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

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**FORM 10-K**

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(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, 2007**

OR

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

FOR THE TRANSITION PERIOD FROM TO

**Commission file number: 001-31321**

**NAUTILUS, INC.**

(Exact name of Registrant as specified in its charter)

**Washington**  
(State or other jurisdiction of  
incorporation or organization)

**94-3002667**  
(I.R.S. Employer  
Identification No.)

**16400 S.E. Nautilus Drive**  
**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  
**Common Stock, no par value**

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

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

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the last sales price (\$12.04) 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, 2007) was \$379,803,437.

The number of shares outstanding of the registrant's common stock as of February 29, 2008 was 31,557,136 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 2008 Annual Meeting of Shareholders.

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## PART I

### Item 1. Business

#### OVERVIEW

Nautilus, Inc. is a leading designer, developer, manufacturer and marketer of branded fitness products sold under such well-known brand names as Nautilus, Bowflex, Schwinn Fitness and StairMaster. As used in this Form 10-K, the terms “we,” “our,” “us,” “Nautilus” and the “Company” refer to Nautilus, Inc. and its subsidiaries. Founded in 1986 and incorporated in the state of Washington in 1993, the Company had 2007 net sales from continuing operations of \$501 million. In 2007 the Company experienced a decline in net sales after several years of growth achieved through a combination of internal growth of our Bowflex brand and a series of strategic acquisitions of well-recognized brands, including Nautilus International, Inc. (“Nautilus”) in January 1999, the fitness division of Schwinn/GT Corp. and its affiliates (“Schwinn Fitness”) in September 2001, and StairMaster Sports/Medical, Inc. (“StairMaster”) in February 2002. The Company acquired DashAmerica, Inc. d/b/a Pearl Izumi USA (“Pearl Izumi”) in July 2005; however, this unit was for sale at the end of 2007 and is considered a discontinued operation in the accompanying financial statements. In February 2008 we entered into an agreement to sell Pearl Izumi and we anticipate the transaction to be completed late in the first quarter of 2008.

Our common stock is listed on the New York Stock Exchange and trades under the symbol “NLS.” Our principal executive offices are located at 16400 SE Nautilus Drive, Vancouver, Washington 98683, and our telephone number is (360) 859-2900.

#### OUR STRATEGY

We view our Company as a global fitness products company providing innovative, quality solutions to help people achieve a fit and healthy lifestyle. We are focused on becoming a global organization, emphasizing quality, delivering innovation to provide a competitive edge, and ensuring a coordinated brand strategy for all products.

We envision presenting innovative, branded strength and cardiovascular products where people shop for home fitness equipment and where they exercise using commercial quality fitness equipment.

#### RECENT DEVELOPMENTS

We experienced a challenging business environment in 2007, partially because of softening conditions for consumer discretionary purchases and partially because the Company did not execute well in our effort to bring innovative branded solutions to people around the world. In August 2007 the Company’s Board of Directors replaced our Chairman and CEO with Mr. Robert Falcone, who at the time of his appointment was serving as our Lead Independent Director. After a search by a leading recruiting firm, the Board appointed Mr. Falcone as permanent CEO in October 2007. The Company began an intensive turnaround process in the second half of 2007 that resulted in substantial charges, especially in the fourth quarter.

The Company has taken a number of steps to improve our operational performance. Among them:

- The Company completed a broad-based reduction in force involving 140 positions or 9% of the Company’s employee base.
- We have suspended the sale of two cardiovascular products sold in the commercial market that were causing unusually high warranty and service costs. One of these, the commercial TreadClimber, is expected to be reintroduced once its durability can be improved.
- We closed the Australian direct sales operation during early 2008, consolidated call centers in North America resulting in the anticipated second quarter 2008 closure of our Winnipeg call center, and announced the April 2008 closure of our large distribution center in the Chicago suburb of Bolingbrook, Illinois.

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- We began a rationalization and segmentation of the products offered in various channels. The result is expected to be fewer and more profitable products offered with clear delineation of product offerings between segments.
- We initiated a gross margin improvement program that includes: (i) a focus on reducing the cost of existing products; (ii) a focus on profitability by customer and (iii) a global evaluation of our manufacturing and distribution infrastructure.

In addition, we took several actions during the second half of 2007 to restore strength to our balance sheet. The Company decided in the fourth quarter 2007 to divest our Fitness Apparel segment by seeking a purchaser for the Pearl Izumi business. In addition, we addressed EBITDA-related covenant violations in our \$100 million unsecured debt agreement by replacing the credit facility with a 5-year \$100 million asset-based line of credit (to be reduced to \$70 million upon the close of the Pearl Izumi sale). We also initiated an inventory reduction program to reduce the working capital required to operate the business, and sold a building we owned in Louisville, Colorado.

For a further discussion of the financial impact of these actions, refer to *Management's Discussion and Analysis of Financial Condition and Results of Operation* located at Part II, Item 7 of this Form 10-K.

On September 20, 2007, Sherborne Investors LP (together with its affiliates, "Sherborne"), our largest shareholder, sent a letter to the Company demanding a special meeting of shareholders for the purpose of presenting certain proposals, including a proposal to remove four members of our Board and replace them with nominees put forth by Sherborne. Following a proxy contest, a special meeting of shareholders was convened on December 18, 2007 at which the Company's shareholders voted in favor of all the proposals put forth by Sherborne. As a result, in December 2007 four of the Company's former directors were removed and replaced by the Sherborne nominees and Mr. Edward J. Bramson, the Managing Member of Sherborne, was named Chairman of our Board of Directors.

## **BUSINESS SEGMENTS**

The Company's reportable segments are evidence of the structure of the Company's internal organization and allow focus on specific business opportunities in the Company's worldwide market. Following the 2007 decision to exit its Fitness Apparel Segment, which is reported as a discontinued operation, the Company operates in two business segments as follows:

- The Fitness Equipment Business is responsible for the design, production, marketing and the selling of branded fitness equipment sold under the Nautilus, Bowflex, Schwinn Fitness, and StairMaster brand names and is responsible for servicing customers within North and South America.  
The Company's original flagship product was a Bowflex home exercise gym with Power Rod Technology. The Company has been diversifying its product line since 1999 through acquisitions and innovation. As a result, sales of the original Bowflex Power Rod home gyms have continued to drop as a percentage of revenue. In 2007, our Power Rod home gym product line accounted for approximately 31% of our revenue, down from 43% and 46% in 2006 and 2005, respectively, as we continue our strategy of diversifying our breadth of products in all channels.
- The International Equipment Business is responsible for marketing and selling branded fitness equipment under the Nautilus, Bowflex, Schwinn Fitness, and StairMaster brand names and is responsible for servicing customers outside of the Americas. The International Equipment Business primarily reflects sales in the commercial business sector. Sales in this segment have grown over the last three years and comprised 15%, 10% and 9% of consolidated sales for the years ended December 31, 2007, 2006 and 2005, respectively.

Detailed financial information about our business segments, including information regarding geographic areas, is included in Note 13 of the Notes to Consolidated Financial Statements.

## PRODUCTS

The Company's principal business activity is the design, development, manufacturing, and worldwide marketing of high quality cardiovascular and strength products and related accessories.

### ***Branded Fitness Equipment Products***

The fitness equipment line is comprised of high-quality cardiovascular and strength products that cover a broad range of technology, price points, and features that are believed to be among the best in categories in which they compete.

- Our Nautilus brand includes four distinct lines of strength equipment, free weights and benches, and a complete line of cardio equipment including treadmills, ellipticals, and upright and recumbent exercise bicycles.
- Our StairMaster brand is best known for steppers and stepmills designed for excellent lower-body and cardiovascular workouts.
- Our Bowflex brand has been expanded to represent a complete line of fitness equipment to include both strength and cardio products. Included in the Bowflex brand are multiple models of rod-based home gyms, the Revolution home gym, SelectTech dumbbells, weight benches, home TreadClimbers and treadmills.
- Our Schwinn Fitness brand includes a popular line of equipment designed for indoor cycling which includes upright and recumbent exercise bikes, as well as treadmills and ellipticals.
- We acquired the Universal brand in 2006 and we expect to introduce a line of strength products under this brand in 2009.

## SALES AND MARKETING

### ***Fitness Equipment Business***

The Fitness Equipment Business products are marketed and sold through a diversified direct, retail, and commercial sales distribution channel within the Americas, which includes the United States (the "U.S."), Mexico, Canada and South America. These distribution channels consist of independent authorized dealers, our own sales force, distributors and our e-commerce web sites that are accessible through the overall website ([www.nautilusinc.com](http://www.nautilusinc.com)). We believe we position our products to better meet consumer demand and shopping patterns and to further expand our sales channels by offering more of the products consumers want in the places they shop and exercise.

Our Fitness Equipment Business has three distinct sales channels:

- In the *direct channel*, we market and sell our products directly to the end-consumer. We market and sell a line of Bowflex branded cardiovascular, strength, and fitness accessory products through this channel utilizing an integrated combination of media and direct consumer contact. Along with "spot" television advertising, which ranges in length from 30 seconds to as long as five minutes, we utilize extended 30-minute television infomercials, Internet advertising, our product websites, inquiry response mailings, catalogs, and inbound/outbound call centers.

We use the spot commercials and infomercials, together with Internet advertising and search-engine placement, to lead consumers to our website, as we believe consumers who visit our website are more inclined to purchase our products. We believe we successfully balance our goals of finalizing sales and capturing consumer information by strategically designing our web pages and carefully analyzing web page visits, conversion rates, average sales prices and inquiry counts.

We contract with large telemarketing companies to receive and process information requests generated by our spot television advertising. The telemarketing agents for these companies collect names, addresses and other basic information from callers but do not directly sell our products.

We manage our own customer service call center in Vancouver, Washington. It operates 18 to 23 hours per day to receive and process the vast majority of all infomercial-generated and customer service-related inquiries.

- In the *commercial channel*, we market and sell our Nautilus, Schwinn Fitness, and StairMaster commercial fitness equipment through an internal sales force and selected dealers and distributors to health clubs, government agencies, hotels, corporate fitness centers, colleges, universities and assisted living facilities. Our commercial sales force is focused on expanding the market position of our existing Nautilus, Schwinn Fitness, and StairMaster commercial product lines through joint marketing programs with clubs thus making fitness inviting for guests, and utilizing our knowledge from the Nautilus Institute, a Company-sponsored fitness advocacy initiative, to improve our product offerings.

There are several national and regional industry trade shows, such as the International Health, Racquet and Sportsclub Association and Club Industry, as well as certain regional events that showcase our programs and products. Trade shows provide opportunities to meet face-to-face with our customers and the media to obtain valuable feedback by being able to test market messages, receive customer input on product designs, and evaluate the competition.

We maintain a database that includes contacts at thousands of commercial facilities and enables us to monitor responses to direct mail promotions. All direct mail promotions are supplemented by a telemarketing effort to maximize customer response. We maintain a modest advertising presence in certain trade publications.

