	(1,664 )	(5.8 )%
Research and development	15,446	13,919	1,527	11.0 %
Asset impairment charge	8,800	—	8,800	— %
Total operating expenses	167,579	158,131	9,448	6.0 %
Operating income	36,303	53,394	(17,091 )	(32.0 )%
Other income (expense):				
Interest income	653	234	419	
Interest expense	(1,552 )	(1,928 )	376	
Other, net	301	(119 )	420	
Total other expense, net	(598 )	(1,813 )	1,215	
Income before income taxes	35,705	51,581	(15,876 )	
Income tax expense	8,080	16,480	(8,400 )	
Income from continuing operations	27,625	35,101	(7,476 )	
Loss from discontinued operations, net of income taxes	(1,358 )	(923 )	(435 )	
Net income	\$26,267	\$34,178	\$(7,911)	

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

	Year Ended December 31,			
	2018	2017	Change	% Change
Net sales:				
Direct	\$184,925	\$219,440	\$(34,515)	(15.7 )%
Retail	208,092	183,875	24,217	13.2 %
Royalty	3,736	2,869	867	30.2 %
	\$396,753	\$406,184	\$(9,431 )	(2.3 )%
Cost of sales:				
Direct	\$73,446	\$78,716	\$(5,270 )	(6.7 )%
Retail	141,564	123,569	17,995	14.6 %
Royalty	3	17	(14 )	(82.4 )%
	\$215,013	\$202,302	\$12,711	6.3 %
Gross profit:				
Direct	\$111,479	\$140,724	\$(29,245)	(20.8 )%
Retail	66,528	60,306	6,222	10.3 %
Royalty	3,733	2,852	881	30.9 %
	\$181,740	\$203,882	\$(22,142)	(10.9 )%
Gross margin:				
Direct	60.3	% 64.1	% (380 )	basis points
Retail	32.0	% 32.8	% (80 )	basis points



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	Year Ended December 31,		Change	% Change	
	2017	2016			
Net sales:					
Direct	\$219,440	\$225,057	\$(5,617)	(2.5)	%
Retail	183,875	177,920	5,955	3.3	%
Royalty	2,869	3,062	(193)	(6.3)	%
	\$406,184	\$406,039	\$145	—	%
Cost of sales:					
Direct	\$78,716	\$75,390	\$3,326	4.4	%
Retail	123,569	119,080	4,489	3.8	%
Royalty	17	44	(27)	(61.4)	%
	\$202,302	\$194,514	\$7,788	4.0	%
Gross profit:					
Direct	\$140,724	\$149,667	\$(8,943)	(6.0)	%
Retail	60,306	58,840	1,466	2.5	%
Royalty	2,852	3,018	(166)	(5.5)	%
	\$203,882	\$211,525	\$(7,643)	(3.6)	%
Gross margin:					
Direct	64.1	% 66.5	(240)		) basis points
Retail	32.8	% 33.1	(30)		) basis points

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

	Year Ended December 31,		Change	% Change	
	2018	2017			
Direct net sales:					
Cardio products <sup>(1)</sup>	\$160,132	\$197,683	\$(37,551)	(19.0)	%
Strength products <sup>(2)</sup>	24,793	21,757	3,036	14.0	%
	184,925	219,440	(34,515)	(15.7)	%
Retail net sales:					
Cardio products <sup>(1)</sup>	165,911	143,020	22,891	16.0	%
Strength products <sup>(2)</sup>	42,181	40,855	1,326	3.2	%
	208,092	183,875	24,217	13.2	%
Royalty income					
	3,736	2,869	867	30.2	%
	\$396,753	\$406,184	\$(9,431)	(2.3)	%



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	Year Ended December 31,			
	2017	2016	Change	% Change
Direct net sales:				
Cardio products <sup>(1)</sup>	\$ 197,683	\$ 209,569	\$(11,886)	(5.7 )%
Strength products <sup>(2)</sup>	21,757	15,488	6,269	40.5 %
	219,440	225,057	(5,617 )	(2.5 )%
Retail net sales:				
Cardio products <sup>(1)</sup>	143,020	135,562	7,458	5.5 %
Strength products <sup>(2)</sup>	40,855	42,358	(1,503 )	(3.5 )%
	183,875	177,920	5,955	3.3 %
Royalty income	2,869	3,062	(193 )	(6.3 )%
	\$406,184	\$406,039	\$145	— %

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

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

***Net Sales and Cost of Sales****Direct*

The 15.7% decrease in year-over-year Direct net sales for 2018 compared to 2017 was primarily due to decreased consumer demand for our Max Trainer® and was partially offset by an increase in strength products. The 2.5% decrease in year-over-year Direct net sales for 2017 compared to 2016 was primarily due to decreased consumer demand for our TreadClimber® cardio products, partially offset by an increase in sales of strength products. The business also benefited from higher U.S. consumer credit approval rates in both years.

Combined consumer credit approvals by our primary and secondary U.S. third-party financing providers were 55.3% in 2018 compared to 54.4% in 2017 and 50.6% in 2016.

The decrease in Direct cost of sales in 2018 compared to 2017 was due to the decrease in net sales. The increase in Direct cost of sales in 2017 compared to 2016 was due to higher product costs, partially offset by the decrease in net sales.

The 380 basis point decrease in the gross margin of our Direct business for 2018 compared to 2017 was due to unfavorable product mix and unfavorable overhead absorption due to the decrease in net sales.

The 240 basis point decrease in the gross margin of our Direct business for 2017 compared to 2016 was due to higher discounting of select products, increased product costs related to unfavorable currency trends, and unfavorable product mix.

*Retail*

The 13.2% increase in Retail net sales in 2018 compared to 2017 was driven primarily by sales increases across a variety of product offerings in both the mass retail and specialty and commercial channel.

The 3.3% increase in Retail net sales in 2017 compared to 2016 was driven primarily by sales increases across a variety of product offerings in the mass retail channel, partially offset by weakness in the specialty and commercial channel.

The increases in Retail cost of sales in 2018 compared to 2017, and in 2017 compared to 2016, were due to the increases in Retail net sales mentioned above.

The 80 and 30 basis point decreases in Retail gross margin in 2018 compared to 2017, and in 2017 compared to 2016, respectively, were due to higher promotional discounting, increases in product costs, and unfavorable product mix.

Table of Contents**Selling and Marketing**

Dollars in thousands	Year Ended December 31,		Change	
	2018	2017	\$	%
Selling and marketing	\$115,920	\$116,222	\$(302)	(0.3)%
As % of net sales	29.2%	28.6%		
Dollars in thousands	Year Ended December 31,		Change	
	2017	2016	\$	%
Selling and marketing	\$116,222	\$115,437	\$785	0.7%
As % of net sales	28.6%	28.4%		

Selling and marketing expenses in 2018 compared to 2017 were relatively flat year-over-year. The increase in selling and marketing in 2017 compared to 2016 was primarily due to a \$5.5 million increase in media advertising, coupled with a \$1.0 million increase in creative production costs related to HVT, partially offset by reductions in variable sales expenses of \$5.8 million, mainly reduced financing fees.

The slight increases in sales and marketing as a percentage of net sales in 2018 compared to 2017, and in 2017 compared to 2016, were primarily due to less efficient performance of media, resulting in increased media spends in 2018 and 2017 to achieve Direct sales levels.

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

Dollars in thousands	Year Ended December 31,		Change	
	2018	2017	\$	%
Media advertising	\$65,017	\$65,130	\$(113)	(0.2)%
Dollars in thousands	Year Ended December 31,		Change	
	2017	2016	\$	%
Media advertising	\$65,130	\$59,638	\$5,492	9.2%

The return metrics we achieved on media performance declined in 2018 and 2017, requiring approximately the same media investment to achieve lower Direct net sales. We continue to closely monitor our media investments in order to optimize the investment and sales.

**General and Administrative**

Dollars in thousands	Year Ended December 31,		Change	
	2018	2017	\$	%
General and administrative	\$28,226	\$27,111	\$1,115	4.1%
As % of net sales	7.1%	6.7%		
Dollars in thousands	Year Ended December 31,		Change	
	2017	2016	\$	%
General and administrative	\$27,111	\$28,775	\$(1,664)	(5.8)%
As % of net sales	6.7%	7.1%		

The increase in general and administrative in 2018 compared to 2017 was primarily due to increased legal expense.

The decrease in general and administrative in 2017 compared to 2016 was primarily due to \$1.5 million of savings related to lower integration and administrative costs related to Octane, and a \$1.3 million reduction in incentive and stock compensation expense, offset by increased litigation costs of \$1.3 million.

The increase in general and administrative as a percentage of net sales in 2018 compared to 2017 was primarily due to the increase in legal expenses and the lower total net sales.

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The decrease in general and administrative as a percentage of net sales in 2017 compared to 2016 was primarily due to achieving cost synergies related to the Octane Fitness acquisition.

**Research and Development**

Dollars in thousands	Year Ended		Change	
	December 31, 2018	December 31, 2017	\$	%
Research and development	\$16,825	\$15,446	\$1,379	8.9%
As % of net sales	4.2%	3.8%		

  

Dollars in thousands	Year Ended		Change	
	December 31, 2017	December 31, 2016	\$	%
Research and development	\$15,446	\$13,919	\$1,527	11.0%
As % of net sales	3.8%	3.4%		

The increases in research and development in 2018 compared to 2017, and in 2017 compared to 2016, 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.

**Asset Impairment Charge**

During the fourth quarter of 2017, we identified impairment indicators in our Octane Fitness brand name originally acquired through the Octane Fitness acquisition on December 31, 2015. Weakness in the specialty retail channel as a result of retailer consolidation had a negative impact on Octane branded sales and projected growth trends. We utilized the relief-from-royalty method to quantify the impairment, resulting in an \$8.8 million non-cash impairment charge for 2017. The impairment charge was recorded in operating expenses on the consolidated statements of operations.

**Interest Expense**

Interest expense of \$1.1 million, \$1.6 million and \$1.9 million in 2018, 2017 and 2016, respectively, was primarily related to our term loan.

**Other, Net**

Other, net primarily relates to the effect of currency exchange rate fluctuations with the U.S. and our foreign subsidiaries. In addition, 2017 included a gain of \$0.2 million for an insurance reimbursement related to inventory loss.

**Income Tax Expense**

Dollars in thousands	Year Ended		Change	
	December 31, 2018	December 31, 2017	\$	%
Income tax expense	\$5,891	\$8,080	\$(2,189)	(27.1)%
Effective tax rate	28.1%	22.6%		

  

Dollars in thousands	Year Ended		Change	
	December 31, 2017	December 31, 2016	\$	%
Income tax expense	\$8,080	\$16,480	\$(8,400)	(51.0)%
Effective tax rate	22.6%	31.9%		

Income tax expense in all years was primarily attributable to the income generated domestically and internationally. Income tax expense in 2018 benefited from the Tax Cuts and Jobs Act ("TCJA"), which reduced the U.S. federal

corporate rate to 21%. Further, 2018 income tax expense included a \$0.6 million state tax rate adjustment. This adjustment was associated with the 2017 provision to the tax returns and valuation allowance related to the state net operating loss deferred tax assets, which impacted the effective tax rate by 2.8%.

Income tax expense in 2017 was partially offset by a \$5.6 million income tax benefit related to the change in U.S. tax law that resulted in the revaluation of certain deferred tax assets and liabilities.

Income tax expense for 2016 included a release of previously unrecognized tax benefits of \$2.7 million associated with certain non-U.S. filing positions, which resulted from completing the deregistration of a certain foreign entity.

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The amount of valuation allowance offsetting our deferred tax assets was \$1.2 million as of December 31, 2018. Of the total remaining valuation allowance, \$0.9 million primarily relates to domestic state tax credit carryforwards and state net operating loss carryforwards as we currently do not anticipate generating income of appropriate character to utilize those deferred tax assets. In addition, \$0.3 million of the remaining valuation allowance relates to foreign net operating loss carryforwards. As of the end of fiscal year 2018, there were no material changes to our foreign operations since December 31, 2017 and, accordingly, we maintain our existing valuation allowance on foreign deferred income tax assets in such jurisdictions at December 31, 2018.

Refer to Note 15, *Income Taxes*, to our consolidated financial statements included in Part II, Item 8 of this report for additional information.

## **LIQUIDITY AND CAPITAL RESOURCES**

As of December 31, 2018, we had \$63.5 million of cash and investments, compared to \$85.2 million as of December 31, 2017. Cash provided by operating activities was \$21.3 million for 2018, compared to cash provided by operating activities of \$35.0 million for 2017. We expect our cash, cash equivalents and available-for-sale securities at December 31, 2018, along with cash expected to be generated from operations, to be sufficient to fund our operating and capital requirements for at least twelve months from December 31, 2018.

The decrease in cash flows from operating activities for 2018, compared to 2017, was primarily due to decreased operating performance and the changes in our operating assets and liabilities as discussed below.

Trade receivables increased by \$3.2 million to \$45.8 million as of December 31, 2018, compared to \$42.7 million as of December 31, 2017, due to the increase of Retail sales in the fourth quarter of 2018 compared to the same period of 2017.

Inventories increased by \$15.1 million to \$68.5 million as of December 31, 2018, compared to \$53.4 million as of December 31, 2017, primarily due to lower than expected net sales in the Direct segment, coupled with a strategic inventory buildup to mitigate supply chain uncertainties due to potential international tariffs.

Prepays and other current assets increased by \$0.7 million to \$8.0 million as of December 31, 2018, compared to \$7.2 million as of December 31, 2017, due to added marketing costs for future campaigns, partially offset by royalty payments received in the current year.

Trade payables increased by \$20.4 million to \$87.3 million as of December 31, 2018, compared to \$66.9 million as of December 31, 2017, primarily due to increased spending on inventory in the fourth quarter of 2018.

Accrued liabilities decreased by \$2.4 million to \$8.4 million as of December 31, 2018 compared to \$10.8 million as of December 31, 2017, primarily due to reductions in income tax payable and sales returns reserves in the current year.

Warranty obligations decreased by \$0.5 million to \$5.6 million as of December 31, 2018 compared to \$6.1 million as of December 31, 2017, primarily due to improvement in the experience rates of our products, resulting from better product quality, full stock of parts availability and sales mix.

Net deferred income tax liabilities increased by \$3.3 million to \$11.8 million as of December 31, 2018, compared to \$8.6 million as of December 31, 2017, primarily due to the full expensing of certain business assets for tax purposes as a result of the recent change in the U.S. tax law.

Cash provided by investing activities of \$18.7 million for 2018 was primarily related to the net maturities of marketable securities of \$31.8 million, partially offset by \$10.4 million used for capital expenditures during 2018, primarily for information technology assets, the Max Intelligence platform, and production tooling and equipment. We anticipate spending \$8.0 million to \$10.0 million in 2019 for digital platform enhancements and production tooling.

Cash used in financing activities of \$28.6 million for 2018 was related to principal repayments on our term loan of \$16.0 million and share repurchase program spending of \$13.0 million.

***Financing Arrangements***

On December 31, 2015 we entered into an amendment (the “Amendment”) to our existing Credit Agreement, dated December 5, 2014, with JPMorgan Chase Bank, N.A. (“Chase Bank”) that provided for an \$80.0 million term loan (the “Term Loan”) to finance the acquisition of Octane Fitness, which matures on December 31, 2020. The Term Loan and our existing \$20.0 million revolving



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line of credit with Chase Bank are secured by substantially all of our assets. The Credit Agreement was amended again on December 21, 2018, which, among other changes, extended the term of the \$20.0 million revolving line of credit to December 31, 2021.

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

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

The interest rate applicable to the Term Loan, as well as each advance under the revolving line of credit, is based on either Chase Bank's floating prime rate or adjusted LIBOR, plus an applicable margin. As of December 31, 2018 our borrowing rate for both the Term Loan and line of credit advances was 3.34%.

As of December 31, 2018, we had outstanding borrowings of \$32.0 million on our term loan and no letters of credit issued under the Credit Agreement. As of December 31, 2018, we were in compliance with the financial covenants of the Credit Agreement, and there were no borrowings under the \$20.0 million line of credit available.

***Stock Repurchase Program***

On April 25, 2017, our Board of Directors authorized a \$15.0 million share repurchase program. Under this program, shares of common stock may be repurchased from time to time through April 25, 2019. During 2018, repurchases under this program totaled \$12.0 million. As of November 2018, the stock repurchases under this program were completed in full and the program expired.

On February 21, 2018 our Board of Directors authorized an additional \$15.0 million share repurchase program. Under this program, shares of our common stock may be repurchased from time to time through February 21, 2020. As of December 31, 2018, repurchases under this program totaled \$1.0 million.

During 2018, we repurchased 990,229 shares at an average price of \$13.12

Repurchases may be made in open market transactions at prevailing market prices, in privately negotiated transactions, or by other means in accordance with federal securities laws. Share repurchases are funded with existing cash balances, and the repurchased shares are retired and returned to unissued authorized shares.

***Commitments and Contingencies***

For a description of our commitments and contingencies, refer to Note 22, *Commitments and Contingencies*, to our consolidated financial statements in Part II, Item 8 of this report.

***Non-Cancellable Contractual Obligations***

Our operating cash flows include the effect of certain non-cancellable contractual obligations. A summary of such obligations as of December 31, 2018 is as follows (in thousands):

Payments due by period				
Total	Less than 1	1-3 years	3-5 years	More than 5

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		year		years	
Long-term debt obligations, including interest	\$32,816	\$16,604	\$16,212	\$—	\$—
Operating lease obligations	21,866	5,366	9,426	4,427	2,647
Purchase obligations <sup>(1)</sup>	27,240	27,240	—	—	—
Minimum royalty obligations	1,138	1,138	—	—	—
Capital lease obligations	305	132	173	—	—
Total	\$83,365	\$50,480	\$25,811	\$4,427	\$2,647

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

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capacity from our vendors in advance. Our third-party manufacturing contracts are generally of annual or shorter duration, or manufactured products are sourced on the basis of individual purchase orders.

Due to uncertainty with respect to the timing of future cash flows associated with our unrecognized tax benefits at December 31, 2018, we are unable to make reasonably reliable estimates of the timing of any cash settlements with the respective taxing authorities. Therefore, approximately \$3.7 million of liabilities related to unrecognized tax benefits, including interest and penalties on uncertain tax positions, have been excluded from the contractual table above. For further information, refer to Note 15, *Income Taxes*, to our consolidated financial statements in Part II, Item 8 of this report.

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

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

The nature and terms of these indemnifications vary from contract to contract, and generally a maximum obligation is not stated. We hold insurance policies that mitigate potential losses arising from certain types of indemnifications. Because we are unable to estimate our potential obligation, and because management does not expect these obligations to have a material adverse effect on our consolidated financial position, results of operations or cash flows, no liabilities are recorded at December 31, 2018.

## **INFLATION**

We do not believe that inflation had a material effect on our business, financial condition or results of operations in 2018, 2017 or 2016. Inflation pressures do exist in countries where our contract manufacturers are based; however, we have largely mitigated these increases through cost improvement measures.

## **NEW ACCOUNTING PRONOUNCEMENTS**

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

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

***Interest Rate and Foreign Exchange Risk***

Our exposure to market risk from changes in interest rates relates primarily to our cash equivalents, marketable debt securities, derivative assets, and variable-rate debt obligations. As of December 31, 2018, we had cash equivalents of \$7.6 million held in money market funds, and marketable debt securities of \$25.4 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.

Our negotiated credit facilities generally charge interest based on a benchmark rate such as LIBOR. Fluctuations in short-term interest rates may cause interest payments on term loan principal and drawn amounts on the revolving line to increase or decrease. As of December 31, 2018, the outstanding balances on our credit facilities totaled \$32.0 million.

As of December 31, 2018, we had a \$32.0 million receive-variable, pay-fixed interest rate swap outstanding with Chase Bank, which amortizes 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 2.34% at December 31, 2018.

The fair value of our interest rate swap agreement represents the estimated receipts or payments that would be made to terminate the agreement. The amounts related to our cash flow hedge are recorded as deferred gains or losses in our consolidated balance sheets with the offset recorded in accumulated other comprehensive income, net of tax. At December 31, 2018, the fair value of our interest rate swap agreement was an asset of \$0.4 million. The estimated amount expected to be reclassified into earnings within the next twelve months was \$0.3 million at December 31, 2018.

We enter into foreign exchange forward contracts to offset the earnings impacts of exchange rate fluctuations on certain monetary assets and liabilities. Total notional amounts outstanding at December 31, 2018 were \$28.6 million. A hypothetical 10% increase in interest rates, or a 10% movement in the currencies underlying our foreign currency derivative positions, would not have material impacts on our results of operations, financial position or cash flows.

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

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

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders and Board of Directors  
Nautilus, Inc.:

***Opinion on the Consolidated Financial Statements***

We have audited the accompanying consolidated balance sheets of Nautilus, Inc. and subsidiaries (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited the adjustments to the 2016 consolidated financial statements to retrospectively apply the change in accounting for revenue recognition due to the adoption of ASC 606 Revenue from Contracts with Customers, as described in Note 4. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2016 consolidated financial statements of the Company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2016 consolidated financial statements taken as a whole.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 27, 2019 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

***Basis for Opinion***

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audit included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as the Company's auditor since 2017.

Portland, Oregon  
February 27, 2019

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**Report of Independent Registered Public Accounting Firm**

To the Shareholders and Board of Directors

Nautilus, Inc.:

***Opinion on Internal Control Over Financial Reporting***

We have audited Nautilus, Inc. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements), and our report dated February 27, 2019 expressed an unqualified opinion on those consolidated financial statements.

***Basis for Opinion***

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB. We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

***Definition and Limitations of Internal Control Over Financial Reporting***

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

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

/s/ KPMG LLP

Portland, Oregon  
February 27, 2019

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

We have audited, before the effects of the adjustments to retrospectively apply the change in accounting discussed in Note 4 to the consolidated financial statements, the consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows of Nautilus, Inc. and subsidiaries (the "Company") for the year ended December 31, 2016 (the 2016 consolidated financial statements before the effects of the adjustments discussed in Note 4 to the consolidated financial statements are not presented herein). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such 2016 consolidated financial statements, before the effects of the adjustments to retrospectively apply the change in accounting discussed in Note 4 to the consolidated financial statements, present fairly, in all material respects, the results of their operations and cash flows of Nautilus, Inc. and subsidiaries for the year ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America. We were not engaged to audit, review, or apply any procedures to the adjustments to retrospectively apply the change in accounting discussed in Note 4 to the consolidated financial statements and, accordingly, we do not express an opinion or any other form of assurance about whether such retrospective adjustments are appropriate and have been properly applied. Those retrospective adjustments were audited by other auditors.

*/s/ Deloitte & Touche LLP*

Portland, Oregon  
February 27, 2017

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

	As of December 31,	
	2018	2017
		*
<b>Assets</b>		
Cash and cash equivalents	\$38,125	\$27,893
Available-for-sale securities	25,392	57,303
Trade receivables, net of allowances of \$99 and \$119	45,847	42,685
Inventories	68,465	53,354
Prepays and other current assets	7,980	7,240
Income taxes receivable	5,653	17
Total current assets	191,462	188,492
Property, plant and equipment, net	22,216	15,827
Goodwill	63,452	62,030
Other intangible assets, net	55,240	57,743
Other assets	574	684
Total assets	\$332,944	\$324,776
<b>Liabilities and Shareholders' Equity</b>		
Trade payables	\$87,265	\$66,899
Accrued liabilities	8,370	10,764
Warranty obligations, current portion	3,213	3,718
Note payable, current portion, net of unamortized debt issuance costs of \$7 and \$7	15,993	15,993
Total current liabilities	114,841	97,374
Warranty obligations, non-current	2,362	2,399
Income taxes payable, non-current	3,427	2,955
Deferred income tax liabilities, non-current	11,888	8,558
Other long-term liabilities	1,837	2,315
Note payable, non-current, net of unamortized debt issuance costs of \$7 and \$14	15,993	31,986
Total liabilities	150,348	145,587
Commitments and contingencies (Note 22)		
Shareholders' equity:		
Common stock - no par value, 75,000 shares authorized, 29,545 and 30,305 shares issued and outstanding	215	—
Retained earnings	183,290	179,448
Accumulated other comprehensive loss	(909	) (259 )
Total shareholders' equity	182,596	179,189
Total liabilities and shareholders' equity	\$332,944	\$324,776

\*See Note 4.

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2018	2017	2016
		*	*
Net sales	\$396,753	\$406,184	\$406,039
Cost of sales	215,013	202,302	194,514
Gross profit	181,740	203,882	211,525
Operating expenses:			
Selling and marketing	115,920	116,222	115,437
General and administrative	28,226	27,111	28,775
Research and development	16,825	15,446	13,919
Asset impairment charge	—	8,800	—
Total operating expenses	160,971	167,579	158,131
Operating income	20,769	36,303	53,394
Other income (expense):			
Interest income	1,044	653	234
Interest expense	(1,051)	(1,552)	(1,928)
Other, net	239	301	(119)
Total other income (expense), net	232	(598)	(1,813)
Income from continuing operations before income taxes	21,001	35,705	51,581
Income tax expense	5,891	8,080	16,480
Income from continuing operations	15,110	27,625	35,101
Discontinued operations:			
Loss from discontinued operations before income taxes	(206)	(1,713)	(1,077)
Income tax expense (benefit) of discontinued operations	246	(355)	(154)
Loss from discontinued operations	(452)	(1,358)	(923)
Net income	\$14,658	\$26,267	\$34,178
Basic income per share from continuing operations	\$0.50	\$0.90	\$1.13
Basic loss per share from discontinued operations	(0.02)	(0.04)	(0.03)
Basic net income per share <sup>(1)</sup>	\$0.49	\$0.86	\$1.10
Diluted income per share from continuing operations	\$0.50	\$0.89	\$1.12
Diluted loss per share from discontinued operations	(0.01)	(0.04)	(0.03)
Diluted net income per share <sup>(1)</sup>	\$0.48	\$0.85	\$1.09
Shares used in per share calculations:			
Basic	30,099	30,671	31,032
Diluted	30,355	31,010	31,301

<sup>(1)</sup> May not add due to rounding.

\*See Note 4.

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2018	2017	2016
Net income	\$14,658	\$26,267	\$34,178
Other comprehensive income (loss):		*	*
Unrealized gain (loss) on marketable securities, net of income tax expense (benefit) of \$13, \$(27), and \$5	58	(56)	) 8
Gain (loss) on derivative securities, effective portion, net of income tax expense (benefit) of \$(17), \$171, and \$(14)	7	240	(24 )
Foreign currency translation adjustment, net of income tax expense (benefit) of \$(2), \$1, and \$(5)	(715	) 774	126
Other comprehensive income (loss)	(650	) 958	110
Comprehensive income	\$14,008	\$27,225	\$34,288

\*See Note 4.

See accompanying notes to consolidated financial statements.

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

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount			
<b>Balances at January 1, 2016</b>	31,005	\$ 796	\$ 127,522	\$ (1,327 )	\$ 126,991
Net income	—	—	34,178	*—	34,178
Unrealized gain on marketable securities, net of income tax expense of \$5	—	—	—	8	8
Loss on derivative securities, effective portion, net of income tax benefit of \$14	—	—	—	(24 )	(24 )
Foreign currency translation adjustment, net of income tax benefit of \$5	—	—	—	126	126
Stock-based compensation expense	—	2,613	—	—	2,613
Common stock issued under equity compensation plan, net of shares withheld for tax payments	116	117	—	—	117
Common stock issued under employee stock purchase plan	24	381	—	—	381
Tax benefit related to stock-based awards	—	1,857	—	—	1,857
Repurchased shares	(320 )	(5,186)	(204 )	—	(5,390 )
<b>Balances at December 31, 2016</b>	30,825	578	161,496	(1,217 )	160,857
Net income	—	—	26,267	*—	26,267
Unrealized gain on marketable securities, net of income tax benefit of \$27	—	—	—	(56 )	(56 )
Loss on derivative securities, effective portion, net of income tax expense of \$171	—	—	—	240	240
Foreign currency translation adjustment, net of income tax expense of \$1	—	—	—	774	774
Stock-based compensation expense	—	1,884	(28 )	—	1,856
Common stock issued under equity compensation plan, net of shares withheld for tax payments	231	(181 )	—	—	(181 )
Common stock issued under employee stock purchase plan	37	487	—	—	487
Repurchased shares	(788 )	(2,768)	(8,287 )	—	(11,055 )
<b>Balances at December 31, 2017</b>	30,305	—	179,448	(259 )	179,189
Net income	—	—	14,658	—	14,658
Unrealized loss on marketable securities, net of income tax expense of \$13	—	—	—	58	58
Gain on derivative securities, effective portion, net of income tax benefit of \$17	—	—	—	7	7
Foreign currency translation adjustment, net of income tax benefit of \$2	—	—	—	(715 )	(715 )
Stock-based compensation expense	—	1,981	—	—	1,981
Common stock issued under equity compensation plan, net of shares withheld for tax payments	192	(30 )	—	—	(30 )
Common stock issued under employee stock purchase plan	38	444	—	—	444

Repurchased shares	(990 )	(2,180 )	(10,816 )	—	(12,996 )
<b>Balances at December 31, 2018</b>	<b>29,545</b>	<b>\$ 215</b>	<b>\$ 183,290</b>	<b>\$ (909 )</b>	<b>\$ 182,596</b>

\*See Note 4.