- In the *retail channel*, we market and sell a comprehensive line of consumer fitness equipment under the Nautilus, Schwinn Fitness, StairMaster, and to a lesser extent Bowflex, brands through a network of more than 6,200 locations consisting of sporting goods, warehouse clubs, department stores, governmental agencies, mass retailers, specialty retailers, and independent bike dealers. Over time, the Company expects to present its products in fewer retail locations.

The main focus for marketing our retail products is two-fold: 1) fully support our network of customers, and 2) leverage our direct marketing advertising programs to market brands and products through the retail sales channel that were previously only available to consumers through the direct sales channel. Company sponsored marketing programs have been developed to ensure that our Nautilus, Schwinn Fitness, Bowflex, and StairMaster brands remain prominent in the minds of customers and consumers and drive consumers to their local retailers.

### ***International Equipment Business***

The International Equipment Business product line is marketed and sold through a diversified retail and commercial sales distribution channel outside of the Americas through our own sales force and international distributors. The sales are predominately commercial with retail sales comprising 21% of the total for the International Equipment Business. By offering a complete line of strength and cardio products, we now have greater ability to compete in the international marketplace where many commercial customers prefer to buy from one supplier that can offer a broad array of products at a competitive price. We believe our brand names have strong recognition in the international marketplace which has allowed us to compete more effectively.

To allow us to effectively manage our international sales channels, we operate our own offices in our largest international markets which include Switzerland, the United Kingdom, Germany, Italy, and China. Each office possesses a team of sales and service representatives that focus on selling to fitness clubs, governments and hotels.

### **PRODUCT DESIGN AND INNOVATION**

Innovation is a vital part of our business as we continue expansion and diversification of our product offerings in fitness products through leveraging our advanced research and development capabilities and our strong brand

name recognition. On an ongoing basis, we evaluate new product concepts and seek to respond to the requirements and needs of our consumers by frequently introducing new products and repositioning existing products. We develop these products either from internally generated ideas or by acquiring or licensing patented technology from outside inventors and then enhancing the technology.

Our research and development costs were approximately \$10.4 million, \$9.4 million, and \$10.4 million, for the years ended December 31, 2007, 2006, and 2005, respectively. In 2007 and for all periods presented, we reclassified preproduction royalties into research and development expenses from a royalty expense line previously included within operating expenses. Preproduction royalties represent payments made for the use of third party owned licensed patented technologies prior to a product being developed and sold. Included in research and development costs were \$1.0 million, \$0.7 million and \$0.4 million of preproduction royalties for the years ended December 31, 2007, 2006 and 2005, respectively.

Also in 2007, we reclassified royalty expense related to products sold into cost of goods sold. Royalty expense was previously reported as a separate line within operating expenses for those products utilizing a licensed patented technology. The reclassification was made for all periods presented. We incurred \$4.9 million, \$4.9 million, and \$5.0 million in royalties for licensing patented technology for the years ended December 31, 2007, 2006, and 2005, respectively. We did not have any customer-sponsored research and development expenses in any of these years.

## SEASONALITY

### ***Fitness Equipment Products***

In general, U.S. and international sales in our direct, commercial, and retail fitness equipment channels are seasonal. We believe that sales within these channels are lower in the second quarter of the year compared to the other quarters, especially in the direct and retail channels. Our strongest quarter for these channels is generally the fourth quarter, followed by the first and third quarters. We believe the principal reason for this trend is the fitness industry's preparation for the impact of seasonal weather patterns that encourage more fitness activity indoors in the winter months.

## MANUFACTURING AND DISTRIBUTION

### ***Fitness Equipment Business***

Our primary manufacturing and distribution objectives for all of our products are to maintain product quality, reduce and control costs, maximize production flexibility, and improve delivery speed. This is accomplished by optimizing our manufacturing and distribution infrastructure. Our products are manufactured in the U.S. at our Oklahoma and Virginia plants, and at contracted manufacturing facilities in Asia. We have not experienced any significant difficulties with availability of raw materials.

Our commercial strength fitness products are primarily manufactured in our Virginia manufacturing plant, and our commercial cardiovascular fitness products are primarily manufactured in our Oklahoma plant. These operations are vertically integrated and include such functions as metal fabrication, powder coating, upholstery, and vacuum-formed plastics processes. By managing our own manufacturing operations, we can control the quality of our commercial products and offer customers build-to-order capability and unique product configurations.

We inspect, package, and ship our products from our distribution facilities in Oregon, Virginia, Illinois, Oklahoma and Winnipeg, Canada. We rely primarily on United Parcel Service (UPS) to deliver our direct products. We distribute our retail and commercial fitness equipment from our facilities in Illinois and Oklahoma using various commercial truck lines. We distribute a substantial portion of our commercial strength fitness equipment from our Virginia warehouse facility directly to customers through our own truck fleet which allows us to effectively control the set up and inspection of equipment at the end-user's facilities. We anticipate closing our Illinois facility in the second quarter of 2008.

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### ***International Equipment Business***

Our International Equipment Business primarily consists of sales of commercial products that are manufactured in our Virginia and Oklahoma manufacturing facilities. We utilize our Asian suppliers to manufacture our retail products and several commercial products. Products are shipped to customers outside the Americas primarily from a third party distribution facility in the Netherlands.

### **BACKLOG**

Historically backlog has not been a significant factor in the Company's business.

### **COMPETITION**

The markets for all of our products are highly competitive. Our competitors vary by market and sales channel as discussed below. We believe the principal competitive factors affecting our business are quality and innovation combined with of our well-recognized brand names enhanced by our brand marketing awareness programs. Other principle factors contributing to our ability to stay competitive include pricing strategy with key products and dependable customer service. We believe this combination of factors will allow us to remain competitive in all of our current fitness equipment markets.

*Direct Fitness Equipment:* We primarily sell our Bowflex strength and cardiovascular fitness products in this market. Our direct-marketed brands compete directly with a large number of companies that manufacture, market and distribute home fitness equipment. Our principal direct competitors include *Fitness Quest* and *ICON Health & Fitness*.

*Commercial Fitness Equipment:* Our Nautilus, Schwinn Fitness, and StairMaster brands compete against products of other commercial fitness equipment companies such as *Life Fitness (Brunswick)*, *Precor (Amer Sports)*, *Cybex* and *TechnoGym*.

*Retail Fitness Equipment:* Our Nautilus, Schwinn Fitness, StairMaster, and Bowflex brands compete against the products of other retail fitness equipment companies such as *Johnson Health Tech*, *ICON Health & Fitness* and many others.

In our International Equipment Business, our Nautilus, Schwinn Fitness, StairMaster, and Bowflex brands compete against the products of such companies as *Life Fitness*, *Johnson Health Tech*, *Cybex*, *StarTrac*, *Precor*, and *TechnoGym*.

### **EMPLOYEES**

As of February 28, 2008, we employed approximately 1,262 employees, excluding 223 employees of Pearl Izumi, as the Company made a decision to exit this business. Management considers its relationship with employees to be good. None of our employees are subject to any collective bargaining agreements. There has never been a material interruption of operations due to labor disruptions.

### **SIGNIFICANT CUSTOMERS**

We had no individual customers that accounted for 10 percent or more of our consolidated net sales during fiscal 2007, 2006, and 2005.



## INTELLECTUAL PROPERTY

**Trademarks** – We own many trademarks including Nautilus®, Bowflex®, Power Rod®, TreadClimber®, Schwinn® Fitness, SelectTech®, StairMaster®, Trimline® and Universal®. Our trademarks, the great majority of which are either registered or protected by common law rights, are used on nearly all of our products sold in the U.S. and internationally. We believe that having distinctive trademarks readily identifiable by consumers is an important factor in creating a market for our goods, in identifying our Company, and in distinguishing our goods from others.

Each federally registered trademark is renewable indefinitely if the trademark is still in use at the time of renewal. We are not aware of any material claims of infringement or other challenges to our trademark rights.

**Patents** – The Company has a broad array of patents, both issued and pending, covering its exercise equipment. Within these patents are various products and technologies including TreadClimber, variable stride ellipticals, selectorized weights, recumbent bicycles, and Spiraflex. Our patent protection for some of these technologies extends as far as 2025. Expiration of our patents could trigger the introduction of similar products by our competitors.

Building our intellectual property portfolio is an important factor in maintaining our competitive position in the fitness equipment and apparel industries. We have followed a policy of filing applications for the U.S. and foreign patents on inventions, new designs and improvements that we deem valuable to our business. If we do not, or are unable to, adequately protect our intellectual property, our sales and profitability could be materially adversely affected. We protect our proprietary rights vigorously and take prompt action to prevent counterfeit reproductions of or other infringing on our intellectual property. As we increase our market share, geographic scope and product categories, we anticipate that intellectual property disputes will increase making it more expensive for us to establish and/or protect our proprietary rights, and to defend against claims of infringement by others. Refer to Note 14 to the consolidated financial statements located at Part II, Item 8 of this Form 10-K for a discussion of significant intellectual property disputes.

## ENVIRONMENTAL MATTERS

Our operations are subject to federal, state and local health and safety and environmental laws and regulations, as well as those in other countries that impose workplace standards and limitations on the discharge of pollutants into the environment and establish standards for the handling, generation, emission, release, discharge, treatment, storage and disposal of materials, substances and wastes. U.S. federal environmental legislation having particular impact on the Company 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, Compensation and Liability Act (also known as Superfund). We are also subject to regulation by the Occupational Safety and Health Administration (OSHA) concerning employee safety and health matters. The United States Environmental Protection Agency (EPA), OSHA, and other federal agencies have the authority to promulgate regulations that have an impact on our operations.

The nature of our manufacturing and assembly operations exposes us to the risk of claims with respect to environmental matters, and although compliance with local, state, federal and international requirements relating to the protection of the environment has not had a material adverse effect on our financial condition or results of operations, there can be no assurance that material costs or liabilities will not be incurred in connection with such environmental matters. Future events, such as changes in existing laws and regulations or enforcement policies or the discovery of contamination on sites owned or operated by us may give rise to additional compliance costs or operational interruptions which could have a material adverse effect on our financial condition, results of operations, and cash flows. While we are not aware of any existing conditions that are likely to result in material costs or liabilities to us, there can be no assurance that all potential instances of soil or ground water contamination have been identified even where Environment Site Assessments have been conducted.

Accordingly, there can be no assurance that previously unknown environmental conditions, or known conditions which have not been fully evaluated, will not be discovered at any of our properties, whether presently or formerly owned or leased, or that the cost of remediating such conditions will not be material.

## **WHERE YOU CAN FIND MORE INFORMATION**

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 (“Exchange Act”). 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. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. The SEC maintains an Internet site at <http://www.sec.gov/> where you can obtain most of our SEC filings. We also make available, free of charge, on our website at [www.nautilusinc.com](http://www.nautilusinc.com) our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, if any, filed or furnished with the SEC pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after they are filed electronically with the SEC. In addition, our code of business conduct and ethics, corporate governance policies, and the charters of our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee are available on our corporate website at [www.nautilusinc.com](http://www.nautilusinc.com). The information found on our website is not part of this Form 10-K.

## **Item 1A. Risk Factors**

### ***Special Note Regarding Forward-Looking Statements and Analysts Reports***

This Form 10-K, including Item 1 of Part I and Items 7 and 7(A) of Part II, contains forward-looking statements. Forward-looking statements include any statements related to our expectations regarding future performance or conditions, including any statements regarding anticipated sales growth across markets, distribution channels, and product categories, expenses and gross margins, expense as a percentage of revenue, anticipated earnings, new product introductions, future capital expenditures, 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 Item 1(A), *Risk Factors*, of this Form 10-K. We do not undertake any duty to update forward-looking statements after the date they are made or to conform them to actual results or to changes in circumstances or expectations.

### **We may need to raise additional financing if our financial results do not improve.**

We sustained a pretax loss from continuing operations of \$72.0 million during the year ended December 31, 2007, contributing to a decrease in net working capital of \$54.5 million from 2006. Beginning in September 2007, we initiated a number of actions to improve the strength of our balance sheet, including efforts to divest our Fitness Apparel Business through the sale of Pearl Izumi and the negotiation of a new \$100 million asset-based line of credit, which will be reduced to \$70 million upon the close of the sale of Pearl Izumi. We also initiated an inventory reduction program to reduce the working capital required to operate our business and sold a building we owned in Louisville, Colorado. However, if we continue to experience significant operating losses and reductions in net working capital, these actions may not be adequate to address our financing requirements and we may need to obtain additional debt or equity financing to continue current business operations. There is no guarantee that we will be able to raise additional funds on favorable terms, if at all.

### **The actions we have taken to improve our operating performance may not be successful.**

Beginning in September 2007, we have implemented a series of actions to improve our operating performance with the goal of simplifying the business and returning the Company to profitability. We have implemented

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actions to reduce our operating expenses, including a reduction in workforce, suspended sale of two cardiovascular products sold in the commercial channel due to durability issues, we closed the Australia direct sales operations, we announced the closure of the Winnipeg, Canada call center and Bolingbrook, Illinois distribution center. By themselves, these actions are not sufficient to return the Company to profitability.

### **Failure to successfully implement our turnaround strategies may adversely affect revenues and decrease margins**

To implement our business strategy, we must effectively manage our turnaround in each of our operating channels. We will continue to change various aspects of our business, to maintain and enhance our information systems and operations, and to attract, retain and manage qualified personnel. Turnaround could place an increasing strain on management, financial, product design, marketing, distribution and other resources, and we could experience operating difficulties. Turnaround involves many risks and uncertainties that, if not managed effectively, could have a material adverse effect on our results of operations and financial condition.

### **A significant decline in availability of media time or fluctuating advertising rates may hinder our ability to effectively market our products and may reduce profitability**

We depend primarily on television commercials and television infomercials to market and sell our direct-marketed products. 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.

### **A decline in consumer spending due to unfavorable economic conditions could negatively affect our product revenues and earnings**

Success of each of our products depends substantially on the amount of discretionary funds available to consumers and their purchasing preferences. Economic and political uncertainties could adversely impact the U.S. and international economic environments. A decline in general economic conditions due to increased freight and transportation costs as well as increasing interest rates, among other factors, could further depress consumer spending, especially discretionary spending for big ticket products like ours. Higher interest rates could increase monthly payments for consumer products financed through one of our monthly payment plans. These poor economic conditions could in turn lead to substantial decreases in our net sales.

### **We have terminated our agreements to acquire our Asian manufacturing partner. Damage claims and/or impact to our business relationship resulting from disputes related to such agreements could harm our business.**

On January 19, 2008, we gave written notice to Land America Health & Fitness Co., Ltd, our Asian manufacturing partner, and Treuriver Investments, Limited, its related trading company (collectively, “Land America”), that we were exercising our right to terminate our agreements with Land America to purchase substantially all of Land America’s assets. By letter dated January 21, 2008, legal counsel to Land America notified us that Land America considers us to be in breach of certain duties set forth in such agreements and that Land America has incurred significant economic damages as a result of such alleged breach. While we believe that we have defenses to any such claim and would vigorously assert those defenses in any such proceeding, if Land America were to prevail in large part on a successful damages claim against us, such claim could negatively impact our financial results. Additionally, if our business relationship with Land America is damaged by a dispute related to these agreements, our business and operations may be negatively impacted.

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

We have outsourced the manufacturing of many of our products, including substantially all of our consumer products, to third party manufacturers. We rely on our contract manufacturers to procure components and

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provide spare parts in support of our warranty and customer service obligations. We generally commit the manufacturing of each product platform 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 lack of adequate capacity to manufacture all or a part of the products we require; and
- Reduced control over the availability of our products.

Our contract manufacturers are primarily located in Asia 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. In addition, we do not have long-term contracts with any of our third-party contract manufacturers and these contracts are terminable by either party on relatively short notice.

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

Our results of operations for any individual quarter or for the year are not necessarily indicative of results to be expected in future periods. Our operating results have historically been, and are expected to continue to be, subject to quarterly and yearly fluctuations as a result of a number of factors, including:

- The introduction and market acceptance of new products;
- Variations in product selling prices and costs and the mix of products sold;
- The size and timing of customer orders, which, in turn, often depend upon the success of our customers' business or specific products;
- Changes in the conditions in the markets for consumer and commercial fitness equipment;
- The availability of consumer and commercial credit;
- The timing and availability of products coming from our offshore contract manufacturing partners; and
- Seasonality of markets such as the direct retail and consumer retail markets, which vary quarter to quarter and are influenced by outside factors such as overall consumer confidence and the availability and cost of television advertising time.

These trends and factors could harm our business, operating results and financial condition in any particular period.

**Our operating expenses and portions of our costs of revenues are relatively fixed and we may have limited ability to reduce expenses quickly in response to any revenue shortfalls.**

Our operating expenses and inventory handling costs 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 revenue shortfall, it could negatively impact our financial results.

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

Our future success depends on our ability to develop or acquire the rights to, and then effectively produce, market, and sell new products that create and/or respond to new and evolving consumer demands. Accordingly, our net sales and profitability may be harmed if we are unable to develop, or acquire the rights to new or different products that satisfy consumers' preferences. In addition, any new products that we market may not generate sufficient net sales or profits to recoup their development or acquisition costs.

**A delay in getting foreign sourced products through customs in a timely manner could result in cancelled orders and unanticipated inventory accumulation**

Many of our imported products are subject to duties, tariffs or quotas that affect the cost and quantity of various types of goods imported into the U.S. or our other sales markets. The countries in which our products are produced or sold may adjust or impose new quotas, duties, tariffs or other restrictions. Further, our business depends on our ability to source and distribute products in a timely manner. As a result, we rely on the free flow of goods through open and operational ports worldwide. Labor disputes at various ports create significant risks for our business, particularly if these disputes result in work slowdowns, lockouts, strikes, or other disruptions during our peak importing seasons. Any of these factors could have a material adverse effect on our business, potentially resulting in reduced revenues and earnings, cancelled orders by customers, and/or unanticipated inventory accumulation.

**Unpredictable events and circumstances relating to our international operations, including our use of foreign manufacturers, could result in cancelled orders, unanticipated inventory accumulation, and reduced revenues and earnings**

A portion of our revenues is derived from sales outside the U.S.; for the year ended December 31, 2007, international sales, including sales from the International division and Canada, represented approximately 21% of our consolidated net sales. In addition, a substantial portion of our products is manufactured outside of the U.S. Accordingly, our future results could be materially adversely affected by a variety of factors, 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 for a period of time longer than those made in the U.S.

**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. If we do not or are unable to adequately protect our intellectual property, our sales and profitability may be adversely affected. We currently hold a number of patents and trademarks and have several patent and trademark applications pending. However, our efforts to protect our proprietary rights may be inadequate, and applicable laws provide only limited protection.

**Intense competition may have a negative impact on our net sales and operating results**

Our products are sold in highly competitive markets with limited barriers to entry. As a result, introduction of lower priced competing products could result in a significant decline in our net sales and operating results.

**Inability to effectively manage our distribution facilities may harm our business and financial results**

Our ability to meet customer expectations, manage inventory, complete sales and achieve objectives for operating efficiencies depends on the proper operation of our existing distribution facilities and the timely

performance of services by third parties, including those involved in shipping product to and from our distribution facilities. In the U.S., we rely primarily on our distribution centers in Portland, Oregon; Independence, Virginia; Tulsa, Oklahoma; Bolingbrook, Illinois; and in Europe we rely primarily on a third party warehouse and logistics provider in the Netherlands. The Company has announced the April 2008 closure of the Bolingbrook, Illinois distribution center.

Operations at our distribution facilities could be interrupted by disasters such as earthquakes or fires. We maintain business interruption insurance, but it may not adequately protect us from the adverse effect that could be caused by significant disruptions in our distribution facilities.

#### **Failure to maintain our information systems could result in interruptions to our business**

Our business is increasingly reliant on information technology. Information systems are used in all stages of our production cycle, from design to distribution, and are used as a method of communication between employees, our subsidiaries overseas, as well as our customers. We also rely on our information systems to allocate resources and forecast operating results. 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, or failure to properly protect, repair or maintain systems. Any interruption of critical business information systems may have a material adverse affect on our results of operations and financial condition.

#### **Currency exchange rate fluctuations could result in higher costs and decreased margins**

We have significant sales outside of the U.S. As a result, we conduct transactions in various currencies which increase our exposure to fluctuations in foreign currency exchange rates relative to the U.S. dollar. Our international revenues and expenses generally are derived from sales and operations in foreign currencies, and these revenues and expenses could be affected by currency fluctuations. Currency exchange rate fluctuations could also disrupt the business of the independent manufacturers that produce our products by making their purchases of raw materials more expensive and more difficult to finance. Therefore, 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 conduct business.

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

We experience moderate fluctuations in aggregate sales volume during the year. Historically, our strongest quarter for sales is the fourth quarter, followed by the first and third quarters. 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.

#### **We may be adversely affected by the financial health of our customers**

We extend credit to our customers, generally without requiring collateral, based on the assessment of a customer's financial circumstances. To assist in the scheduling of production and the shipping of seasonal products, we offer customers the ability to place orders four to six months ahead of delivery. These advance orders may be cancelled and the risk of cancellation may increase when dealing with financially challenged customers struggling with economic uncertainty. In the past, some customers have experienced financial difficulties which in turn have had an adverse effect on our business. From time to time, customers will be more cautious than usual with orders as a result of weakness in the retail economy. A slowing economy in our key markets could have an adverse effect on the financial health of our customers which could in turn have an adverse effect on our results of operations and financial condition.

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

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

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

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

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

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

In early 2008, the Company suspended sales of the commercial TreadClimber products as a result of product durability issues until those issues can be corrected. The severity of the quality issues and costs related to either replacing or maintaining this product increased significantly during the fourth quarter of 2007 leading management to take specific action with this product. Management is currently evaluating alternatives for addressing this warranty issue and has recorded its best estimate of the cost to remediate the issues identified which is included in accrued liabilities and other long-term liabilities. Management's estimate of costs to remediate could be materially different than the actual cost of remediation.