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2018	2017	2016
		*	*
<b>Cash flows from operating activities:</b>			
Income from continuing operations	\$15,110	\$27,625	\$35,101
Loss from discontinued operations	(452 )	(1,358 )	(923 )
Net income	14,658	26,267	34,178
Adjustments to reconcile net income to net cash provided by operating activities:			
Asset impairment charge	—	8,800	—
Depreciation and amortization	8,942	8,643	7,874
Bad debt expense	27	311	289
Inventory lower-of-cost-or-market/NRV adjustments	558	1,067	245
Stock-based compensation expense	1,981	1,856	2,613
Loss on asset disposals	32	56	147
Deferred income taxes, net of valuation allowances	3,229	(8,556 )	9,510
Excess tax benefit related to stock-based awards	—	—	(1,857 )
Other	133	(117 )	5
Changes in operating assets and liabilities:			
Trade receivables	(3,030 )	2,516	(694 )
Inventories	(15,634 )	(7,526 )	(3,110 )
Prepays and other current assets	(495 )	1,080	(1,415 )
Income taxes receivable	(5,636 )	3,214	(2,792 )
Trade payables	19,312	449	6,464
Accrued liabilities, including warranty obligations	(2,826 )	(3,044 )	(5,606 )
<b>Net cash provided by operating activities</b>	<b>21,251</b>	<b>35,016</b>	<b>45,851</b>
<b>Cash flows from investing activities:</b>			
Acquisition of business, net of cash acquired	(2,750 )	—	(3,468 )
Purchases of property, plant and equipment and intangible assets	(10,380 )	(3,792 )	(4,656 )
Purchases of available-for-sale-securities	(29,522 )	(88,413 )	(34,739 )
Proceeds from maturities of available-for-sale securities	61,365	62,939	32,923
Proceeds from sales of available-for-sale securities	—	—	71
<b>Net cash provided by (used in) investing activities</b>	<b>18,713</b>	<b>(29,266 )</b>	<b>(9,869 )</b>
<b>Cash flows from financing activities:</b>			
Payments on long-term debt	(16,000 )	(16,000 )	(16,000 )
Proceeds from employee stock purchases	444	487	381
Proceeds from exercise of stock options	366	560	356
Tax payments related to stock award issuances	(396 )	(741 )	(239 )
Excess tax benefit related to stock-based awards	—	—	1,857
Payments for stock repurchases	(12,996 )	(11,055 )	(5,390 )
<b>Net cash used in financing activities</b>	<b>(28,582 )</b>	<b>(26,749 )</b>	<b>(19,035 )</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>(1,150 )</b>	<b>1,018</b>	<b>149</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>10,232</b>	<b>(19,981 )</b>	<b>17,096</b>
<b>Cash and cash equivalents:</b>			
<b>Beginning of year</b>	<b>27,893</b>	<b>47,874</b>	<b>30,778</b>
<b>End of year</b>	<b>\$38,125</b>	<b>\$27,893</b>	<b>\$47,874</b>
<b>Supplemental disclosure of cash flow information:</b>			

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Cash paid for income taxes, net	\$8,885	\$11,630	\$11,511
Cash paid for interest	1,044	1,545	1,920
<b>Supplemental disclosure of non-cash investing activities:</b>			
Capital expenditures incurred but not yet paid	\$1,220	\$404	\$210

\*See Note 4.

See accompanying notes to consolidated financial statements.

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

**(1) SIGNIFICANT ACCOUNTING POLICIES**

***Organization and Business***

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

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

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

***Basis of Consolidation and Presentation***

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

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. We have reclassified certain amounts in prior-period financial statements to conform to the current period's presentation. On the consolidated balance sheets, we have reclassified income taxes receivable from "prepaids and other current assets."

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

***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 our former Commercial business during 2016 through 2018, we continue to have product liability and other legal expenses associated with product previously sold into the Commercial channel.

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

***Critical Accounting Estimates***

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

other long-term assets valuation. Actual results could differ from our estimates.

***Concentrations***

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

We rely on third-party contract manufacturers in Asia for substantially all of our products and for certain product engineering support. Business operations could be disrupted by natural disasters, difficulties in transporting products from non-U.S. suppliers, as well as political, social or economic instability in the countries where contract manufacturers or their vendors or customers conduct business. While any such contract manufacturing arrangement could be replaced over time, the temporary loss of the services of any primary contract manufacturer could delay product shipments and cause a significant disruption in our operations.

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We derive a significant portion of our net sales from a small number of our Retail customers. A loss of business from one or more of these large customers, if not replaced with new business, would negatively affect our operating results and cash flows. In 2018, two customers each individually accounted for more than 10%, but less than 15%, of our net sales. In each of 2017 and 2016, one customer accounted for more than 10%, but less than 15%, of our net sales.

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

All highly liquid investments with original maturities of three months or less at purchase are considered to be cash equivalents. As of December 31, 2018, cash equivalents consisted of money market funds and totaled \$7.6 million. As of December 31, 2017, cash equivalents consisted of money market funds and commercial paper and totaled \$12.9 million.

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

We classify our marketable debt securities as available-for-sale and, accordingly, record them at fair value. Marketable securities with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. Unrealized holding gains and losses, which are immaterial, are excluded from earnings and are reported net of tax in other comprehensive income until realized. Dividend and interest income is recognized when earned. Realized gains and losses, which were not material in 2018 or 2017, are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

We periodically evaluate whether declines in fair values of our investments below their cost are "other-than-temporary." This evaluation consists of qualitative and quantitative factors regarding the severity and duration of the unrealized loss, as well as our ability and intent to hold the investment until a forecasted recovery occurs. For additional information, refer to Note 5, *Fair Value Measurements*.

### ***Derivative Securities***

We record our derivative securities at fair value, and our portfolio currently consists of an interest rate swap contract and foreign currency forward contracts. The fair value of our interest rate swap agreement, which is classified as a cash flow hedge, represents the estimated receipts or payments that would be made to terminate the agreement. The amounts related to the cash flow hedge are recorded as deferred gains or losses in our consolidated balance sheets with the offset recorded in accumulated other comprehensive loss, net of tax.

We enter into foreign exchange forward contracts to offset the earnings impacts of exchange rate fluctuations on certain monetary assets and liabilities. A hypothetical 10% increase in interest rates, or a 10% movement in the currencies underlying our foreign currency derivative positions, would not have material impacts on our results of operations, financial position or cash flows. Gains and losses on foreign currency forward contracts are recognized in the *Other, net* line of our consolidated statements of operations.

We do not enter into derivative instruments for any purpose other than to manage our interest rate or foreign currency exposure. That is, we do not engage in interest rate or currency exchange rate speculation using derivative instruments. For additional information, refer to Note 6, *Derivatives*.

### ***Trade Receivables***

Accounts receivable primarily consists of trade receivables due from our Retail segment customers. We determine an allowance for doubtful accounts based on historical customer experience and other currently available evidence. When a specific account is deemed uncollectible, the account is written off against the allowance. For additional information, refer to Note 7, *Trade Receivables*.

***Inventories***

Inventories are stated at the lower of cost and net realizable value ("NRV"), with cost determined based on the first-in, first-out method. We establish inventory allowances for excess, slow-moving and obsolete inventory based on inventory levels, expected product life and forecasted sales. Inventories are written down to NRV based on historical demand, competitive factors, changes in technology and product lifecycles. For additional information, refer to Note 8, *Inventories*.

***Property, Plant and Equipment***

Property, plant and equipment is stated at cost, net of accumulated depreciation. Improvements or betterments which add new functionality or significantly extend the life of an asset are capitalized. Software costs related to an asset developed for internal use are capitalized after the preliminary project stage, management has committed to the completion of the project and it is probable the project will be complete and used as intended. Expenditures for maintenance and repairs are expensed as incurred. The cost of assets retired, or otherwise disposed of, and the related accumulated depreciation, are removed from the accounts at the time

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of disposal. Gains and losses resulting from asset sales and dispositions are recognized in the period in which assets are disposed. Depreciation is recognized, using the straight-line method, over the lesser of the estimated useful lives of the assets or, in the case of leasehold improvements, the lease term, including renewal periods if we expect to exercise our renewal options. Depreciation on automobiles, computer software and equipment, machinery and equipment, and furniture and fixtures is determined based on estimated useful lives, which generally range from two-to-seven years. For additional information, refer to Note 9, *Property, Plant and Equipment*.

### ***Goodwill***

Goodwill consists of the excess of acquisition costs over the fair values of net assets acquired in business combinations. It is not amortized, but rather is tested at the reporting unit level at least annually for impairment or more frequently if triggering events or changes in circumstances indicate impairment. Initially, qualitative factors are considered to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Some of these qualitative factors may include macroeconomic conditions, industry and market considerations, a change in financial performance, entity-specific events, a sustained decrease in share price, and consideration of the difference between the fair value and carrying amount of a reporting unit as determined in the most recent quantitative assessment. If, through this qualitative assessment, the conclusion is made that it is more likely than not that a reporting unit's fair value is less than its carrying amount, a quantitative impairment analysis is performed. A quantitative impairment analysis involves estimating the fair value of a reporting unit using widely-accepted valuation methodologies including the income and market approaches, which requires the use of estimates and assumptions. These estimates and assumptions include revenue growth rates, discounts rates, and determination of appropriate market comparables. If the fair value of the reporting unit is less than its carrying amount, an impairment loss is recognized in an amount equal to that excess, not to exceed the carrying amount of the goodwill.

We performed assessments of goodwill in the fourth quarters of 2018, 2017 and 2016, and determined no impairments were indicated in those years. We evaluate goodwill at the reporting unit level. Our goodwill assets related to our Canadian subsidiary and the Paofit acquisition are attributable to our Direct reporting unit, and our goodwill related to the Octane acquisition is attributable to our Retail reporting unit. For further information regarding goodwill, see Note 10, *Goodwill*.

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

Indefinite-lived intangible assets consist of acquired trademarks, specifically trade names. Indefinite-lived intangible assets are stated at cost and are not amortized; instead, they are tested for impairment at least annually. We review our indefinite-lived trademarks for impairment in the fourth quarter of each year and when events or changes in circumstances indicate that the assets may be impaired. The fair value of trademarks is estimated using the relief-from-royalty method to estimate the value of the cost savings and a discounted cash flows method to estimate the value of future income. The sum of these two values for each trademark is the fair value of the trademark. If the carrying amount of trademarks exceeds the estimated fair value, we calculate impairment as the excess of carrying amount over the estimate of fair value.

We tested our indefinite-lived trademarks for impairment in the fourth quarters of 2018, 2017 and 2016. During the fourth quarter of 2017, we identified impairment indicators in our Octane Fitness brand name originally acquired through the Octane Fitness acquisition on December 31, 2015. Ongoing weakness in the specialty retail channel, as a result of retailer consolidation, had a negative impact on Octane branded sales and projected growth trends. We utilized the relief-from-royalty method to quantify the impairment, resulting in an \$8.8 million non-cash impairment charge for 2017. The impairment charge is recorded in operating expenses on the consolidated statements of operations. We determined no impairment was indicated in 2018 and 2016 for our indefinite-lived intangible assets.

Definite-lived intangible assets, primarily acquired trade names, customer relationships, patents and patent rights, are stated at cost, net of accumulated amortization, and are evaluated for impairment as discussed below under *Impairment of Long-Lived Assets*. We recognize amortization expense for our definite-lived intangible assets on a straight-line basis over the estimated useful lives. For further information regarding other intangible assets, see Note 11, *Other Intangible Assets*.

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

Long-lived assets, including property, plant and equipment and definite-lived intangible assets, are evaluated for impairment when events or circumstances indicate the carrying value may be impaired. When such an event or condition occurs, we estimate the future undiscounted cash flows to be derived from the use and eventual disposition of the asset to determine whether a potential impairment exists. If the carrying value exceeds estimated future undiscounted cash flows, we record impairment expense to reduce the carrying value of the asset to its estimated fair value. No impairment charges were recorded in 2018, 2017 and 2016.

***Share Repurchases***

Shares of our common stock may be repurchased from time to time as authorized by our Board of Directors. Repurchases may be made in open market transactions at prevailing prices, in privately negotiated transactions, or by other means in accordance

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with federal securities laws. Share repurchases are funded from existing cash balances, and repurchased shares are retired and returned to unissued authorized shares. These repurchases are accounted for as reductions to our common stock to the extent available with remaining amounts allocated against retained earnings. For additional information, see Note 18, *Stock Repurchase Programs*.

***Revenue Recognition and Adoption of Topic 606***

On January 1, 2018, we adopted ASU 2014-09 and all subsequent ASUs that modified ASC 606. We elected to apply the standard and all related ASUs retrospectively to each prior reporting period presented. The implementation of the new standard had no material impact on the measurement or recognition of revenue, resulting in no adjustments to prior periods. Additional disclosures, however, have been added in accordance with the ASU.

Our Direct and Retail revenues are recognized when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services. Our product sales and shipping revenues are reported net of promotional discounts, returns allowances, contractual rebates, and consideration payable to our customers. We estimate the revenue impact of retail sales incentive programs based on the planned duration of the program and historical experience.

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

For additional information, see Note 4, *Revenues*.