**In order to be successful, we must attract, retain and motivate key employees, and failure to do so may have an adverse impact on our business**

Our future success depends on our ability to attract and retain key executives, managers, product development engineers, sales personnel, and others. We face intense competition for such individuals worldwide. Not being able to attract or retain these employees may have a material adverse effect on our results of operations and financial condition.

**Item 1B. Unresolved Staff Comments**

None.

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### Item 2. Properties

The following is a summary of principal properties owned or leased by the Company.

Reportable Segment	Location	Primary Function(s)	Owned or Leased
Fitness Equipment	Washington	World headquarters, call center, retail store, and warehouse	Leased
	Oregon	Warehouse and distribution	Leased
	Virginia	Warehouse and distribution	Owned
	Virginia	Commercial equipment manufacturing	Owned
	Virginia	Engineering, prototyping, customer service, and administrative	Owned
	Virginia	Showroom	Owned
	Virginia	Commercial equipment sales and warehouse	Owned
	Virginia	Two warehouse and distribution facilities	Owned
	Illinois	Warehouse and distribution	Leased
	Colorado	Administrative, warehouse, production, testing, engineering and distribution	Leased
	Oklahoma	Manufacturing	Leased
	Oklahoma	Distribution	Leased
	Canada	Call center, distribution, administration, warehouse, and showroom	Leased
International Equipment	Switzerland	Administrative	Leased
	Switzerland	Warehouse and distribution	Leased
	Germany	Administrative, showroom, and warehouse	Leased
	United Kingdom	Administrative, showroom, and warehouse	Leased
	Italy	Administrative and distribution	Leased
	Australia	Administrative, call center, showroom sales, and warehouse	Leased
	China	Administrative	Leased
	China	Research and development	Leased
Fitness Apparel	California	Four retail stores	Leased(*)
	Colorado	Apparel headquarters and warehouse	Leased(*)
	Colorado	Retail store	Leased(*)
	Georgia	Retail store	Leased(*)
	Germany	European headquarters and warehouse	Leased(*)
	New Hampshire	Retail store	Leased(*)
	Illinois	Retail store	Leased(*)
	Oregon	Two retail stores	Leased(*)
	Texas	Retail store	Leased(*)
	Utah	Retail store	Leased(*)

(\*) The leases with the Fitness Apparel Business will be transferred with the sale of the Pearl Izumi business.

In general, our properties are well maintained, adequate and suitable for their purposes, and we believe these properties will meet our operational needs for the foreseeable future. If we require additional warehouse or office space, we believe we will be able to obtain such space on commercially reasonable terms.



### Item 3. Legal Proceedings

For a description of the legal proceedings that affect us, refer to Note 14 to the consolidated financial statements located at Item 8 of this Form 10-K.

### Item 4. Submission of Matters to a Vote of Security Holders

A special meeting of shareholders of Nautilus, Inc. was held on December 18, 2007, at which the following actions were taken:

1. The shareholders approved a proposal to remove the following four incumbent members of Nautilus' board of directors (the "Board"). The voting results for such proposals were as follows:

	FOR REMOVAL	AGAINST REMOVAL	ABSTAIN
Peter A. Allen	16,186,038	5,180,340	62,759
Evelyn V. Follit	12,197,569	9,166,493	65,077
Donald W. Keeble	16,242,449	5,124,513	62,177
Diane L. Neal	12,173,076	9,190,066	65,996

2. The shareholders elected to amend Section 2.4 of Article II of Nautilus' Amended and Restated Bylaws (the "Bylaws"), to provide that any vacancies on the Board resulting from the removal of directors by the shareholders of Nautilus may not be filled by the Board and shall only be filled by the shareholders of Nautilus. The voting results were as follows:

FOR	AGAINST	ABSTAIN
14,110,726	7,268,290	50,119

3. The shareholders elected to amend Section 2.2 of Article II of the Bylaws to fix the number of directors serving on the Board at seven; provided, however, that such number may be decreased (but not increased) by the Board. The voting results were as follows:

FOR	AGAINST	ABSTAIN
16,220,656	5,336,081	204,182

4. The shareholders voted to fill the four vacancies resulting from the approval of Proposal 1 above. The voting results were as follows:

	FOR	WITHHOLD
Peter A. Allen	5,136,939	823,804
Evelyn V. Follit	5,138,667	822,076
Donald W. Keeble	5,086,813	873,930
Diane L. Neal	5,145,452	815,291
Edward J. Bramson (to fill first vacancy)	13,205,920	2,262,475
Gerard L. Eastman (to fill the second vacancy)	13,386,782	2,081,613
Michael A. Stein (to fill third vacancy)	15,343,419	124,976
Richard A. Horn (to fill the fourth vacancy)	11,392,378	4,076,017

As a result of the voting set forth above Messrs. Bramson, Eastman, Stein and Horn were elected to replace Mr. Allen, Ms. Follit, Mr. Keeble and Ms. Neal, each of whom were removed from the Board.

## 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 29, 2008, 31,557,136 shares of our common stock were issued and outstanding, the number of beneficial shareholders was approximately 6,000 and the number of shareholders of record was 75.

The following table summarizes the high and low closing prices and dividends paid per common share for each period indicated:

	<u>High</u>	<u>Low</u>	<u>Dividends Paid</u>
<b>2007:</b>			
Quarter 1	\$ 18.53	\$ 13.86	\$ 0.10
Quarter 2	16.07	12.04	0.10
Quarter 3	12.63	7.70	0.10
Quarter 4	8.22	4.47	—
<b>2006:</b>			
Quarter 1	\$ 19.70	\$ 13.91	\$ 0.10
Quarter 2	18.49	14.92	0.10
Quarter 3	15.66	11.49	0.10
Quarter 4	16.10	13.65	0.10

The total amount of dividends paid in 2007 and 2006 were \$9.5 million (\$0.30 per share) and \$12.9 million (\$0.40 per share), respectively. In the fourth quarter of 2007, the Board of Directors suspended the dividend. Payment of any future dividends 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. The Company’s loan agreement contains covenants that include limitations on paying dividends when certain ratios are not met. Based on the covenants, the Company is currently precluded from paying dividends.

#### *Equity Compensation Plans*

The following table provides information about the Company’s equity compensation plans as of December 31, 2007:

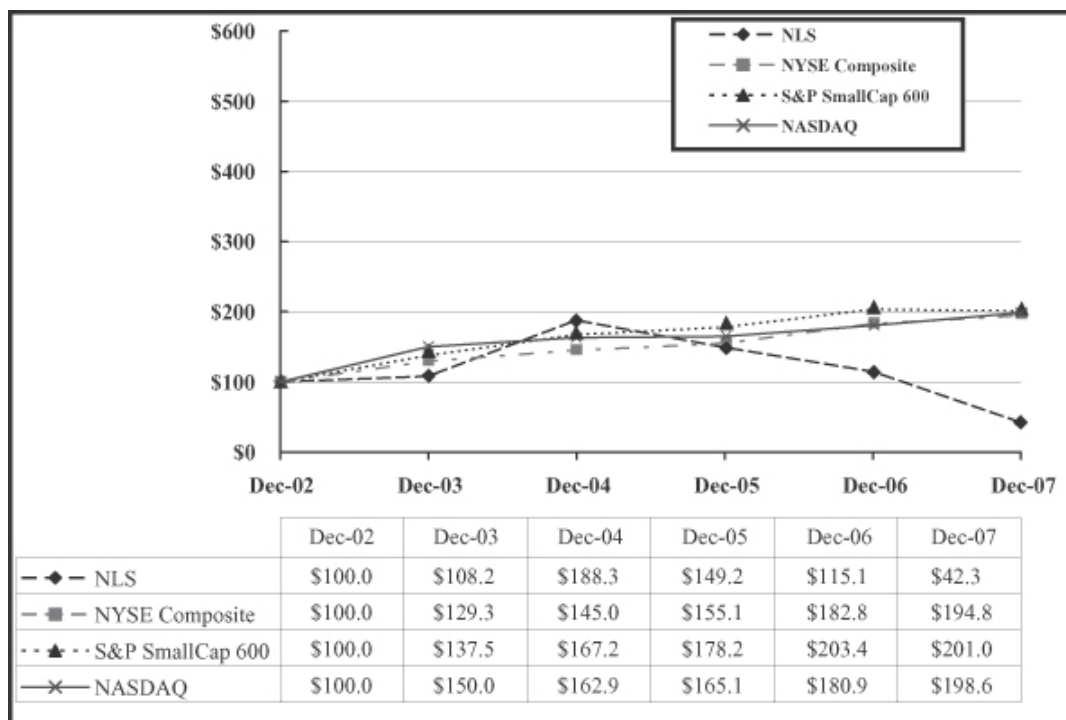
<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)</u>	<u>Weighted average exercise price of outstanding options, warrants and rights (b)</u>	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)</u>
Equity compensation plans approved by security holders	3,118,250	\$ 13.54	2,939,619
Equity compensation plans not approved by security holders	—	—	—
<b>Total</b>	<b>3,118,250</b>	<b>\$ 13.54</b>	<b>2,939,619</b>

For further information regarding the Company’s equity compensation plans, refer to Note 10 to the consolidated financial statements located at Item 8 of this Form 10-K.

### Stock Performance Graph

Below is a line graph and table comparing the cumulative total shareholder return of our common stock with the cumulative total return of the *NYSE Composite Index*, *NASDAQ*, and the *S&P SmallCap 600 Index* for the period commencing December 31, 2002 and ending on December 31, 2007. The *S&P 600 Small Cap Index* 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 Index* represents a broad-based index of companies with similar market capitalization. Our common stock was added to the *S&P SmallCap 600* on March 19, 2003.

The graph assumes that \$100 was invested in our common stock and each index in December 2002. 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 selected consolidated financial data presented below is for, and as of the end of, each of the years in the five-year period ended December 31, has been derived from the audited consolidated financial statements. This data should be read in conjunction with our financial statements and notes thereto and Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operation*.

In the fourth quarter of 2007, management committed to a plan to sell the operations of our Fitness Apparel Business. Our Fitness Apparel Business consists primarily of Pearl Izumi which designs, markets and sells branded fitness apparel and footwear sold primarily under the Pearl Izumi brand globally. In February 2008, the Company entered into an agreement to sell Pearl Izumi and the Company anticipates the sale to be completed late in the first quarter 2008. Accordingly, assets, liabilities, and results of operations of the Fitness Apparel Business for all periods presented have been presented as discontinued operations in the consolidated financial statements in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". See Note 2 "Discontinued Operations" to Nautilus, Inc.'s Consolidated Financial Statements and later in the MD&A.