***Sales Discounts and Returns Allowance***

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

	2018	2017	2016
<b>Balance, January 1</b>	\$6,920	\$5,901	\$5,677
Charges to reserve	15,058	18,377	12,935
Reductions for sales discounts and returns	(17,559)	(17,358)	(12,711)
<b>Balance, December 31</b>	\$4,419	\$6,920	\$5,901

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

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

***Shipping and Handling Fees***

Shipping and handling fees billed to customers are recorded net of discounts and included in both net sales and cost of sales. We generally account for our shipping and handling activities as a fulfillment activity, consistent with the timing of revenue recognition; that is, when our customer takes control of the transferred goods.

***Cost of Sales***

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

***Product Warranty Obligations***

Our products carry defined warranties for defects in materials or workmanship which, according to their terms, generally obligate us to pay the costs of supplying and shipping replacement parts to customers and, in certain instances, pay for labor and other costs to service products. Outstanding product warranty periods range from thirty days to, in limited circumstances, the lifetime of certain product components. We record a liability at the time of sale for the estimated costs of fulfilling future warranty claims. If necessary, we adjust the liability for specific warranty-related matters when they become known and are reasonably estimable.



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Estimated warranty expense is included in cost of sales, based on historical warranty claim experience and available product quality data. Warranty expense is affected by the performance of new products, significant manufacturing or design defects not discovered until after the product is delivered to the customer, product failure rates, and higher or lower than expected repair costs. If warranty expense differs from previous estimates, or if circumstances change such that the assumptions inherent in previous estimates are no longer valid, the amount of product warranty obligations is adjusted accordingly.

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

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

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

We expense our advertising and promotion costs as incurred. Production costs of television advertising commercials are recorded in prepaids and other current assets until the initial broadcast, at which time such costs are expensed. Advertising and promotion costs are included in selling and marketing expenses and totaled \$65.7 million, \$66.4 million and \$60.7 million for the years ended December 31, 2018, 2017 and 2016, respectively. Prepaid advertising and promotion costs were \$2.7 million and \$1.5 million as of December 31, 2018 and 2017, respectively.

### ***Research and Development***

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

### ***Income Taxes***

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

### ***Unrecognized Tax Benefits***

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

### ***Foreign Currency Translation***

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

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

***Fair Value of Financial Instruments***

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

For additional information on financial instruments recorded at fair value on a recurring basis as of December 31, 2018 and 2017, refer to Note 5, *Fair Value Measurements*.

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### ***Stock-Based Compensation***

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

Fair value of stock options and shares subject to our employee stock purchase plan are estimated using the Black-Scholes valuation model; fair value of performance share unit ("PSU") awards, restricted stock unit ("RSU") awards and restricted stock awards ("RSA") is based on the closing market price on the day preceding the grant.

Prior to our adoption of Financial Accounting Standards Board's ("FASB") Accounting Standards Update ("ASU") 2016-09 in January 2017, we estimated future forfeitures, at the time of grant and in subsequent periods, based on historical turnover rates, previous forfeiture experience and changes in the business or key personnel that would suggest future forfeitures may differ from historical data. We recognized compensation expense for only those stock options and other stock-based awards that were expected to vest. We reevaluated estimated forfeitures monthly and, if applicable, recognized a cumulative effect adjustment in the period of the change if the revised estimate of the impact of forfeitures differed significantly from the previous estimate. With our adoption of ASU 2016-09, we changed our accounting treatment of forfeiture expense reversals from "at vest date" to "at forfeiture date." As a result, we no longer estimate future forfeitures prior to their actual occurrence.

Shares to be issued upon the exercise of stock options or the vesting of stock awards will come from newly issued shares.

### ***Income Per Share Amounts***

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

### ***Recent Accounting Pronouncements***

#### *Newly-Adopted Pronouncements*

##### **ASU 2018-15**

In August 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-15, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract." The amendments in ASU 2018-15 align the requirements for capitalizing implementation costs incurred in a cloud computing hosting arrangement ("CCA") that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The accounting for the service element of a hosting arrangement that is a service contract is not affected. ASU 2018-15 also includes provisions for expensing the capitalized implementation costs over the term of the hosting arrangement, and application of impairment and abandonment guidance under Subtopics 350-40 and 360-10, respectively. Further, the amendments include presentation requirements in the entity's financial statements for the capitalized implementation costs and related amortization expense. ASU 2018-15 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted, and the amendments should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. We early adopted ASU 2018-15 as of October 1, 2018 on a prospective basis. Our adoption of ASU 2018-15 had no material impact on our financial position, results of operations or cash flows.

**ASU 2018-05**

In March 2018, the FASB issued ASU 2018-05, "Income Taxes (Topic 740)." ASU 2018-05 provides amendments to SEC paragraphs pursuant to Staff Accounting Bulletin ("SAB") No. 118 related to the accounting for the income tax effects of the Tax Cuts and Jobs Act ("TCJA" or the "Act") enacted as of December 22, 2017. ASU 2018-05 clarifies the income tax effects of the TCJA when accounting under Topic 740 is (1) complete, (2) incomplete, but for which a reasonable estimate can be determined, or (3) incomplete, but for which a reasonable estimate cannot be determined. The adoption of ASU 2018-05 as of the March 13, 2018 issuance date had no material impact on our financial position, results of operations or cash flows. Upon further analysis of our transition tax calculation, we recorded an increase to the provisional amount of less than \$0.1 million, which equates to a less than 1.0% impact to the effective tax rate, in 2018. This amount is included as a component of income tax expense from continuing operations. Our accounting for the income tax effects of the TCJA was completed as of December 31, 2018.

**ASU 2017-09**

In May 2017, the FASB issued ASU 2017-09, "Compensation - Stock Compensation (Topic 718) - Scope in Modification Accounting." ASU 2017-09 provides clarity and reduces diversity in practice and cost and complexity when applying the guidance in Topic 718 to a change to the terms or conditions of a share-based payment award. An entity should account for the effects of a

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modification unless all of certain criteria are met. Those criteria relate to fair value, vesting conditions and classification of the modified award. If all three conditions are the same for the modified award as for the original award, then the entity should not account for the effects of the modification. ASU 2017-09 was effective for all entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017. Our adoption of ASU 2017-09 as of January 1, 2018 had no material impact on our financial position, results of operations or cash flows.

### **ASU 2017-01**

In January 2017, the FASB issued ASU 2017-01, "Business Combinations (Topic 805) - Clarifying the Definition of a Business." ASU 2017-01 provides a screen to determine when a set is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. If the screen is not met, ASU 2017-01 (1) requires that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) removes the evaluation of whether a market participant could replace missing elements. The ASU provides a framework to assist entities in evaluating whether both an input and a substantive process are present. ASU 2017-01 was effective for all public business entities annual periods, including interim periods within those annual periods, beginning after December 15, 2017. Our adoption of ASU 2017-01 as of January 1, 2018 had no material impact on our financial position, results of operations or cash flows.

### **ASU 2016-16**

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory." Current GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset is sold to an outside party. The amendments in ASU 2016-16 eliminate the exception for an intra-entity transfer of an asset other than inventory, and allows recognition of the income tax consequences when the transfer occurs. ASU 2016-16 was effective for public companies' fiscal years, including interim periods within those fiscal years, beginning after December 15, 2017, applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings. Our adoption of ASU 2016-16 as of January 1, 2018 had no material effect on our financial position, results of operations or cash flows.

### **ASU 2016-15**

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments." The amendments in ASU 2016-15 are intended to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows, with the intent of reducing diversity in practice for the eight types of cash flows identified. ASU 2016-15 was effective for public companies' fiscal years, including interim periods within those fiscal years, beginning after December 15, 2017. Our adoption of ASU 2016-15 as of January 1, 2018 had no 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 (Topic 606)." ASU 2014-09 replaces most existing revenue recognition guidance, and requires companies to recognize revenue based upon the transfer of promised goods and/or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and/or services. In addition, the standard requires disclosures related to the nature, timing, and uncertainty of revenue and cash flows arising from contracts with customers. We applied the five-step method outlined in the ASU to all revenue streams and elected the full retrospective method for our adoption of the standard as of January 1, 2018. The additional disclosures required by the ASU are included in Note 4, *Revenues*.

## Recently Issued Pronouncements Not Yet Adopted

**ASU 2018-13**

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement." The amendments in ASU 2018-13 modify the disclosure requirements on fair value measurements in Topic 820 based on the concepts in the FASB Concepts Statement, *Conceptual Framework for Financial Reporting - Chapter 8: Notes to Financial Statements*, which was finalized in August 2018. The main provisions include removals, modifications, and additions of specific disclosure requirements. ASU 2018-13 is effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments should be applied prospectively for only the most recent interim or annual period presented in the initial year of adoption, while all other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted, and an entity may early adopt upon issuance of ASU 2018-13 those amendments that remove or modify disclosures and delay adoption of the additional disclosures until the effective date. While we do not expect the adoption of ASU 2018-13 to have a material effect on our business, we are evaluating the potential impact that the new ASU may have on our financial position, results of operations and cash flows.

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### **ASUs 2018-11, 2018-10, 2018-01 and 2016-02**

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 replaces the existing guidance in Accounting Standards Codification ("ASC") 840, Leases. The new standard requires lessees to recognize leases on-balance sheet and disclose key information about leasing arrangements. Topic 842 was subsequently amended by ASU 2018-01, "Land Easement Practical Expedient for Transition to Topic 842"; ASU 2018-10, "Codification Improvements to Topic 842, Leases;" and ASU 2018-11, "Targeted Improvements." The new standard establishes a right-of-use model ("ROU") that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases will be classified as finance or operating. 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.

The new standard is effective for us on January 1, 2019, with early adoption permitted. We expect to adopt the new standard on its effective date. A modified retrospective transition approach is required, applying the new standard to all leases existing at the date of initial application. An entity may choose to use either (1) its effective date or (2) the beginning of the earliest comparative period presented in the financial statements as its date of initial application. We expect to adopt the new standard on January 1, 2019 and use the effective date as our date of initial application. Consequently, financial information will not be updated and the disclosures required under the new standard will not be provided for dates and periods before January 1, 2019.

The new standard provides a number of optional practical expedients in transition. We expect to elect the 'package of practical expedients', which permits us not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. We expect to elect the use-of-hindsight practical expedient with respect to determining lease terms. We do not expect to elect the practical expedient pertaining to land easements as it is not applicable to us.

We expect the new standard to have a material effect on our financial statements. While we continue to assess all of the effects of adoption, we currently believe the most significant effects relate to the recognition of new ROU assets and lease liabilities on our balance sheet for our facilities operating leases, and providing significant new disclosures about our leasing activities. Based on our analyses to date, we have identified potential accounting and financial reporting impacts to our business processes, controls and systems as a result of the new standard, and we are planning for those changes.

We are continuing to review our existing vendor contracts for potential embedded leases as well as renewal options and whether exercises of renewal options are reasonably certain. Based on our analyses to date of our existing operating and financing leases, we currently expect to recognize additional operating lease liabilities of approximately \$28 million, with corresponding ROU assets of the same amount based on the present value of the remaining minimum lease payments under current leasing standards for existing operating leases, net of reductions for the impacts of deferred rents and lease incentives.

The new standard also provides practical expedients for an entity's ongoing accounting. We currently expect to elect the short-term lease recognition exemption for all leases that qualify. This means, for those leases that qualify, we will not recognize ROU assets or lease liabilities, and this includes not recognizing ROU assets or lease liabilities for existing short-term leases of those assets in transition. We also plan to elect the practical expedient to not separate lease and non-lease components for all of our leases.

### **ASU 2018-09**

In July 2018, the FASB issued ASU 2018-09, "Codification Improvements." The FASB has a standing project to address suggestions received from stakeholders on the Accounting Standards Codification ("ASC" or "Codification") and to make other incremental improvements to GAAP. This perpetual project facilitates ASC updates for technical

corrections, clarifications, and other minor improvements, and these amendments are referred to as Codification improvements. ASU 2018-09 includes amendments affecting a wide variety of topics and applies to all reporting entities within the scope of the affected accounting guidance. The transition and effective date guidance is based on the facts and circumstances of each amendment. Some of the amendments in the ASU do not require transition guidance and are effective upon issuance of the ASU. However, many of the amendments in the ASU have transition guidance with effective dates for annual periods beginning after December 15, 2018, for public business entities. While we do not expect the adoption of ASU 2018-09 to have a material effect on our business, we are evaluating the potential impact that the new ASU may have on our financial position, results of operations and cash flows.

**ASU 2018-07**

In June 2018, the FASB issued ASU 2018-07, "Compensation - Stock Compensation (Topic 718) - Improvements to Nonemployee Share-Based Payment Accounting." ASU 2018-07 expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. An entity should apply the requirements of Topic 718 to nonemployee awards with certain exceptions. ASU 2018-07 specifies that Topic 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor's own operations by issuing share-based payment awards. Further, Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards



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granted in conjunction with selling goods or services to customers as part of a contract accounted for under Topic 606, *Revenue from Contracts with Customers*. ASU 2018-07 is effective for public companies' fiscal years, including interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. While we do not expect the adoption of ASU 2018-07 to have a material effect on our business, we are evaluating the potential impact that the new ASU may have on our financial position, results of operations and cash flows.

### **ASU 2018-02**

In February 2018, the FASB issued ASU 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220)." ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the TCJA, thereby eliminating the stranded tax effects and improving the usefulness of reported information to financial statement users. ASU 2018-02 is effective for all entities for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period, for public business entities for which financial statements have not yet been issued. While we do not expect the adoption of ASU 2018-02 to have a material effect on our business, we are evaluating the potential impact that the new ASU may have on our financial position, results of operations and cash flows.

### **ASU 2017-12**

In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815) - Targeted Improvements to Accounting for Hedging Activities." ASU 2017-12 provides better alignment of an entity's risk management activities and financial reporting of hedges through changes to both the designation and measurement guidance for qualifying hedging relationships. In addition, the amendments in ASU 2017-12 also simplify the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements to increase the understandability of the results of an entity's intended hedging strategies. ASU 2017-12 is effective for public companies' fiscal years, including interim periods within those fiscal years, beginning after December 15, 2018. Early application is permitted in any interim period after issuance of the new standard, with effect of adoption reflected as of the beginning of the fiscal year of adoption. For cash flow and net investment hedges existing as of the adoption date, an entity should apply a cumulative-effect adjustment related to eliminating the separate measurement of ineffectiveness to accumulated other comprehensive income and opening retaining earnings. Amended presentation and disclosure guidance is required only prospectively, and certain transition elections are available upon adoption. While we do not expect the adoption of ASU 2017-12 to have a material effect on our business, we are evaluating the potential impact that ASU 2017-12 may have on our financial position, results of operations and 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 the potential impact that the new ASU may have on our financial position, results of operations and cash flows.

## **(2) BUSINESS ACQUISITIONS**

On December 6, 2018, we acquired certain assets of Paofit Holdings Pte Limited, its subsidiaries and related companies (collectively, "Paofit") for an aggregate purchase price of \$2.8 million. The acquisition was funded with cash on hand. Based primarily in Singapore, the Paofit business is focused on developing and distributing software applications known as RunSocial® and RideSocial™. The Paofit acquisition is expected to broaden our digital platform

applications and deepen our talent pool. We accounted for the transaction as a business combination.

Since the acquisition occurred on December 6, 2018, no amount of net sales or net income related to the Paofit business was included in our reported 2018 amounts. We expect to categorize Paofit's results of operations in our Direct segment.

Total acquisition costs incurred through December 31, 2018 were \$0.2 million and w

***Purchase Price Allocation***

Acquired assets 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 \$1.6 million, all of which was assigned to the Direct segment, and is attributed primarily to Paofit's intellectual property base, employee workforce and application to future digital

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technologies. The goodwill is not expected to be deductible for income tax purposes. No liabilities were acquired as part of the transaction.

The purchase price allocation was determined based on the preliminary fair values of the assets identified as of the acquisition date. It may be adjusted, within a period of no more than 12 months from the acquisition date, if the preliminary fair values change as a result of circumstances existing at the acquisition date, and upon receipt of final appraisals and valuations. Such fair value adjustments may arise in respect to intangible assets and inventories upon completion of the necessary valuations and physical verifications of such assets.

As of December 31, 2018, the fair values of the assets acquired are preliminary because final appraisals and valuations have not yet been completed. The following table summarizes the preliminary fair values of the assets acquired as of the December 6, 2018 acquisition date (in thousands):

	<b>Preliminary Valuation at December 6, 2018</b>
Inventories	\$ 8
Intangible assets	1,140
Identifiable assets acquired	1,148
Goodwill	1,602
Total assets acquired	\$ 2,750

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

	<b>Estimated fair value</b>	<b>Weighted-average amortization period (years)</b>
Trade mark - RunSocial	\$ 250	5
Patents	410	7
Developed technology	480	5
	\$ 1,140	5.7

This acquisition is not material to our net sales, results of operations or total assets during any period presented. Accordingly, our consolidated results from operations do not differ materially from historical performance as a result of this acquisition, and, therefore, pro forma results are not presented.

**(3) DISCONTINUED OPERATIONS**

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

	<b>Year Ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Loss from discontinued operations before income taxes	\$(206)	\$(1,713)	\$(1,077)
Income tax expense (benefit)	246	(355)	(154)
Total loss from discontinued operations	\$(452)	\$(1,358)	\$(923)

During 2017, our litigation with Biosig Instruments, Inc. ("Biosig") was settled. The litigation began in 2004 and alleged patent infringement in connection with our incorporation of heart rate monitors into certain cardio products of our former Commercial business. We paid Biosig \$1.2 million under the settlement, and the matter was dismissed with prejudice. The settlement was expensed in discontinued operations in 2017.

Table of Contents**(4) REVENUES*****Adoption of Topic 606***

On January 1, 2018, we adopted ASU 2014-09 and all subsequent ASUs that modified ASC 606. We elected to apply the standard and all related ASUs retrospectively to each prior reporting period presented. The implementation of the new standard had no material impact on the measurement or recognition of revenue, resulting in no adjustments to prior periods. Additional disclosures, however, have been added in accordance with the ASU.

***Revenue Recognition***

Revenues are recognized when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services. For our Direct channel, control is transferred when products are shipped and title passes to customers. For Retail, control is transferred when both title and risk of loss passes to the customer, generally upon our delivery to the carrier, in accordance with the terms of a sales contract.

Our product sales and shipping revenues are reported net of promotional discounts, returns allowances, contractual rebates, and consideration payable to our customers. We estimate the revenue impact of retail sales incentive programs based on the planned duration of the program and historical experience. Sales incentives are estimated using the expected value method at the time of sale to determine any variable consideration to be included in the transaction price. Otherwise, such consideration payable is recorded at the later of the time the customer is notified of the sales incentive or the time of the sale. We estimate our liability for product returns based on historical experience, and record the expected customer refund liability as a reduction of revenue, and the expected inventory right of recovery, net of estimated scrap, as a reduction of cost of sales. If actual return costs differ from previous estimates, the amount of the liability and corresponding revenue are adjusted in the period in which such costs occur.

We provide standard assurance-type warranties on our products which cover defective materials or nonconforming products, and is included with each product at no additional charge. In addition, we offer service-type/extended warranties for an additional fee to our Direct channel customers and Retail specialty and commercial customers. These warranty contracts provide coverage on labor and parts beyond the standard assurance warranty period.

For our product sales, services, and freight and delivery fees, we are the principal in the contract and recognize revenue at a point in time. For our Direct channel extended warranty contracts, we are the agent and recognize revenue on a net basis because our performance obligation is to facilitate the arrangement between our customers and the third-party performance obligor. We recognize revenue related to extended warranty contracts at the same time as the revenue associated with the products that are subject to such extended warranty coverage.

For customer contracts that include multiple performance obligations, we allocate revenue to each performance obligation based on its relative standalone selling price. We generally determine standalone selling price based on prices charged to customers on stand alone sales or using expected cost plus margin.

Our revenues from contracts with customers disaggregated by revenue source, excluding sales-based taxes, were as follows (in thousands):

	<b>Year Ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Product sales	\$380,489	\$388,442	\$390,833
Extended warranties and services	9,226	11,572	7,954
Other <sup>(1)</sup>	7,038	6,170	7,252
Net sales	\$396,753	\$406,184	\$406,039

<sup>(1)</sup> Other revenue is primarily freight and delivery and royalty income.



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Our revenues disaggregated by geographic region, based on ship-to address, were as follows (in thousands):

	Year Ended December 31,		
	2018	2017	2016
United States	\$348,712	\$352,703	\$353,893
Canada	20,489	25,589	26,005
All other	27,552	27,892	26,141
Net sales	\$396,753	\$406,184	\$406,039

As of December 31, 2018, estimated revenue expected to be recognized in the future totaled \$2.9 million primarily related to customer order backlog which includes firm orders for future shipment to our Retail customers, as well as unfulfilled consumer orders within the Direct channel. Retail orders of \$1.5 million and Direct orders of \$1.4 million comprise our backlog as of December 31, 2018. The estimated future revenues are net of contractual rebates and consideration payable for applicable Retail customers, and net of current promotional programs and sales discounts for our Direct customers.

The following table provides information about our liabilities from contracts with customers, primarily customer deposits and deferred revenue for which advance consideration is received prior to the transfer of control. Revenue is recognized when transfer of control occurs. All customer deposits and deferred revenue received are short-term in nature. Significant changes in contract liabilities balances, including revenue recognized in the reporting period that was included in opening contract liabilities, are shown below (in thousands):

	2018	2017	2016
<b>Balance, January 1</b>	\$1,084	\$1,095	\$315
Cash additions	1,794	2,019	882
Revenue recognition	(2,062 )	(2,030 )	(102 )
<b>Balance, December 31</b>	\$816	\$1,084	\$1,095

***Exemptions and Elections***

We apply the practical expedient as per ASC 606-10-50-14 and do not disclose information related to remaining performance obligations due to their original expected durations are one year or less.

We expense sales commissions when incurred because the amortization period would have been less than one year. These costs are recorded in selling and marketing expense.

We generally account for our shipping and handling activities as a fulfillment activity, consistent with the timing of revenue recognition; that is, when our customer takes control of the transferred goods. In the event that a customer were to take control of a product prior to shipment, we make an accounting policy election to treat such shipping and handling activities as a fulfillment cost.

**(5) 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.



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

	<b>December 31, 2018</b>			
	<b><u>Level</u></b>	<b><u>Level 2</u></b>	<b><u>Level</u></b>	<b><u>Total</u></b>
	<b><u>1</u></b>		<b><u>3</u></b>	
<b>Assets:</b>				
Cash Equivalents				
Money market funds	\$7,646	\$—	\$	—\$7,646
	7,646	—	—	7,646
Available-for-Sale Securities				
Certificates of deposit <sup>(1)</sup>	—	10,379	—	10,379
Corporate bonds	—	7,522	—	7,522
U.S. government bonds	—	7,491	—	7,491
	—	25,392	—	25,392
Derivatives				
Interest rate swap contract	—	363	—	363
Foreign currency forward contracts	—	240	—	240
	—	603	—	603
Total assets at fair value	\$7,646	\$25,995	\$	—\$33,641

	<b>December 31, 2017</b>			
	<b><u>Level 1</u></b>	<b><u>Level 2</u></b>	<b><u>Level</u></b>	<b><u>Total</u></b>
			<b><u>3</u></b>	
<b>Assets:</b>				
Cash Equivalents				
Money market funds	\$10,946	\$—	\$	—\$10,946
Commercial paper	—	1,996	—	1,996
Total cash equivalents	10,946	1,996	—	12,942
Available-for-Sale Securities				
Certificates of deposit(1)	—	19,875	—	19,875
Corporate bonds	—	29,239	—	29,239
U.S. government bonds	—	8,189	—	8,189
Total available-for-sale securities	—	57,303	—	57,303
Derivatives				
Interest rate swap contract	—	372	—	372
Foreign currency forward contracts	—	390	—	390
	—	762	—	762
Total assets at fair value	\$10,946	\$60,061	\$	—\$71,007

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

We did not have any liabilities measured at fair value on a recurring basis as of December 31, 2018 or 2017.

For our assets measured at fair value on a recurring basis, we recognize transfers between levels at the actual date of the event or change in circumstance that caused the transfer. There were no transfers between levels during the years ended December 31, 2018 and 2017. Additionally, we did not have any changes to our valuation techniques during the years ended December 31, 2018 and 2017.



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We classify our marketable debt 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 values of our interest rate swap contract and our foreign currency forward contracts are calculated as the present value of estimated future cash flows using discount factors derived from relevant Level 2 market inputs, including forward curves and volatility levels.

We recognize or disclose the fair value of certain assets, such as non-financial assets, primarily property, plant and equipment, goodwill, other intangible assets and certain other long-lived assets in connection with impairment evaluations. All of our nonrecurring valuations use significant unobservable inputs and therefore fall under Level 3 of the fair value hierarchy. Other than our annual goodwill and indefinite-lived trade names impairment assessments and valuations effective as of October 1, 2018 and 2017, we did not perform any assessments or valuations on assets or liabilities that are valued at fair value on a nonrecurring basis. For the year ended December 31, 2018, we did not record any other-than-temporary impairments on our financial assets required to be measured at fair value on a nonrecurring basis. During the year ended December 31, 2017, we recorded an impairment to our indefinite-lived Octane Fitness trade name in the amount of \$8.8 million.

The carrying values of cash and cash equivalents, trade receivables, prepaids and other current assets, trade payables and accrued liabilities approximate fair value due to their short maturities. The carrying value of our term loan approximates its fair value and falls under Level 2 of the fair value hierarchy, as the interest rate is variable and based on current market rates.

## **(6) DERIVATIVES**

From time to time, we enter into interest rate swaps to fix a portion of our interest expense, and foreign exchange forward contracts to offset the earnings impacts of exchange rate fluctuations on certain monetary assets and liabilities. We do not enter into derivative instruments for any purpose other than to manage interest rate or foreign currency exposure. That is, we do not engage in interest rate or currency exchange rate speculation using derivative instruments.

As of December 31, 2018, we had a \$32.0 million interest rate swap outstanding with JPMorgan Chase Bank, N.A. This interest rate swap matures on December 31, 2020 and has a fixed rate of 1.42% per annum. The variable rate on the interest rate swap is the one-month LIBOR benchmark. At December 31, 2018, the one-month LIBOR rate was 2.34%.

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 hedge ineffectiveness are recognized in current earnings. For the years ended December 31, 2018 and 2017, there was no ineffectiveness. As of December 31, 2018, we expect to reclassify a gain of \$0.3 million from accumulated other comprehensive loss to earnings within the next twelve months.

We may hedge our net recognized foreign currency assets and liabilities with forward foreign exchange contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in foreign currency exchange

rates. These derivative instruments hedge assets and liabilities that are denominated in foreign currencies and are carried at fair value with changes in the fair value recorded as other income. These derivative instruments do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being hedged. As of December 31, 2018, total outstanding contract notional amounts were \$28.6 million. At December 31, 2018, these outstanding balance sheet hedging derivatives had maturities of 90 days or less.

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

	<b>Balance Sheet Classification</b>	<b>As of December 31,</b>	
		<b>2018</b>	<b>2017</b>
Derivative instruments designated as cash flow hedges:			
Interest rate swap contract	Prepays and other current assets	\$ 291	\$ 134
	Other assets	72	238
		\$ 363	\$ 372
Derivative instruments not designated as cash flow hedges:			
Foreign currency forward contracts	Prepays and other current assets	\$ 240	\$ 390

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

	<b>Statement of Operations Classification</b>	<b>Year Ended December 31,</b>		
		<b>2018</b>	<b>2017</b>	<b>2016</b>
Derivative instruments designated as cash flow hedges:				
Gain (loss) recognized in other comprehensive income before reclassifications	---	\$165	\$80	\$(450)
Gain (loss) reclassified from accumulated other comprehensive income to earnings for the effective portion	Interest expense	219	(207 )	(626 )
Income tax benefit (expense)	Income tax expense	(61 )	47	200
Derivative instruments not designated as cash flow hedges:				
Loss recognized in earnings	Other, net	\$(743 )	\$(382 )	\$—
Income tax benefit	Income tax expense	185	86	—

For additional information related to our derivatives, see Notes 5 and 16.