<u>(In thousands except per share amounts)</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net sales	\$ 501,471	\$ 617,271	\$ 607,274	\$ 523,837	\$ 498,836
Gross profit	179,363	266,378	262,806	238,933	243,894
Operating income (loss)	(68,612)	34,758	31,560	44,462	51,816
Income (loss) from continuing operations	(45,812)	24,920	21,974	29,985	34,402
Gain (loss) from discontinued operations, net of tax	(9,801)	4,180	1,026	—	—
Net income (loss)	\$ (55,613)	\$ 29,100	\$ 23,000	\$ 29,985	\$ 34,402
Earnings (loss) per share from continuing operations:					
Basic	\$ (1.45)	\$ 0.77	\$ 0.66	\$ 0.92	\$ 1.06
Diluted	\$ (1.45)	\$ 0.77	\$ 0.65	\$ 0.90	\$ 1.04
Cash dividends declared and paid per share	\$ 0.30	\$ 0.40	\$ 0.40	\$ 0.40	\$ 0.40
Cash, cash equivalents, and short-term investments	\$ 7,911	\$ 4,262	\$ 7,984	\$ 104,585	\$ 72,634
Working capital	97,334	151,820	156,184	169,549	138,711
Total assets	390,840	424,942	413,286	359,641	311,935
Long-term debt	—	—	1,396	200	—

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

This Management's Discussion and Analysis of Financial Condition and Results of Operation (the "MD&A") should be read in conjunction with our consolidated financial statements and related notes located at Item 8 of this Form 10-K. We believe that period-to-period comparisons of our operating results are not necessarily indicative of future performance. You should consider our prospects in light of the risks, expenses and difficulties typically encountered by most companies. We may not be able to successfully address these risks and difficulties and, consequently, we cannot assure you of any future growth or profitability. For more information, see our discussion of *Risk Factors* located at Part I, Item 1A of this Form 10-K.

## EXECUTIVE OVERVIEW

We are a leading designer, developer, manufacturer and marketer of branded fitness products sold around the world. We operate in two segments; the Fitness Equipment Business and the International Equipment Business. During 2007, the Company decided to exit the Fitness Apparel Business and the related financial results have been classified as discontinued operations. In addition, management made a number of strategic decisions which impacted 2007 operating results:

- In January 2008 we exercised our right to terminate the agreements to purchase the Land America manufacturing facility in China resulting in charges of \$19.4 million in operating expenses (general

and administrative) related to nonrefundable deposits made towards the purchase and costs incurred during the Company's due diligence efforts;

- In the first quarter of 2008, we suspended sales and production of the commercial TreadClimber and retired certain commercial grade elliptical trainers due to quality and reliability issues resulting in pretax charges of \$16.9 million charged to cost of goods sold in 2007;
- We stopped or delayed development of certain products which resulted in intellectual property impairment charges in the amount of \$3.0 million charged to operating expenses;
- We exited certain marketing contracts, resulting in a \$1.2 million charge to operating expenses; and
- We restructured staff to address declining revenues, terminated the former Chief Executive Officer and incurred fees recruiting for a new Chief Executive, resulting in a \$3.6 million charge to operating expenses.

For the year, we delivered net sales from continuing operations of \$501.5 million compared to \$617.3 million in 2006, a decrease of 18.8%. Gross profit margins decreased to 35.8% in 2007 compared to 43.2% in 2006. The largest contributor to our decrease in gross margins in 2007 was a \$16.9 million charge recorded for warranty and inventory reserves related to quality issues and the decision to stop selling certain of our commercial cardiovascular products until quality issues can be remedied. Operating expenses were \$248.0 million in 2007 compared to \$231.6 million in the prior year, an increase of 7.1%. This increase is primarily the result of \$30.5 million of significant charges incurred in connection with strategic decisions made by management in an effort to return the company to profitability, offset by an \$18.3 million lawsuit settlement in which the Company received the rights to utilize a variety of fitness equipment patents and related technologies.

In the fourth quarter of 2007, management committed to a plan to sell the operations of our Fitness Apparel Business. Our Fitness Apparel Business primarily consists of Pearl Izumi which designs, markets and sells branded fitness apparel and footwear sold primarily under the Pearl Izumi brand globally. In February 2008 the Company entered into an agreement to sell Pearl Izumi and the Company anticipates the sale to be completed late in the first quarter of 2008. Accordingly, assets, liabilities and results of operations of the Fitness Apparel Business have been presented as discontinued operations in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". See Note 2 "Discontinued Operations" to Nautilus, Inc.'s Consolidated Financial Statements and later in the MD&A.

Loss from discontinued operations in 2007 was \$9.8 million, including an impairment charge of \$13.2 million, compared to income from discontinued operations of \$4.2 million in 2006.

## RESULTS OF OPERATIONS

The following table sets forth selected financial information derived from our consolidated financial statements. The discussion that follows the table should be read in conjunction with the consolidated financial statements.

(In thousands)	Years Ended December 31,					
	2007	% of 2007 net sales	2006	% of 2006 net sales	2005	% of 2005 net sales
Net sales	\$501,471	100.0%	\$617,271	100.0%	\$607,274	100.0%
Cost of sales	322,108	64.2%	350,893	56.8%	344,468	56.7%
Gross profit	179,363	35.8%	266,378	43.2%	262,806	43.3%
Operating expenses:						
Selling and marketing	181,244	36.1%	175,307	28.4%	175,333	28.9%
General and administrative	74,606	14.9%	46,897	7.6%	45,518	7.5%
Research and development	10,425	2.1%	9,416	1.5%	10,395	1.7%
Litigation settlement	(18,300)	(3.6%)	—	—	—	—
Total operating expenses	247,975	49.4%	231,620	37.5%	231,246	38.1%
Operating income (loss)	(68,612)	(13.7%)	34,758	5.6%	31,560	5.2%
Other Income (Expense):						
Interest income	364	0.1%	710	0.1%	1,575	0.2%
Interest expense	(5,014)	(1.0%)	(2,576)	(0.4%)	(413)	(0.1%)
Other income (expense), net	1,234	0.2%	1,124	0.2%	497	0.1%
Total other income (expense)	(3,416)	(0.7%)	(742)	(0.1%)	1,659	0.3%
Income (loss) before income taxes	(72,028)	(14.4%)	34,016	5.5%	33,219	5.5%
Income tax expense (benefit)	(26,216)	(5.2%)	9,096	1.5%	11,245	1.9%
Income (loss) from continuing operations	(45,812)	(9.1%)	24,920	4.0%	21,974	3.6%
Gain (loss) from discontinued operations	(9,801)	(2.0%)	4,180	0.7%	1,026	0.2%
Net income (loss)	<u>\$ (55,613)</u>	(11.1%)	<u>\$ 29,100</u>	4.7%	<u>\$ 23,000</u>	3.8%

## COMPARISON OF THE YEARS ENDED DECEMBER 31, 2007 AND DECEMBER 31, 2006

### Net Sales

Net sales were \$501.5 million in 2007 compared to \$617.3 million in 2006, a decrease of \$115.8 million or 18.8%. The decrease is a result of decreases in the retail and direct channels in the Fitness Equipment Business offset by an increase in sales in the International Equipment Business.

**Fitness Equipment Business** – The fitness equipment business designs, produces, markets and sells fitness products under the Nautilus, Bowflex, Schwinn Fitness, and StairMaster brand names. Depending on the brand, our fitness equipment is marketed and sold through the direct, commercial, and retail channels of distribution located in North and South America. Net sales for the fitness equipment business were \$423.9 million in 2007 as compared to \$553.4 million last year, a decrease of \$129.5 million or 23.4%. Specific channel net sales information is detailed below:

In the **direct channel**, net sales declined 12.5% to \$247.7 million in 2007 compared to \$283.1 million last year. Sales in the direct channel consist of our Bowflex branded products and primarily include our rod-based home gyms, TreadClimber products, Bowflex Revolution and SelectTech dumbbells. The decrease in net sales is primarily due to a decrease in sales of rod based home gyms. The decrease in sales of rod based home gyms resulted primarily from of reduced advertising for rod based home gyms and a higher number of similar power rod products being sold at our retail partner locations during 2007. During 2007 we experienced increased advertising costs which led to fewer ads being purchased for the same dollars due to increased competition for

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advertising space. The decrease in sales of rod based home gyms was slightly offset by an increase in sales volume for our Bowflex Revolution and the Bowflex TreadClimbers. Sales of these products increased as a result of increased advertising and the introduction during 2007 of the Revo XP with an upright bench format.

In the **retail channel**, net sales declined 49.3% to \$99.5 million as compared to \$196.1 million last year. The decline in this channel was mainly due to a shift in strategy as we are limiting the number of power-rod home gyms being offered into this channel to more clearly differentiate and segment products by channel. The retail channel experienced a general softness in consumer spending during 2007 which has caused the Company to provide a greater level of support to its customers in the form of discounts to allow our customers to sell through their existing inventory.

In the **commercial channel**, net sales remained substantially unchanged at \$73.6 million in 2007 compared to \$73.0 million last year. Product features of Nautilus branded bikes were refreshed during 2007 which led to significant increases in sales volumes for those products. We also experienced increased sales of the TreadClimber product and Stairmaster stepping products. This was offset by decreased sales of Schwinn branded indoor bikes, other Nautilus branded cardio equipment and a slight decline in sales of the strength product lines as a result of delays in production and delivery of the Company's newly launched Nautilus One and certain free weight product lines. Sales of the Company's commercial TreadClimber products were suspended in early 2008 as a result of durability issues. Sales will be suspended until the product can be re-engineered and the durability and warranty issues can be corrected. We anticipate this will lead to a reduction in commercial channel revenue during 2008 compared with 2007.

**Royalty income** represents the revenue the Company receives for licensing certain owned patents, trademarks and brands to other companies. Royalty income increased to \$3.1 million in 2007 compared to \$1.2 million last year. The increase was a result of acquiring a large patent group related to elliptical machines during 2006 on which the Company had previously paid royalties. The acquisition of the patent group allowed the Company to begin collecting royalty income from other parties who use the licensed technology.

**International Equipment Business** – The International Equipment Business markets and sells fitness products sold under the Nautilus, Bowflex, Schwinn Fitness, and StairMaster, brand names through the commercial, retail and direct channels of distribution located outside of the Americas. Net sales for the International Equipment Business improved 21.3% to \$77.5 million as compared to \$63.9 million last year. The increase in net sales was due to expansion of our commercial sales channel in our four western European subsidiaries, as well as increased sales through our distributors following the introduction of the TreadClimber in international sales markets. In addition, we established a subsidiary in China during the third quarter of 2006 and added a direct division in Australia during 2007. The direct Australia division added \$1.3 million in sales during 2007. The direct Australia division was closed in early 2008 and the market will be supported through the traditional distributor model business going forward. Sales of the Company's commercial TreadClimber products were suspended in early 2008 as a result of durability issues. Sales will be suspended until the product can be re-engineered and the durability issues can be corrected. We anticipate this to cause a reduction in International Equipment Business revenue during 2008 compared with 2007.