**(7) TRADE RECEIVABLES**

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

	<b>As of December 31,</b>	
	<b>2018</b>	<b>2017</b>
Trade receivables	\$45,946	\$42,804
Allowance for doubtful accounts	(99 )	(119 )
	\$45,847	\$42,685

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

	<b>2018</b>	<b>2017</b>	<b>2016</b>
<b>Balance, January 1</b>	\$119	\$170	\$918
Charges to bad debt expense	27	311	289
Write-offs, net	(47 )	(362 )	(1,037)
<b>Balance, December 31</b>	\$99	\$119	\$170



Table of Contents**(8) INVENTORIES**

Our inventories consisted of the following (in thousands):

	As of December 31,	
	2018	2017
Finished goods	\$63,257	\$48,771
Parts and components	5,208	4,583
Total inventories	\$68,465	\$53,354

**(9) PROPERTY, PLANT AND EQUIPMENT**

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

	Estimated Useful Life (in years)	As of December 31,	
		2018	2017
Automobiles	5	\$23	\$23
Leasehold improvements	4 to 20	3,782	3,542
Computer software and equipment	2 to 7	23,776	17,024
Machinery and equipment	3 to 5	16,756	15,178
Furniture and fixtures	5 to 20	2,827	2,295
Work in progress <sup>(1)</sup>	N/A	1,590	1,052
Total cost		48,754	39,114
Accumulated depreciation		(26,538 )	(23,287 )
Total property, plant and equipment, net		\$22,216	\$15,827

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

Depreciation expense was as follows (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Depreciation expense	\$5,778	\$5,387	\$4,320

**(10) GOODWILL**

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

	Direct	Retail	Total
<b>Balance, January 1, 2017</b>	\$2,180	\$59,708	\$61,888
Currency exchange rate adjustment	155	(13 )	142
<b>Balance, December 31, 2017</b>	2,335	59,695	62,030
Currency exchange rate adjustment	(185 )	5	(180 )
Business acquisition (Note 2)	1,602	—	1,602
<b>Balance, December 31, 2018</b>	\$3,752	\$59,700	\$63,452

We performed our annual goodwill impairment evaluations during the fourth quarters of 2018 and 2017. Our 2018 and 2017 evaluations were performed using a qualitative assessment of each reporting unit and determined that it was not more-likely-than-not that the fair value of any reporting unit was less than its carrying amount. We determined no impairments of goodwill were indicated in 2018 and 2017.





Table of Contents**(11) OTHER INTANGIBLE ASSETS**

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

	Estimated Useful Life (in years)	As of December 31,	
		2018	2017
Indefinite-lived trademarks <sup>(1)</sup>	N/A	\$23,252	\$23,252
Definite-lived trademarks	5 to 15	2,850	2,600
Patents	7 to 24	14,243	15,187
Customer relationships	10 to 15	24,700	24,700
		65,045	65,739
Accumulated amortization - definite-lived intangible assets		(9,805 )	(7,996 )
		\$55,240	\$57,743

<sup>(1)</sup> During the fourth quarter of 2017, we identified impairment indicators in our Octane Fitness brand name originally acquired through the Octane Fitness acquisition on December 31, 2015. Ongoing weakness in the specialty retail channel, as a result of retailer consolidation, has had a negative impact on Octane branded sales and projected growth trends. We utilized the relief-from-royalty method to quantify the impairment, resulting in an \$8.8 million non-cash impairment charge for 2017.

Amortization expense was as follows (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Amortization expense	\$3,164	\$3,256	\$3,554

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

2019	\$3,242
2020	3,217
2021	3,187
2022	3,187
2023	3,187
Thereafter	15,968
	\$31,988

**(12) ACCRUED LIABILITIES**

Accrued liabilities consisted of the following (in thousands):

	As of December 31,	
	2018	2017
Payroll and related liabilities	\$3,620	\$3,659
Other	4,750	7,105
Total accrued liabilities	\$8,370	\$10,764

**(13) PRODUCT WARRANTIES**

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

2018	2017	2016
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<b>Balance, January 1</b>	\$6,117	\$7,450	\$8,545
Accruals	3,884	3,008	2,480
Payments	(4,426 )	(4,341 )	(3,575 )
<b>Balance, December 31</b>	<b>\$5,575</b>	<b>\$6,117</b>	<b>\$7,450</b>

Table of Contents**(14) BORROWINGS*****Term Loan and Line of Credit***

On December 31, 2015 we entered into an amendment (the “Amendment”) to our existing Credit Agreement, dated December 5, 2014, with JPMorgan Chase Bank, N.A. (“Chase Bank”) that provided for an \$80 million term loan to finance the acquisition of Octane Fitness (the “Term Loan”), which matures on December 31, 2020. The Term Loan and our existing \$20 million revolving line of credit with Chase Bank are secured by substantially all of the assets of Nautilus. The Credit Agreement was amended again on December 21, 2018, which, among other changes, extended the term of the \$20.0 million revolving line of credit to December 31, 2021.

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

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

The interest rate applicable to the Term Loan and to each advance under the revolving line of credit is based on either Chase Bank's floating prime rate or adjusted LIBOR, plus an applicable margin. As of December 31, 2018, our borrowing rate for the Term Loan and line of credit advances was 3.34%.

As of December 31, 2018, we had outstanding borrowings of \$32.0 million on our term loan and no letters of credit issued under the Credit Agreement. As of December 31, 2018, we were in compliance with the financial covenants of the Credit Agreement, and \$20.0 million was available for borrowing under the line of credit.

Future principal maturities of our Term Loan are as follows (in thousands):

2019 \$16,000  
 2020 16,000  
     \$32,000

**(15) INCOME TAXES*****Income Tax Expense***

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

	Year Ended December 31,		
	2018	2017	2016
U.S.	\$19,109	\$34,259	\$50,651
Non-U.S.	1,892	1,446	930
	\$21,001	\$35,705	\$51,581

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

	<b>Year Ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Current:			
U.S. federal	\$1,750	\$14,409	\$6,765
U.S. state	477	1,887	318
Non-U.S.	435	330	118
Total current	2,662	16,626	7,201
Deferred:			
U.S. federal	2,235	(9,418 )	8,130
U.S. state	1,059	819	1,037
Non-U.S.	(65 )	53	112
Total deferred	3,229	(8,546 )	9,279
	\$5,891	\$8,080	\$16,480

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

	<b>Year Ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
U.S. statutory income tax rate	21.0 %	35.0 %	35.0 %
State tax, net of U.S. federal tax benefit	5.7	5.0	2.4
Non-U.S. income taxes	0.1	(0.1 )	0.3
Nondeductible operating expenses	3.1	0.8	0.3
Research and development credit	(3.1 )	(1.5 )	(1.0 )
Change in deferred tax measurement rate <sup>(1)</sup>	0.1	(15.3 )	(0.1 )
Change in uncertain tax positions	0.8	0.8	(5.1 )
Excess tax benefits from stock plans	(0.7 )	(2.1 )	—
Change in valuation allowance	1.8	0.1	0.2
Other	(0.7 )	(0.1 )	(0.1 )
Effective income tax rate	28.1 %	22.6 %	31.9 %

<sup>(1)</sup> Effective income tax rate for 2017 includes impacts related to the Tax Cuts and Jobs Act (the "TCJA").

On December 22, 2017, the TCJA was enacted and provided significant changes to the U.S. Internal Revenue Code. As a result, and in accordance with SAB 118, we made an effort to reasonably estimate the impact of the TCJA on our operating results and recorded certain income tax effects as provisional as of December 31, 2017. Those provisional amounts were subject to adjustment during a measurement period until the accounting under ASC 740 was complete. Upon further analysis of our transition tax calculation during 2018, we recorded an increase to the provisional amount of less than \$0.1 million, which equates to a less than 1.0% impact to the effective tax rate, in 2018. This amount is included as a component of income tax expense from continuing operations. Our accounting for the income tax effects of the TCJA was completed as of December 31, 2018.

Table of Contents**Deferred Income Taxes**

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

	<b>As of December 31,</b>	
	<b>2018</b>	<b>2017</b>
Deferred income tax assets:		
Accrued liabilities	\$2,453	\$3,000
Allowance for doubtful accounts	23	12
Inventory valuation	424	254
Capitalized indirect inventory costs	442	383
Stock-based compensation expense	811	897
Deferred rent	520	588
Net operating loss carryforward	1,137	1,715
Basis difference on long-lived assets	608	548
Credit carryforward	747	634
Other	219	179
Gross deferred income tax assets	7,384	8,210
Valuation allowance	(1,247 )	(914 )
Deferred income tax assets, net of valuation allowance	6,137	7,296
Deferred income tax liabilities:		
Prepaid advertising	(674 )	(370 )
Other prepaids	(762 )	(610 )
Basis difference of long-lived assets	(16,474 )	(14,856 )
Other	(4 )	(18 )
Deferred income tax liabilities	(17,914 )	(15,854 )
Net deferred income tax liabilities	\$(11,777 )	\$(8,558 )

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

	<b>As of December 31,</b>	
	<b>2018</b>	<b>2017</b>
Deferred income tax assets, non-current (recorded in "other assets")	111	—
Deferred income tax liabilities, non-current	(11,888 )	(8,558 )
Net deferred income tax liabilities	\$(11,777 )	\$(8,558 )

We account for income taxes based on the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. We have recorded a valuation allowance to reduce our deferred income tax assets to the amount we believe is more likely than not to be realized. Evaluating the need for, and amount of, a valuation allowance for deferred tax assets often requires significant judgment and extensive analysis of all available evidence on a jurisdiction-by-jurisdiction basis. Such judgments require us to interpret existing tax law and other published guidance as applied to our circumstances. As part of this assessment, we consider both positive and negative evidence. The weight given to the potential effect of positive and negative evidence must be commensurate with the extent to which the strength of the evidence can be objectively verified. Based on our analysis during the fourth quarter of 2018, we determined that \$0.2 million of valuation allowance was necessary against the U.S state net operating loss carryforward deferred tax assets, and, accordingly, the amount is included as a component of income tax expense from continuing operations in 2018.

As of December 31, 2018, we had a valuation allowance against net deferred income tax assets of \$1.2 million. Of the valuation allowance, \$0.9 million primarily relates to domestic state tax credit carryforwards and state net operating loss carryforwards as we currently do not anticipate generating income of appropriate character to utilize those deferred tax assets. The remainder of \$0.3 million relates to foreign net operating loss carryforwards. Should it be determined in the future that it is more likely than not that our domestic deferred income tax assets will be realized, an additional valuation allowance would be released during the

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period in which such an assessment is made. There have been no material changes to our foreign operations since December 31, 2017, and, accordingly, we maintain our existing valuation allowance on foreign deferred income tax assets in such jurisdictions at December 31, 2018.

***Income Tax Carryforwards***

As of December 31, 2018, we had the following income tax carryforwards (in millions):

	Amount	Expires in
<b>Net operating loss carryforwards</b>		
U.S. state	\$ 21.5	2019 - 2031
China	\$ 0.5	2020 - 2022
<b>Income tax credit carryforwards</b>		
U.S. Federal	\$ —	2018 - 2035
U.S. state	\$ 1.0	2019 - 2031

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

***Unrecognized Tax Benefits***

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

	2018	2017	2016
<b>Balance, January 1</b>	\$2,194	\$1,970	\$2,519
Additions for tax positions taken in prior years	41	38	21
Reductions for tax positions taken in prior years	(4 )	(5 )	(523 )
Additions for tax positions related to the current year	116	211	83
Lapses of statutes of limitations	(12 )	(11 )	(130 )
Other	(5 )	(9 )	—
<b>Balance, December 31</b>	\$2,330	\$2,194	\$1,970

Of the \$2.3 million of gross unrecognized tax benefits from uncertain tax positions outstanding as of December 31, 2018, \$2.1 million would affect our effective tax rate if recognized.

We recorded tax-related interest and penalty expense (benefit) of \$0.3 million, \$0.3 million and \$(1.9) million in 2018, 2017 and 2016, respectively. We had a cumulative liability for interest and penalties related to uncertain tax positions as of December 31, 2018 and 2017 of \$1.3 million and \$1.0 million, respectively.

Our U.S. federal income tax returns for 2009 through 2018 are open to review by the U.S. Internal Revenue Service. Our state income tax returns for 2007 through 2018 are open to review, depending on the respective statute of limitation in each state. In addition, we file income tax returns in several non-U.S. jurisdictions with varying statutes of limitation.

As of December 31, 2018, we believe it is reasonably likely that, within the next twelve months, \$0.1 million of the previously unrecognized tax benefits related to certain non-U.S. filing positions may be recognized due to the expirations of the statutes of limitations.





Table of Contents**(16) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

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

	<b>Unrealized Gain (Loss) on Available-for-Sale Securities</b>	<b>Gain (loss) on Derivative Securities</b>	<b>Foreign Currency Translation Adjustments</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>
<b>Balance, January 1, 2016</b>	\$ (16 )	\$ —	\$ (1,311 )	\$ (1,327 )
Current period other comprehensive income (loss)	8	(450 )	126	(316 )
Reclassification of amounts to earnings	—	426	—	426
Net other comprehensive income (loss) during period	8	(24 )	126	110
<b>Balance, December 31, 2016</b>	(8 )	(24 )	(1,185 )	(1,217 )
Current period other comprehensive income (loss) before reclassifications	(56 )	80	774	798
Reclassification of amounts to earnings	—	160	—	160
Net other comprehensive income (loss) during period	(56 )	240	774	958
<b>Balance, December 31, 2017</b>	(64 )	216	(411 )	(259 )
Current period other comprehensive income (loss) before reclassifications	58	165	(715 )	(492 )
Reclassification of amounts to earnings	—	(158 )	—	(158 )
Net other comprehensive income (loss) during period	58	7	(715 )	(650 )
<b>Balance, December 31, 2018</b>	\$ (6 )	\$ 223	\$ (1,126 )	\$ (909 )

**(17) STOCK-BASED COMPENSATION****2015 Long-Term Incentive Plan**

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

Upon adoption, there were approximately 4.8 million shares available for issuance under the 2015 Plan. The number of shares available for issuance upon adoption of the 2015 Plan included new shares approved, plus any shares of common stock which were previously reserved for issuance under our preceding plan and were not subject to grant as of April 28, 2015, or as to which the stock-based compensation award is forfeited on or after April 28, 2015. The number of shares available for issuance is reduced by (i) two shares for each share delivered in settlement of any stock appreciation rights, RSA, RSU or PSU awards, and (ii) one share for each share delivered in settlement of a stock option award. In no event shall more than 1.0 million aggregate shares of common stock subject to stock options, stock appreciation rights, RSA, RSU or PSU awards be granted to any one participant in any one year under the 2015 Plan. At December 31, 2018, we had 3.5 million shares available for future grant under our 2015 Plan, and a total of

4.3 million shares of our common stock are reserved for future issuance pursuant to awards currently outstanding under the 2015 Plan and our previous plan combined.