## **Gross Profit**

As a result of our decline in sales, our total gross profit declined by 32.7% to \$179.4 million in 2007 as compared to \$266.4 million last year. As a percentage of consolidated net sales from continuing operations our gross profit margin decreased to 35.8% as compared to 43.2% last year. The decrease in gross profit margin was due primarily to charges incurred during 2007 of \$16.9 million resulting from warranty and inventory reserves related to commercial cardiovascular products. This change impacted margin by 3.4 percentage points. Gross profit margin also decreased as a result of the continued shift in our sales product mix both between and within product categories and among our selling channels. During 2007, the Company reclassified royalty expense into cost of goods sold for all reporting periods. Royalties were previously reported as a separate line item included in operating expenses.

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**Fitness Equipment Business** – Gross profit for our Fitness Equipment Business declined to \$158.6 million in 2007 as compared to \$250.5 million last year. As a percentage of net sales, the gross profit margin declined to 37.4% in 2007 compared to 45.3% last year. Factors affecting gross profit included significant charges related to warranty and inventory write-offs resulting from suspension of sales of the commercial TreadClimber product and a commercial elliptical product. Other factors affecting gross profit margin include sales channel and product sales mix and additional promotions in the direct and retail channels. Most notable is the reduction of sales in power-rod home gyms sold in both the direct and retail channels that historically provide higher margins than most of our other finished goods. During 2007 the Company's gross margins benefited from rebates payable under our Supply Agreement with Land America. As a result of the termination of the agreement to purchase the Land America assets, those rebates will not be available in 2008. The negative impact on gross margins resulting from termination of the rebates will depend on the volume of purchases from Land America.

During 2007, the Company reclassified royalty expense related to products sold into cost of goods sold. Royalty expense was previously reported as a separate line within operating expenses for those products utilizing a licensed patented technology. The reclassification was made for all periods presented. Royalty expense of \$4.9 and \$4.9 million for the years ended December 31, 2007 and 2006, respectively is included in gross profit.

**International Equipment Business** – Gross profit for our International Equipment Business was \$20.7 million in 2007 compared to \$15.9 million in 2006, an increase of \$4.8 million or 30.2%. As a percentage of net sales, the gross profit margin increased to 26.7% in 2007 compared to 24.9% in 2006. The increased gross profit is the result of a better sales mix in the retail channel and improved margins due to the inclusion of some direct sales in China and Australia. The Company closed the Australia direct business in early 2008 because of lack of overall profitability in that channel.

### ***Operating Expenses***

#### ***Selling and Marketing***

Selling and marketing expenses increased by \$5.9 million or 3.4% to \$181.2 in 2007 as compared to \$175.3 million last year. As a percentage of consolidated net sales our selling and marketing expenses increased to 36.1% in 2007 compared to 28.4% last year. The increase in selling and marketing expenses in the Fitness Equipment Business related to incremental bad debt reserves of \$4.8 million primarily resulting from the bankruptcy filing by a former customer and a \$1.2 million charge to exit certain marketing contracts. In addition, selling and marketing expenses within the International Equipment Business increased in support of growing revenue, and as a result of costs related to expansion into new markets including China and Australia. These increases were offset by a sales volume decline in the direct channel resulting in lower marketing expenses and financing fees within the Fitness Equipment Business. As a percentage of sales, selling and marketing expenses in the direct channel increased during 2007.

#### ***General and Administrative***

General and administrative expenses increased by \$27.7 million or 59.1% to \$74.6 million in 2007 as compared to \$46.9 million last year. The increase was primarily a result of the following: (i) a \$19.4 million charge related to termination of the Land America asset purchase agreements, (ii) a \$3.0 million intellectual property impairment related to strategic changes in the Company's plans to utilize the patents acquired in the second quarter of 2007, (iii) \$2.7 million of additional expenses incurred in connection with the December 18, 2007 special shareholder meeting, (iv) \$2.3 million in costs associated with the departure of the Company's former CEO, and (v) other increases in recruiting and salaries as new members were added to the management team.

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

Research and development expenses increased by \$1.0 million or 10.7% to \$10.4 million in 2007 as compared to \$9.4 million in 2006. The increase was due to an increase in wages, recruiting and prototyping expenses for our research and development efforts related to the introduction of the Nautilus One and other new products during the year.



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During 2007, the Company reclassified preproduction royalties into research and development expenses for all periods presented which added \$1.0 million and \$0.7 million for 2007 and 2006, respectively. Preproduction royalties represent costs paid to utilize licensed patent technologies prior to the completion of a finished product. The increase in preproduction royalties over the prior year is related to the license of specific patents related to the development of new products.

### Litigation Settlement

During 2007, the Company settled a lawsuit with ICON Health and Fitness, Inc. and as a result we received the rights to utilize a variety of fitness equipment related patents and technologies. We valued those assets and recorded them in litigation settlement as a reduction in operating expenses of \$18.3 million. The Company recorded an impairment charge of \$3.0 million in general and administrative expense during 2007 as changes were made to the plans to utilize the patents and technologies received.

### **Other Income (Expense)**

#### Interest Expense

Interest expense increased to \$5.0 million in 2007 compared to interest expense of \$2.6 million in 2006. The increase in interest expense is due to the increased average short-term borrowings outstanding during 2007 as compared to 2006.

#### Other Income, net

Other income, net remained consistent with 2006 at approximately \$1.2 million for both periods. Other income is a result of foreign currency gains recognized by the Company due to fluctuations in local currencies in which the Company operates.

### **Income Tax Expense (Benefit)**

The provision for income tax expense was a benefit of \$26.2 million during 2007 as compared to an expense of \$9.1 million last year. This change was due to a pre-tax loss in 2007 compared to pre-tax income in 2006. Our effective tax rate in 2007 was 36.4% compared to 26.7% in 2006. The increase in our annual effective rate was primarily due to the change to pre-tax loss from pre-tax income in 2007 and the reduction of tax contingency reserves in 2006.

### **Discontinued Operations**

The Company designated the financial results of the Fitness Apparel Business as discontinued operations during 2007. This resulted in recording the financial results as gain (loss) from discontinued operations. The loss from discontinued operations during 2007 was \$9.8 million compared to gain from discontinued operations of \$4.2 million during the prior year. The 2007 loss from discontinued operations includes an impairment charge of \$13.2 million for the difference between book value of the Fitness Apparel Business net assets and the anticipated net sale proceeds.

## **COMPARISON OF THE YEARS ENDED DECEMBER 31, 2006 AND DECEMBER 31, 2005**

All assets and liabilities and results of operations associated with the Fitness Apparel Business assets have been presented in the consolidated financial statements as discontinued operations separate from continuing operations in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". See Note 2 "Discontinued Operations" to Nautilus, Inc.'s Consolidated Financial Statements and later in the MD&A.

### **Consolidated Net Sales**

Consolidated net sales were \$617.3 million in 2006 compared to \$607.3 million in 2005, an increase of \$10.0 million or 1.6%. The increase is primarily attributed to an increase in sales from our International Equipment Business of approximately \$10.8 million.

*Fitness Equipment Business* – Net sales for the Fitness Equipment Business were flat at \$553.4 million in 2006 as compared to \$554.2 million in 2005. Specific channel net sales information is detailed below:

- In the **direct channel**, net sales declined 3.7% in 2006 to \$283.1 million compared to \$293.9 in 2005. Sales in the direct channel consist of our Bowflex branded products and primarily include our rod-based home gyms, TreadClimber products, SelectTech dumbbells, and the Bowflex Revolution. The decrease in net sales was due to a combination of reduced advertising earlier in 2006 as a result of increased competition for media space and lower conversion rates as consumer confidence was negatively affected by higher interest rates and increasing fuel prices resulting in an overall decrease in sales of our rod-based home gyms. This decrease was slightly offset by an increase in sales volume for our Bowflex TreadClimbers and the Bowflex Revolution, our latest generation of Bowflex home gyms.
- In the **commercial channel**, net sales in 2006 were \$73.0 million compared to \$72.9 million in 2005. During 2006 we made a decision to renegotiate terms and discounts with our commercial dealers in order to increase overall profitability within the channel. As a result of these negotiations we realized a slight reduction in commercial dealer sales volumes. This decrease was offset by realizing a full year of sales from the Nautilus Commercial grade TreadClimber, various new product introductions during the last half of 2006, and a four percent price increase that was issued on a variety of products mid year.
- In the **retail channel**, net sales increased 4.6% in 2006 to \$196.1 million as compared to \$187.4 million in 2005. Growth in the channel was mainly due to an increase in sales volume through our existing retail partners which resulted in additional sales for our Bowflex rod-based home gyms, SelectTech dumbbells, and the Bowflex Blaze home gym, which was launched in the third quarter of 2006. Contributing further to the growth was the realization of a full year of sales from products introduced later in 2005 for our Schwinn Fitness line of cardio equipment. The overall increase was offset by a decrease in sales of our Bowflex TreadClimbers, Nautilus strength products, and the discontinued Trimline cardio products. During the year, we also revised our supply chain strategy to increase the number of shipments to our retail customers directly from our Asian manufacturing partners. While this contributed to a reduction in net sales during the year, our profitability increased due to decreased distribution, freight and the U.S. customs related costs. The channel also realized a slight decrease from the negative effect of poor sell-through in the last quarter of 2006 in our specialty retail customer base that resulted primarily from an increasingly competitive market for specialty products and an increasingly challenging specialty retail environment.

*International Equipment Business* – Net sales for the International Equipment Business improved 20.3% in 2006 to \$63.9 million as compared to \$53.1 million in 2005. The increase in net sales is a result of the growth of sales to the international distributor network which contributed approximately \$5.6 million, and additional sales in China and the western European countries of \$1.9 million and \$2.1 million, respectively.

### **Consolidated Gross Profit**

As a result of our increased sales, our total gross profit increased by 1.4% to \$266.4 million in 2006 as compared to \$262.8 million in 2005. As a percentage of consolidated net sales our gross profit margin decreased to 43.2% as compared to 43.3% last year. The decrease was a result of the continued shift in our sales product mix both between and within product categories and among our selling channels. This was partially offset by a reduction in our warranty costs primarily through a recovery of a portion of such costs from our suppliers. In addition, as a result of improving our operating efficiencies and sustained engineering efforts we have continued to focus on reducing the cost of our sourced products from our Asian manufacturers.

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***Fitness Equipment Business*** – Gross profit for our Fitness Equipment Business improved slightly in 2006 to \$250.5 million as compared to \$249.1 million in 2005. As a percentage of net sales, the gross profit margin improved slightly to 45.3% in 2006 compared to 45.0% in 2005. Factors affecting gross profit included a reduction of our warranty costs through the recovery of a portion of warranty costs from our Asian manufacturers. In addition, we realized reductions in the actual cost of our sourced products through various sustained engineering efforts and continued vendor contract negotiations as we seek strong partnerships with fewer vendors. These cost savings were offset by an increase in freight costs and changes in both the sales channel and product sales mix within the product categories.

***International Equipment Business*** – Gross profit for our International Equipment Business was \$15.9 million in 2006 compared to \$13.7 million in 2005, an increase of \$2.2 million or 16.1%. As a percentage of net sales, the gross profit margin decreased to 24.9% in 2006 from 25.8% in 2005. The decrease as a percentage of sales is a result of increased royalties in 2006 due to the mix of products sold that incur a royalty. The increased gross profit was attributed to efficiency gains in service and logistics performance along with an overall increase in sales volume. The increase was offset by downward pressure on selling prices exerted by strong competition, increased freight costs, and unfavorable sales mix resulting in increased sales volumes from the lower margin retail sales channel.

### ***Consolidated Operating Expenses***

***Selling and Marketing*** – Selling and marketing (“S&M”) expenses remained flat in 2006 at \$175.3 million as compared to \$175.3 million in 2005. As a percentage of consolidated net sales our S&M expenses decreased to 28.4% in 2006 compared to 28.9% in 2005. The increase in total S&M expenses was primarily due to an increase in consumer financing fees due to stronger financing utilization by our direct channel consumers, an increase in direct marketing costs and additional share-based compensation expense of approximately \$0.4 million as a result of adoption of SFAS 123(R). The remainder of the increase resulted from an increase in commission costs of approximately \$1.8 million due to overall increased sales volume.

***General and Administrative*** – General and administrative (“G&A”) expenses increased by 3.1% in 2006 to \$46.9 million as compared to \$45.5 million in 2005. As a percentage of consolidated net sales our G&A expenses were 7.6% in 2006 compared to 7.5% in 2005. The increase was mainly due to a full year of depreciation and rent expense of approximately \$2.2 million for our new corporate headquarters which we occupied late in the third quarter of 2005, and \$1.8 million of share-based compensation expense resulting from the adoption of SFAS 123(R). These increases were partially offset by a decrease of \$1.8 million in legal costs.

***Research and Development*** – Research and development (“R&D”) expenses decreased 9.6% in 2006 to \$9.4 million as compared to \$10.4 million in 2005. In 2005, the Company introduced a large number of new products and in 2006 we reduced the number of projects and resources focused on research and development.

During 2007, the Company reclassified preproduction royalties into research and development expenses for all periods presented which added \$0.7 million and \$0.4 million for 2006 and 2005, respectively. Preproduction royalties represent costs paid to utilize licensed patent technologies prior to a sellable product being available for manufacture and sale. The increase in preproduction royalties over the prior year resulted from the license of specific patents related to the development of new products.

### ***Consolidated Other Income (Expense), net***

#### ***Net Interest***

Net interest expense increased to \$1.9 million in 2006 compared to net interest income of \$1.2 million in 2005. The increase in expense was due to the increase in the average balance of our short-term borrowings that were outstanding during 2006 as compared to the Company being in a cash investment position during most of 2005.

#### Other Income, net

Other income, net increased to \$1.1 million in 2006 from \$0.5 million in 2005 primarily due to foreign currency gains realized by the Company in 2006.

#### ***Consolidated Income Tax Expense***

The provision for income tax expense from continuing operations decreased by 18.8% in 2006 to \$9.1 million as compared to \$11.2 million in 2005. Our effective tax rate from continuing operations in 2006 was 26.7% compared to 33.9% in 2005. The decrease in the effective tax rate was primarily due to a \$3.8 million reduction of our tax contingency reserves resulting from our determination that certain statutory periods for the assessment of additional state income tax have closed.

#### ***Discontinued Operations***

In 2007 the Company designated the financial results of the Fitness Apparel Business as discontinued operations. This resulted in recording the financial results from these operations as gain from discontinued operations. The gain from discontinued operations during 2006 was \$4.2 million compared to \$1.0 million during 2005. The increase in gain from discontinued operations in 2006 was due to the acquisition of Pearl Izumi occurring in July 2005 which resulted in a gain from discontinued operations for six months in 2005 compared to twelve months of operations during 2006.

#### **LIQUIDITY AND CAPITAL RESOURCES**

During 2007, our operating activities from continuing operations provided \$1.8 million in net cash compared to providing net cash of \$38.5 million in 2006. The reduction in operating cash provided from continuing operations year over year was primarily due to a 19% reduction in net sales resulting in a loss from continuing operations of \$45.8 million offset by a reduction in trade receivables of \$43.7 million. As a result of the pre-tax loss recorded in 2007, the Company will be able to obtain tax refunds from prior years in which taxes were paid. We received a tax refund of approximately \$1.9 million in the first quarter 2008 and anticipate receiving approximately \$8.0 million in the second quarter of 2008.

Net cash used in investing activities from continuing operations was \$26.4 million in 2007 compared to \$14.4 million in 2006. During 2007, the Company invested \$21.9 million in the Land America acquisition which was not closed and thus an impairment was recorded as of December 31, 2007. In addition, capital expenditures were \$10.7 million in 2007 compared to \$10.9 million in 2006. Capital expenditures during 2007 consisted of manufacturing equipment and tooling to support new, innovative product offerings, and computer equipment to maintain and expand current information systems. In 2007 we received proceeds from the sale of a building in Louisville, Colorado for \$6.1 million while in the prior year period, we sold a building and received \$7.1 million in net proceeds and acquired intellectual property for \$8.5 million.

Net cash provided by financing activities from continuing operations was \$22.9 million in 2007 compared to net cash used of \$22.9 million in 2006. Cash dividends paid were \$9.5 million 2007 compared to \$12.9 million in 2006. The Company repurchased \$16.7 million of stock in 2006. Due to the current year operating losses and other activities, the Company borrowed \$31.5 million in the current year and \$7.4 million in 2006. In order to conserve cash and reduce our need to borrow, we suspended our quarterly dividend starting in the fourth quarter of 2007.

In the fourth quarter of 2007, management committed to a plan to sell the operations of our Fitness Apparel Business. Our Fitness Apparel Business primarily consists of Pearl Izumi which designs, markets and sells branded fitness apparel and footwear sold primarily under the Pearl Izumi brand globally. In February 2008 the Company entered into an agreement to sell Pearl Izumi and the Company anticipates the sale to be completed late

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in the first quarter of 2008. Accordingly, the results of operations for the Fitness Apparel Business have been reclassified as discontinued operations. Net cash provided by operating activities of discontinued operations during 2007 was \$6.7 million compared to net cash used by discontinued operations of \$4.7 million in 2006. The significant increase is a result of recording an impairment charge of \$13.2 million to adjust the net book value of the Fitness Apparel Business down to fair market value as determined by an accepted sale agreement. Cash flows used in investing activities for discontinued operations were \$1.0 million in 2007 compared to \$0.7 million in 2006. Cash flows used in financing activities for discontinued operations were \$0.2 million in 2007 compared to \$0.6 million in 2006 as the Company made debt payments related to the original acquisition.

The Company expects the sale to be completed in the first quarter of 2008 and the net cash proceeds of approximately \$63 million will be used to reduce the Company's borrowings under its short-term borrowings.

The following table presents our estimated contractual obligations:

(In Thousands)	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating lease obligations (1)	\$ 31,898	\$ 6,808	\$9,945	\$7,623	\$ 7,522
Purchase obligations (2)	43,927	43,895	32	—	—
Short-term borrowings	79,000	79,000	—	—	—
Total	<u>\$154,825</u>	<u>\$129,703</u>	<u>\$9,977</u>	<u>\$7,623</u>	<u>\$ 7,522</u>

- (1) Included in the operating lease total is \$0.8 million of lease obligations related to facilities that will be closed during 2008.
- (2) Given that the majority of our inventory is sourced from Asia, we have long lead times for inventory purchases and therefore need to secure factory capacity from our vendors in advance. As the result, all of the \$43.9 million in purchase obligations is for inventory purchases. This inventory is predominately related to sales anticipated in the first half of 2008.

Due to the uncertainty with respect to the timing of future cash flows associated with our unrecognized tax benefits at December 31, 2007, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority. Therefore, \$3.0 million of unrecognized tax benefits have been excluded from the contractual obligations table above. See Note 9 to the Consolidated Financial Statements for a discussion on income taxes.

### OFF-BALANCE SHEET ARRANGEMENTS

As described in Note 1 to the consolidated financial statements located at Item 8 of this Form 10-K, from time to time, we arrange for leases or other financing sources with third parties to enable certain of our commercial customers to purchase our commercial products. While most of these financings are without recourse, in certain cases we may offer a guarantee or other recourse provisions. At December 31, 2007 and December 31, 2006, the maximum contingent liability under all recourse provisions was approximately \$1.3 million and \$1.6 million, respectively.

The Company has an agreement with a financing company to provide second tier financing for its consumers under which the Company previously shared financial responsibility if consumer default rates exceeded contractual expectations. During the third quarter 2007, the Company renegotiated its second tier financing agreements and transferred risk of loss to the financing company for a settlement payment of \$0.7 million. As a result, a reserve is no longer established for consumer default on second tier financing arrangements. Our financing partners review consumer credit information and determine which consumers will receive financing and approve the amount of financing provided. Refer to Note 1 to the consolidated financial statements for further discussion of these arrangements.

## **INFLATION AND PRICE CHANGES**

We are experiencing cost increases for products and components manufactured in China reflecting increases in foreign currency exchange rates, and Chinese wages, taxes and raw material costs which our third party sourcing partners are seeking to pass along to the Company. Raw material costs have also increased for products manufactured by Nautilus owned facilities in the United States. Gross margins may be negatively impacted if these conditions continue and the Company is unable to find other cost savings opportunities or increase prices enough to offset the cost increases.

During both 2007 and 2006, we experienced increases in transportation costs due to increases in the price for fuel. To the extent these costs continue to increase and we are unable to pass these costs to the customer, our gross margins may continue to be negatively impacted.

## **SEASONALITY**

In general, based on historic trends, we expect our sales from fitness equipment products both in the U.S. and internationally to vary seasonally with sales typically the strongest in the fourth quarter, followed by the first and third quarters, and the weakest in the second quarter. We believe that such factors as the broadcast of national network season finales and seasonal weather patterns influence television viewership and cause our television commercials on national cable television to be less effective in the second quarter than in other periods of the year. In addition, during the spring and summer consumers tend to do more activities outside including exercise, which impacts sales of fitness equipment used indoors. We expect the fluctuation in our net sales between our highest and lowest quarters to be approximately 37%.

## **CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS**

The preparation of financial statements in conformity with U.S. GAAP 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. As described by the Securities and Exchange Commission ("SEC"), critical accounting estimates and assumptions are those that may be 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 that have a material impact on the financial condition or operating performance of the company. Based on this definition, we believe the items listed below are our critical accounting estimates and assumptions.

Management and our independent auditors regularly discuss with our audit committee each of our critical accounting estimates and assumptions, as well as critical accounting policies presented in Note 1 to the consolidated financial statements located at Item 8 of this Form 10-K, and the development and selection of these accounting estimates and the disclosure about each estimate in the MD&A. These discussions typically occur at our quarterly audit committee meetings and include the basis and methodology used in developing and selecting these estimates, the trends in and amounts of these estimates, specific matters affecting the amount of and changes in these estimates, and any other relevant matters related to these estimates, including significant issues concerning accounting principles and financial statement presentation.