Table of Contents**Stock Option Activity**

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

	Options Outstanding	Weighted- Average Exercise Price
<b>Outstanding at December 31, 2017</b>	297	\$ 5.37
Forfeited, canceled or expired	(4 )	17.48
Exercised	(127 )	2.89
<b>Outstanding at December 31, 2018</b>	166	\$ 6.97

Certain information regarding options outstanding at December 31, 2018 was as follows:

	Options Outstanding	Options Exercisable	Options Vested and Expected to Vest
Number (in thousands)	166	166	166
Weighted-average exercise price	\$ 6.97	\$ 6.97	\$ 6.97
Aggregate intrinsic value (in thousands)	\$ 698	\$ 698	\$ 698
Weighted average remaining contractual term (in years)	1.8	1.8	1.8

**RSA Activity**

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

	RSAs Outstanding	Weighted- Average Grant Date Fair Value per Share
<b>Outstanding at December 31, 2017</b>	47	\$ 16.28
Granted	20	14.65
Vested	(17 )	17.60
<b>Outstanding at December 31, 2018</b>	50	\$ 15.18

**RSU Activity**

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

	RSUs Outstanding	Weighted- Average Grant Date Fair Value per Share
<b>Outstanding at December 31, 2017</b>	191	\$ 17.64
Granted	254	12.06
Forfeited, canceled or expired	(32 )	15.55
Vested	(45 )	17.57
<b>Outstanding at December 31, 2018</b>	368	\$ 13.98

***PSU Activity***

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

In April and September 2015, we granted PSU awards to certain of our executive officers and management team covering a total of 56,820 shares of our common stock. The PSUs vested in 2018 based on achievement of goals established for certain operating income and return on asset criteria for the three-year performance period ended December 31, 2017. These awards vested in full at approximately 111% achievement for a total of 49,953 shares, net of actual forfeitures.

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In December 2015, in connection with the acquisition of Octane Fitness, we granted PSU awards to a certain executive officer and management team personnel covering a total of 117,230 shares of our common stock. As of December 31, 2018, these awards had been forfeited or were replaced by comparable awards and were no longer outstanding.

In February 2016, we granted PSU awards to certain of our executive officers and management team covering a total of 54,818 shares of our common stock. The PSUs vest based on achievement of goals established for growth in operating income as a percentage of net revenue and return on invested capital over the three-year performance period ended December 31, 2018. The number of shares that ultimately vest following conclusion of the performance period will be determined based on the level at which the financial goals are achieved. The number of shares vesting can range from 60% of the PSU awards if minimum thresholds are achieved to a maximum of 150%. These awards are expected to vest at 0% achievement. As of December 31, 2018, approximately 47,800 PSU shares remained, net of actual forfeitures to date.

In February 2017, we granted PSU awards to certain of our executive officers and management team covering a total of 72,017 shares of our common stock. The PSUs vest based on achievement of goals established for growth in operating income as a percentage of net revenue and return on invested capital over the three-year performance period ending December 31, 2019. The number of shares that ultimately vest following conclusion of the performance period will be determined based on the level at which the financial goals are achieved. The number of shares vesting can range from 60% of the PSU awards if minimum thresholds are achieved to a maximum of 150%. These awards are currently expected to vest at 0% achievement. As of December 31, 2018, approximately 58,500 PSU shares remained, net of actual forfeitures to date.

In February 2018, we granted PSU awards to certain of our executive officers and management team covering a total of 119,351 shares of our common stock. The PSUs vest based on achievement of goals established for growth in operating income as a percentage of net revenue and return on invested capital over the three-year performance period ending December 31, 2020. The number of shares that ultimately vest following conclusion of the performance period will be determined based on the level at which the financial goals are achieved. The number of shares vesting can range from 60% of the PSU awards if minimum thresholds are achieved to a maximum of 150%. As of December 31, 2018, approximately 115,000 PSU shares remained, net of actual forfeitures to date.

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

	PSUs Outstanding	Weighted- Average Grant Date Fair Value per Share
<b>Outstanding at December 31, 2017</b>	172	\$ 17.65
Granted and additional goal shares awarded	124	12.13
Forfeited, canceled or expired	(25 )	15.26
Vested	(50 )	17.61
<b>Outstanding at December 31, 2018</b>	221	\$ 14.73

***Stock-Based Compensation***

Stock-based compensation expense, primarily included in general and administrative expense, was as follows (in thousands):

Year Ended December 31,		
2018	2017	2016

Stock options	\$6	\$84	\$389
RSAs	292	287	168
RSUs	1,527	954	734
PSUs	52	408	1,211
ESPP	104	123	111
	\$1,981	\$1,856	\$2,613

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Certain other information regarding our stock-based compensation was as follows (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Total intrinsic value of stock options exercised	\$1,451	\$1,522	\$1,221
Fair value of RSUs vested	655	28	311
Fair value of PSUs vested	614	2,036	574

As of December 31, 2018, unrecognized compensation expense for outstanding, but unvested stock-based awards was \$3.7 million, which is expected to be recognized over a weighted average period of 0.3 to 1.5 years.

***Employee Stock Purchase Plan***

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

Pursuant to the ESPP, and subject to certain limitations specified therein, eligible employees may elect to purchase shares of our common stock in one or more of a series of offerings conducted pursuant to the procedures set forth in the ESPP at a purchase price equal to 90% of the lower of the fair market value of the common stock on the first trading day of the offering period or on the last day of the offering period. Offering periods commence on May 15 and November 15 of each year and are six-months in duration, with the exception of the first offering period in 2015, which was a four-month offering. Purchases under the ESPP may be made exclusively through payroll deductions. Persons eligible to participate in the ESPP generally include employees who have been employed for at least 12 months prior to the applicable offering date and who, immediately upon purchasing shares under the ESPP, would own directly or indirectly, an aggregate of less than 5% of the total combined voting power or value of all outstanding shares of our common stock.

Compensation expense for the ESPP is recognized over the six-month offering period based on the total estimated participant contributions and number of shares expected to be purchased.

ESPP activity was as follows (shares in thousands):

	Shares Available for Issuance	Weighted-Average Purchase Price	Weighted-Average Discount per Share
<b>Balance at December 31, 2017</b>	432		
Employee shares purchased	(38 )	\$ 11.55	\$ 2.71
<b>Balance at December 31, 2018</b>	394		

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

	Year Ended December 31,		
	2018	2017	2016
Dividend yield	—%	—%	—%
Risk-free interest rate	1.7%	0.8%	0.4%
Expected life (years)	N/A	N/A	N/A
Expected volatility	40%	44%	56%

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

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



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

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

**(18) STOCK REPURCHASE PROGRAMS**

On May 4, 2016, our Board of Directors authorized the repurchase of up to \$10.0 million of our outstanding common stock from time to time through May 4, 2018. As of November 2017, the stock repurchases under this program were completed in full and the program expired.

On April 25, 2017, our Board of Directors authorized a \$15.0 million share repurchase program. Under this program, shares of common stock may be repurchased from time to time through April 25, 2019. During 2018, repurchases under this program totaled \$12.0 million. As of November 2018, the stock repurchases under this program were completed in full and the program expired.

On February 21, 2018 our Board of Directors authorized an additional \$15.0 million share repurchase program. Under this program, shares of our common stock may be repurchased from time to time through February 21, 2020. As of December 31, 2018, repurchases under this program totaled \$1.0 million and \$14.0 million remained available for future share repurchases under the existing program.

Repurchases for 2016 through 2018 for all programs were as follows:

<b>Year Ended</b>	<b>Number of Shares</b>	<b>Repurchased Amount</b>	<b>Average Price per Share</b>
December 31, 2016	319,805	\$5,390,355	\$16.86
December 31, 2017	788,416	11,054,983	14.02
December 31, 2018	990,229	12,995,791	13.12
	2,098,450	29,441,129	\$14.03

Repurchases may be made in open market transactions at prevailing market prices, in privately negotiated transactions, or by other means in accordance with federal securities laws. Share repurchases are funded with existing cash balances, and the repurchased shares are retired and returned to unissued authorized shares.

**(19) INCOME PER SHARE**

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

	<b>Year Ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Shares used for basic per share calculations	30,099	30,671	31,032
Dilutive effect of outstanding options, RSUs, and PSUs	256	339	269
Shares used for diluted per share calculations	30,355	31,010	31,301

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

	<b>As of December</b>		
	<b>31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Stock options	10	8	8
RSUs	1	—	—

Table of Contents**(20) 401(k) SAVINGS PLAN**

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

	<b>Year ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
401(k) matching contributions	\$1,105	\$1,056	\$1,014

**(21) SEGMENT AND ENTERPRISE-WIDE INFORMATION**

We have two operating segments - Direct and Retail. There have been no changes in our operating segments during the year ended December 31, 2018.

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

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

	<b>Year Ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
<b>Net Sales:</b>			
Direct	\$184,925	\$219,440	\$225,057
Retail	208,092	183,875	177,920
Unallocated royalty	3,736	2,869	3,062
Consolidated net sales	\$396,753	\$406,184	\$406,039
<b>Contribution:</b>			
Direct	\$6,865	\$34,900	\$43,215
Retail	31,516	27,495	29,451
Unallocated royalty	3,733	2,852	3,018
Consolidated contribution	\$42,114	\$65,247	\$75,684
<b>Reconciliation of consolidated contribution to income from continuing operations:</b>			
Consolidated contribution	\$42,114	\$65,247	\$75,684
Amounts not directly related to segments:			
Operating expenses	(21,345 )	(28,944 )	(22,290 )
Other expense, net	232	(598 )	(1,813 )
Income tax expense	5,891	8,080	16,480
Income from continuing operations	\$15,110	\$27,625	\$35,101
<b>Depreciation and amortization expense:</b>			
Direct	\$1,537	\$1,666	\$1,944
Retail	5,098	4,606	4,775
Unallocated corporate	2,307	2,371	1,155
Total depreciation and amortization expense	\$8,942	\$8,643	\$7,874
<b>Assets:</b>			
	<b>As of December 31,</b>		
	<b>2018</b>	<b>2017</b>	
Direct	\$50,907	\$40,532	
Retail	204,921	192,064	
Unallocated corporate	77,116	92,180	
Total assets	\$332,944	\$324,776	

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

In 2018, 2017 and 2016, each of Amazon.com and Dick's Sporting Goods accounted for more than 10% of total net sales as follows:

	<b>Year Ended December</b>		
	<b>31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Amazon.com	11.5%	11.9%	11.4%
Dick's Sporting Goods	13.8% *	*	*

\*Less than 10% of total net sales.



Table of Contents**(22) COMMITMENTS AND CONTINGENCIES*****Operating Leases***

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

	<b>Year Ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Rent expense	\$5,199	\$6,095	\$6,561

As of December 31, 2018, future minimum lease payments under non-cancellable leases, net of sublease income, were as follows (in thousands):

2019	\$5,366
2020	5,279
2021	4,147
2022	2,729
2023	1,698
Thereafter	2,647
	\$21,866

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

We have long lead times for inventory purchases and, therefore, must secure factory capacity from our vendors in advance. As of December 31, 2018, we had approximately \$27.2 million in non-cancelable market-based purchase obligations, primarily for inventory purchases expected to be received within the next twelve months. Purchase obligations can vary from quarter-to-quarter and versus the same period in prior years due to a number of factors, including the amount of products that are shipped directly to Retail customer warehouses versus through Nautilus warehouses. As of December 31, 2018, we had no outstanding letters of credit with any of our vendors.

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

The nature and terms of these indemnification obligations vary from contract to contract, and generally a maximum obligation is not stated within the agreements. We hold insurance policies that mitigate potential losses arising from certain types of indemnification obligations. Management does not deem these obligations to be significant to our financial position, results of operations or cash flows and, therefore, no related liabilities were recorded as of December 31, 2018.

***Legal Matters***

From time to time, in the ordinary course of business, we may be involved in various claims, lawsuits and other proceedings. These legal proceedings involve uncertainty as to the eventual outcomes and losses which may be

realized when one or more future events occur or fail to occur.

Litigation and jury verdicts are, to some degree, inherently unpredictable, and although we have determined that a loss is not probable in connection with any current legal proceeding, it is reasonably possible that a loss may be incurred in connection with proceedings to which we are a party. Assessment of whether incurrence of a loss is probable, or a reasonable possibility, in connection with a particular proceeding, and estimation of the loss, or a range of loss, involves complex judgments and numerous uncertainties. Management is unable to estimate a range of reasonably possible losses related to litigation in which the damages sought are indeterminate, or the legal and factual basis for the relevant claims have not been developed with specificity. As such, zero liability is recorded as of December 31, 2018.

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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.

As of the date of filing of this Annual Report on Form 10-K, we were not involved in any material legal proceedings.

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

The following table summarizes our unaudited quarterly financial data for 2018 and 2017 (in thousands, except per share amounts):

	Quarter Ended				
	March 31	June 30	September 30	December 31	Total
<b>2018</b>					
Net sales	\$ 114,813	\$ 75,498	\$ 91,057	\$ 115,385	\$ 396,753
Gross profit	58,871	33,648	38,506	50,715	181,740
Operating income	10,697	1,202	6,160	2,710	20,769
Income from continuing operations	8,140	1,007	4,503	1,460	15,110
Loss from discontinued operations	(81 )	(79 )	(194 )	(98 )	(452 )
Net income	8,059	928	4,309	1,362	14,658
Net income per share:					
Basic	\$0.27	\$0.03	\$ 0.14	\$0.05	\$0.49
Diluted	0.26	0.03	0.14	0.05	0.48
<b>2017</b>					
Net sales	\$ 113,252	\$ 77,029	\$ 88,132	\$ 127,771	\$ 406,184
Gross profit	61,745	38,378	41,315	62,444	203,882
Operating income <sup>(1)</sup>	12,683	3,849	13,365	6,406	36,303
Income from continuing operations <sup>(2)</sup>	8,185	2,566	8,342	8,532	27,625
Loss from discontinued operations <sup>(3)</sup>	(1,092 )	(77 )	(101 )	(88 )	(1,358 )
Net income	7,093	2,489	8,241	8,444	26,267
Net income per share:					
Basic	\$0.23	\$0.08	\$ 0.27	\$0.28	\$0.86
Diluted	0.23	0.08	0.27	0.27	0.85

<sup>(1)</sup> Operating income for the quarter ended December 31, 2017 included an \$8.8 million non-cash asset impairment charge related to the Octane Fitness brand name.

<sup>(2)</sup> Income from continuing operations for the quarter ended December 31, 2017 included a non-recurring tax benefit of \$5.6 million related to the change in U.S. tax law that resulted in the reassessment of certain deferred tax assets and liabilities.

<sup>(3)</sup> Loss from discontinued operations for the quarter ended March 31, 2017 included a \$1.2 million expense related to a lawsuit settlement with Biosig Instruments, Inc.



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

None.

**Item 9A. Controls and Procedures**

***Disclosure Controls and Procedures***

As of December 31, 2018, we conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended (“Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of December 31, 2018 that our disclosure controls and procedures were effective.

***Management's Report On Internal Control Over Financial Reporting***

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

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

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

***Management's Assessment***

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our internal control over financial reporting based on the criteria established in *Internal Control - Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment, management concluded that our internal control over financial reporting was effective as of December 31, 2018.

Our independent registered public accounting firm has issued an attestation report on the effectiveness of our internal control over financial reporting as of December 31, 2018, which appears in Part II, Item 8 of this report.

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

There were no changes in our internal control over financial reporting that occurred during the three-month period ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**Item 9B. Other Information**

None.

**PART III****Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this item will be set forth under the captions *Election of Directors, Section 16(a) Beneficial Ownership Reporting Compliance, Executive Officers, Information Concerning the Board of Directors and Code of Ethics* in our Proxy Statement for our 2019 Annual Meeting of Shareholders to be filed with the SEC by April 30, 2019 (the "2019 Proxy Statement"). If the 2019 Proxy Statement is not filed with the SEC by April 30, 2019, such information will be included in an amendment to this Annual Report on Form 10-K filed by April 30, 2019.

**Item 11. Executive Compensation**

The information required by this item will be set forth under the captions *Executive Compensation and Director Compensation* in our 2019 Proxy Statement. If the 2019 Proxy Statement is not filed with the SEC by April 30, 2019, such information will be included in an amendment to this Annual Report on Form 10-K filed by April 30, 2019.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*****Equity Compensation Plan Information***

The following table provides information about our equity compensation plan as of December 31, 2018 (shares in thousands):

<u>Plan Category</u>	Number of securities to be issued upon exercise of outstanding options, warrants and rights <sup>(1),(2)</sup> (a)	Weighted average exercise price of outstanding options, warrants and rights <sup>(3)</sup> (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	387	\$ 6.97	3,538
Equity compensation plans not approved by security holders	—	—	—
Total	387	\$ 6.97	3,538

<sup>(1)</sup> Includes approximately 221 PSU awards granted to certain executive officers and management team. The awards vest based on service requirements along with achievement of certain financial goals established for a three-year performance period, and can range from 60% of the PSU awards if minimum thresholds are achieved to a maximum of 150%. Of the 221 PSU shares, 115 are calculated at an estimated 100% of the target award, and 106 are calculated at 0% of target.

<sup>(2)</sup> Excludes 418 RSA and RSU awards outstanding at December 31, 2018, of which 50 RSA shares are subject to vesting and release, and 368 RSU shares are subject to vesting, release and forfeiture.

<sup>(3)</sup> Weighted average exercise price shown in column (b) does not take into account the PSU awards included in column (a) of the table.

For further information regarding our equity compensation plan, refer to Note 17, *Stock-Based Compensation*, to our consolidated financial statements in Part II, Item 8 of this report.

***Beneficial Ownership***

The information required by this item is included under the caption *Security Ownership of Certain Beneficial Owners and Management* in our 2019 Proxy Statement. If the 2019 Proxy Statement is not filed with the SEC by April 30, 2019, such information will be included in an amendment to this Annual Report on Form 10-K filed by April 30, 2019.

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

The information required by this item is included under the caption *Information Concerning the Board of Directors* in our 2019 Proxy Statement. If the 2019 Proxy Statement is not filed with the SEC by April 30, 2019, such information will be included in an amendment to this Annual Report on Form 10-K filed by April 30, 2019.

Table of Contents**Item 14. Principal Accounting Fees and Services**

The information required by this item is included under the caption *Ratification of Appointment of Independent Registered Public Accounting Firm for 2019* in our 2019 Proxy Statement. If the 2019 Proxy Statement is not filed with the SEC by April 30, 2019, such information will be included in an amendment to this Annual Report on Form 10-K filed by April 30, 2019.

**PART IV****Item 15. Exhibits and Financial Statement Schedules*****Financial Statements and Schedules***

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

	Page
Reports of Independent Registered Public Accounting Firms	<u>30</u>
Consolidated Balance Sheets as of December 31, 2018 and 2017	<u>33</u>
Consolidated Statements of Operations for the years ended December 31, 2018, 2017 and 2016	<u>34</u>
Consolidated Statements of Comprehensive Income for the years ended December 31, 2018, 2017 and 2016	<u>35</u>
Consolidated Statements of Shareholders' Equity for the years ended December 31, 2018, 2017 and 2016	<u>36</u>
Consolidated Statements of Cash Flows for the years ended December 31, 2018, 2017 and 2016	<u>37</u>
Notes to Consolidated Financial Statements	<u>38</u>

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

***Exhibits***

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

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**Exhibit No. Description**

- 3.1 Amended and Restated Articles of Incorporation - Incorporated by reference to Exhibit A to Schedule 14A, as filed with the Commission on April 22, 2008.
- 3.2 Amended and Restated Bylaws - Incorporated by reference to Exhibit 3.1 of our Current Report on Form 8-K, as filed with the Commission on April 5, 2005.
- 3.3 Amendment to Amended and Restated Bylaws of the Company - Incorporated by reference to Exhibit 3.1 of our Current Report on Form 8-K, as filed with the Commission on January 31, 2007.
- 10.1\* Company 2005 Long-Term Incentive Plan - Incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K, as filed with the Commission on June 10, 2005.
- 10.2\* First Amendment to Company 2005 Long-Term Incentive Plan - Incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q for the three months ended September 30, 2006, as filed with the Commission on November 9, 2006.
- 10.3\* Form of Nonstatutory Stock Option Agreement - Incorporated by reference to Exhibit 10 of our Current Report on Form 8-K, as filed with the Commission on July 29, 2005.
- 10.4\* Form of Non-Employee Director Nonstatutory Stock Option Agreement - Incorporated by reference to Exhibit 10 of our Current Report on Form 8-K, as filed with the Commission on August 19, 2005.
- 10.5\* Form of Performance Unit Agreement - Incorporated by reference to Exhibit 10.3 to our Quarterly Report on Form 10-Q for the three months ended June 30, 2006, as filed with the Commission on August 9, 2006.
- 10.6 Trademark License Agreement, dated September 20, 2001, by and between Pacific Direct, LLC and Nautilus, Inc. - Incorporated by reference to Exhibit 2.1 of our Quarterly Report on Form 10-Q for the three months ended September 30, 2001, as filed with the Commission on November 14, 2001.
- 10.7 License Agreement dated as of December 29, 2009 between Nautilus, Inc. and Fit Dragon International, Inc. - Incorporated by reference to Exhibit 10.24 of our Form 10-K for the fiscal year ended December 31, 2009 as filed with the Commission on March 8, 2010.
- 10.8 Technology Transfer and License Agreement dated as of December 29, 2009 between Nautilus, Inc. and Fit Dragon International, Inc. - Incorporated by reference to Exhibit 10.26 of our Form 10-K for the fiscal year ended December 31, 2009 as filed with the Commission on March 8, 2010.
- 10.9\* Severance and Employment Agreement, dated September 21, 2007, between the Company and Wayne M. Bolio - Incorporated by reference to Exhibit 10.33 of our Form 10-K for the fiscal year ended December 31, 2010 as filed with the Commission on March 8, 2011.
- 10.10\* Severance and Employment Agreement, dated March 30, 2011, between the Company and William B. McMahon - Incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K as filed with the Commission on March 31, 2011.
- 10.11 Office Lease Agreement dated as of July 25, 2011, by and between Nautilus, Inc. and Columbia Tech Center, L.L.C. - Incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K as filed with

the Commission on July 29, 2011.

Executive Employment Agreement dated as of May 30, 2011, between Nautilus, Inc. and Bruce M.

10.12\* Cazenave - Incorporated by reference to Exhibit 10.1 of our Form 10-Q for the three months ended June 30, 2011 as filed with the Commission on August 11, 2011.

10.13\* Form of Restricted Stock Unit Agreement - Incorporated by reference to Exhibit 10.2 of our Form 10-Q for the three months ended June 30, 2011 as filed with the Commission on August 11, 2011.

10.14\* Form of Non-Employee Director Nonstatutory Stock Option Agreement - Incorporated by reference to Exhibit 10.2 of our Form 10-Q for the three months ended March 31, 2012 as filed with the Commission on May 9, 2012.

10.15\* Form of Non-Employee Director Restricted Stock Unit Award Agreement - Incorporated by reference to Exhibit 10.2 of our Form 10-Q for the three months ended June 30, 2013 as filed with the Commission on August 8, 2013.

10.16\* Executive Employment Agreement dated as of February 10, 2014, by and between Nautilus, Inc. and Sidharth Nayar - Incorporated by reference to Exhibit 10.1 of our Form 10-Q for the three months ended March 31, 2014 as filed with the Commission on May 8, 2014.

10.17\* Offer Letter, dated July 26, 2013, between the Company and Jeffery Collins - Incorporated by reference to Exhibit 10.3 of our Form 10-Q for the three months ended March 31, 2014 as filed with the Commission on May 8, 2014.

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**Exhibit No. Description**

<u>10.18</u>	First Lease Modification Agreement, dated as of June 19, 2014, to the Office Lease by and between Nautilus, Inc. and Columbia Tech Ceter, L.L.C. dated July 25, 2011 - Incorporated by reference to Exhibit 10.1 of our Form 10-Q for the three months ended June 30, 2014 as filed with the Commission on August 7, 2014.
<u>10.19</u>	Credit Agreement dated December 5, 2014 between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.1 of our Form 8-K dated December 5, 2014 as filed with the Commission on December 8, 2014.
<u>10.20</u>	Continuing Security Agreement dated December 5, 2014 between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.2 of our Form 8-K dated December 5, 2014 as filed with the Commission on December 8, 2014.
<u>10.21</u>	Line of Credit Note dated December 5, 2014 between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.3 of our Form 8-K dated December 5, 2014 as filed with the Commission on December 8, 2014.
<u>10.22*</u>	Nautilus, Inc. 2015 Long-Term Incentive Plan - Incorporated by reference to Exhibit 10.1 of our Form 8-K dated April 28, 2015 as filed with the Commission on May 4, 2015.
<u>10.23</u>	Nautilus, Inc. Employee Stock Purchase Plan - Incorporated by reference to Exhibit 10.2 of our Form 8-K dated April 28, 2015 as filed with the Commission on May 4, 2015.
<u>10.24</u>	Consent and Amendment to Loan Documents dated December 31, 2015 between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.30 of our Form 10-K for the year ended December 31, 2015 as filed with the Commission on February 25, 2016.
<u>10.25</u>	Term Note dated December 31, 2015 between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.31 of our Form 10-K for the year ended December 31, 2015 as filed with the Commission on February 25, 2016.
<u>10.26*</u>	Employment Agreement dated January 1, 2017, by and between Nautilus, Inc. and Ryan Simat - Incorporated by reference to Exhibit 10.35 of our Form 10-K for the year ended December 31, 2016 as filed with the Commission on February 27, 2017.
<u>10.27</u>	Second Amendment to Credit Agreement dated March 1, 2017, by and between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.1 of our Form 10-Q for the quarter ended March 31, 2017 as filed with the Commission on May 4, 2017.
<u>10.28*</u>	Offer of employment letter dated November 8, 2017, between the Company and Christopher K. Quatrochi - Incorporated by reference to Exhibit 10.28 of our Form 10-K for the year ended December 31, 2017 as filed with the Commission on March 6, 2018.
<u>10.29</u>	Third Amendment to Loan Documents dated December 21, 2018, by and between Nautilus, Inc. and JPMorgan Chase Bank, N.A. - Incorporated by reference to Exhibit 10.1 of our Form 8-K dated December 21, 2018 as filed with the Commission on December 28, 2018.



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- 10.30\* Offer of employment letter dated April 10, 2018, between the Company and Jay E. McGregor.
- 10.31\* Employment Agreement dated January 14, 2019, by and between Nautilus, Inc. and Carlos Navarro.
- 21 Subsidiaries of the Company.
- 23.1 Consent of Independent Registered Public Accounting Firm.
- 23.2 Consent of Independent Registered Public Accounting Firm.
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
- 101.SCH XBRL Taxonomy Extension Schema Document

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101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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

**Item 16. Form 10-K Summary**

None.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NAUTILUS, INC.  
(Registrant)

February 27, 2019 By: /s/ Bruce M. Cazenave  
Date **Bruce M. Cazenave**  
Chief Executive Officer  
(Principal Executive Officer)

NAUTILUS, INC.  
(Registrant)

February 27, 2019 By: /s/ Sidharth Nayar  
Date **Sidharth Nayar**  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

**POWER OF ATTORNEY**

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 27, 2019.

(Remainder of page is blank.)

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<u>Signature</u>	<u>Title</u>
/s/ Bruce M. Cazenave <b>Bruce M. Cazenave</b>	Chief Executive Officer (Principal Executive Officer)
/s/ Sidharth Nayar <b>Sidharth Nayar</b>	Chief Financial Officer (Principal Financial and Accounting Officer)
* <b>M. Carl Johnson, III</b>	Chairman
* <b>Ronald P. Badie</b>	Director
* <b>Richard A. Horn</b>	Director
* <b>Anne G. Saunders</b>	Director
* <b>Marvin G. Siegert</b>	Director
*By: /s/ Wayne M. Bolio <b>Wayne M. Bolio</b> <i>Attorney-In-Fact</i>	February 27, 2019