### ***Revenue Recognition***

We recognize revenue when products are shipped and we have no significant remaining obligations, persuasive evidence of an arrangement exists, the price to the buyer is fixed or determinable, collectibility is reasonably assured or probable, and title and risk of loss have passed. Revenue is recognized net of applicable promotional discounts, rebates, and return allowances, some of which need to be estimated at the time we recognize revenue. In addition, revenue is recognized upon final installation for the Nautilus commercial equipment if we are

responsible for installation. Return allowances, which reduce product revenue by our best estimate of expected product returns, are estimated using historical experience. In addition, from time to time, we arrange for leases or other financing sources to enable certain of our commercial customers to purchase our equipment. In the event that a guarantee of the commercial customer's lease obligation is made, we record a liability and corresponding reduction of revenue for the estimated fair value of the guarantee and then recognize that revenue over the life of the lease obligation, unless a loss is actually incurred related to such guarantee. We recognize estimated losses as they become probable and can be reasonably estimated.

#### ***Allowance for Doubtful Accounts***

The allowance for doubtful accounts is maintained at a level based on our historical experience adjusted for any known uncollectible amounts. We periodically review the creditworthiness of our customers to help gauge collectibility. Our allowance is sensitive to changes in our customers' ability to pay due to unforeseen changes in the economy, the bankruptcy of a major customer, our efforts to actively pursue collections, and increases in chargebacks. Any major change in the aforementioned factors may result in increasing the allowance for doubtful accounts, which could have a significant impact on our financial position, results of operations and cash flows.

#### ***Inventory Valuation***

Our inventory is valued at the lower of cost or market. Inventory adjustments are applied for any known obsolete or defective products. We periodically review inventory levels of our product lines in conjunction with market trends to assess salability of our products. Our assessment of necessary adjustments to market value of inventory is sensitive to changes in fitness technology and competitor product offerings driven by customer demand. Any major change in the aforementioned factors may result in reductions to market value of inventory below cost, which could have a significant impact on our financial position, results of operations and cash flows.

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

We provide a limited warranty for the replacement of defective products. Our standard warranties require us to repair or replace defective products at no cost to the consumer. We estimate the costs that may be incurred under our basic limited warranty and record a liability in the amount of such costs at the time product revenue is recognized. Factors that affect our warranty liability include the number of units sold, along with the historical and anticipated cost to repair, replace or refund the original sale. We periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary. A significant change in our estimates may have a significant impact on our financial position, results of operations and cash flows.

In early 2008, the Company suspended sales of the commercial TreadClimber products as a result of product durability issues until those issues can be corrected. The severity of the quality issues and costs related to either replacing or maintaining this product increased significantly during the fourth quarter of 2007 leading management to take specific action with this product. Management is currently evaluating alternatives for addressing this warranty issue and has recorded its best estimate of the cost to remediate the issues identified which is included in accrued liabilities and other long-term liabilities.

#### ***Stock Compensation***

We account for employee share-based compensation in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *Share-Based Payment*. The fair value of each equity award as well as determination of probability when performance targets for awards subject to performance conditions are expected to be met require extensive use of judgment. Application of alternative assumptions could produce significantly different amounts of compensation cost recognized in the consolidated statements of income.

***Litigation and Loss Contingencies***

From time to time, we may be involved in various claims, lawsuits and other proceedings. Such litigation involves uncertainty as to possible losses we may ultimately realize when one or more future events occur or fail to occur. We record any such possible losses in accordance with U.S. GAAP. The Company estimates the probability of losses on legal contingencies based on the advice of internal and external counsel, the outcomes from similar litigation, the status of the lawsuits (including settlement initiatives), legislative developments, and other factors. Due to the numerous variables associated with these judgments and assumptions, both the precision and reliability of the resulting estimates of the related loss contingencies are subject to substantial uncertainties. We regularly monitor our estimated exposure to these contingencies and, as additional information becomes known, may change our estimates significantly. A significant change in our estimates, or a result that materially differs from our estimates, may have a significant impact on our financial position, results of operations and cash flows.

***Goodwill and Intangible Assets Valuation***

We evaluate our intangible assets and goodwill for potential impairment annually or when events or circumstances indicate the carrying value may be impaired. Our judgments regarding the existence of impairment are based on anticipated cash flows, market conditions, regulatory and other factors. Future events could cause us to conclude that goodwill or other intangible assets are impaired. Any resulting impairment loss may reduce our net worth and have a material adverse effect on our financial condition and results of operations. As of December 31, 2007, goodwill and intangible assets represented 18.3% of our total assets.

As a result of the decision to exit the business, the Company determined the goodwill for Pearl Izumi was impaired and recorded an impairment charge of \$13.2 million in loss from discontinued operations during 2007. The impairment was calculated based on an offer of \$69.5 million to purchase the business.

Due to the decision to not pursue certain product innovations, the Company determined certain of the intangible assets obtained from the legal settlement during the second quarter of 2007 were impaired during the fourth quarter and recorded as impairment charge of \$3.0 million in general and administrative expenses in 2007.

***Income Tax Provision***

Income taxes are accounted for under the liability method. 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 and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Inherent in the measurement of these deferred balances are certain judgments and interpretations of existing tax law and other published guidance as applied to our operations. When it is more likely than not that all or some portion of specific deferred tax assets will not be realized, a valuation allowance must be established for the amount of the deferred tax assets that are determined not to be realizable. A valuation allowance has been provided for deferred tax assets, which management believes will not be realized in the future. Accordingly, if the Company's facts or financial results were to change thereby impacting the likelihood of realizing the deferred tax assets, judgment would have to be applied to determine changes to the amount of the valuation allowance required to be in place on the financial statements in any given period.

The Company adopted the provisions of FIN 48 – Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109, on January 1, 2007. FIN 48 provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon



examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. This interpretation also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

## **NEW ACCOUNTING PRONOUNCEMENTS**

For a description of the new accounting standards that affect us, refer to Note 1 to the consolidated financial statements located at Item 8 of this Form 10-K.

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

We hold our cash and cash equivalents primarily in bank deposits and in liquid debt instruments with maturity dates of less than one year. We are subject to concentration of credit risk as bank deposits may exceed federally insured limits.

### ***Foreign Exchange Risk***

We are exposed to foreign exchange risk from currency fluctuations, mainly in Canada and Europe, due to sourcing of our products in U.S. dollars and selling them primarily in Canadian dollars, British pounds, Swiss Francs, and Euros. Given the relative size of our current foreign operations, the exposure to the exchange risk could have a material impact on the results of operations. Management estimates the maximum impact on stockholders' equity of a ten percent change in any applicable foreign currency exchange rate to be approximately \$1.5 million.

### ***Interest Rate Risk***

Fluctuations in the general level of interest rates on our current variable rate credit agreements expose us to market risk. As of December 31, 2007, our outstanding borrowings under the credit facilities were \$79.0 million and represented 40.1% of our total liabilities. Rates on these short-term borrowings have declined in recent periods which have decreased the Company's interest expense. Management believes that a material change in interest rates could have a material impact on the Company's financial position, results of operations, or cash flows if the Company's borrowings are not reduced significantly.

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

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

We have audited the accompanying consolidated balance sheets of Nautilus, Inc. and subsidiaries (the “Company”) as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders’ equity and comprehensive income (loss), and of cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Nautilus, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 9 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, on January 1, 2007.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2007, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 17, 2008 expressed an adverse opinion on the Company’s internal control over financial reporting because of a material weakness.

**DELOITTE & TOUCHE LLP**

Portland, Oregon  
March 17, 2008

**NAUTILUS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31, 2007 AND 2006**  
(In Thousands)

	2007	2006
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 7,911	\$ 4,262
Trade receivables, net	88,311	128,427
Inventories, net	58,910	55,548
Prepaid expenses and other current assets	13,759	22,739
Income taxes receivable	11,382	—
Short-term note receivable	2,384	2,461
Assets of discontinued operations	73,771	89,458
Assets held for sale	1,677	1,677
Deferred tax assets	18,615	5,052
Total current assets	276,720	309,624
PROPERTY, PLANT AND EQUIPMENT, net	42,291	51,420
GOODWILL	32,743	32,274
INTANGIBLE AND OTHER ASSETS, net	39,086	31,624
<b>TOTAL ASSETS</b>	<b>\$ 390,840</b>	<b>\$ 424,942</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	\$ 43,993	\$ 57,285
Accrued liabilities	37,318	29,176
Short-term borrowings	79,000	47,500
Income taxes payable	283	5,584
Customer deposits	2,925	2,229
Liabilities of discontinued operations	15,867	16,030
Total current liabilities	179,386	157,804
NON-CURRENT WARRANTY LIABILITY	6,919	—
NON-CURRENT DEFERRED TAX LIABILITIES	5,123	10,504
LONG-TERM TAXES PAYABLE	2,958	—
<b>COMMITMENTS AND CONTINGENCIES (Note 14)</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Common stock – no par value, 75,000 shares authorized, 31,557 and 31,482 shares issued and outstanding at December 31, 2007 and 2006, respectively	4,346	1,026
Retained earnings	185,021	251,418
Accumulated other comprehensive income	7,087	4,190
Total stockholders' equity	196,454	256,634
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 390,840</b>	<b>\$ 424,942</b>

See notes to consolidated financial statements.

**NAUTILUS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005**  
(In Thousands, Except Per Share Amounts)

	2007	2006	2005
NET SALES	\$501,471	\$617,271	\$607,274
COST OF SALES	322,108	350,893	344,468
Gross profit	179,363	266,378	262,806
OPERATING EXPENSES:			
Selling and marketing	181,244	175,307	175,333
General and administrative	74,606	46,897	45,518
Research and development	10,425	9,416	10,395
Litigation settlement	(18,300)	—	—
Total operating expenses	247,975	231,620	231,246
OPERATING INCOME (LOSS)	(68,612)	34,758	31,560
OTHER INCOME (EXPENSE):			
Interest income	364	710	1,575
Interest expense	(5,014)	(2,576)	(413)
Other income, net	1,234	1,124	497
Total other income (expense), net	(3,416)	(742)	1,659
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(72,028)	34,016	33,219
INCOME TAX EXPENSE (BENEFIT)	(26,216)	9,096	11,245
INCOME (LOSS) FROM CONTINUING OPERATIONS	(45,812)	24,920	21,974
DISCONTINUED OPERATIONS:			
Gain (loss) from discontinued operations	(7,743)	6,653	2,074
Income tax expense from discontinued operations	2,058	2,473	1,048
GAIN (LOSS) FROM DISCONTINUED OPERATIONS, net of tax	(9,801)	4,180	1,026
NET INCOME (LOSS)	\$ (55,613)	\$ 29,100	\$ 23,000
EARNINGS (LOSS) PER SHARE FROM CONTINUING OPERATIONS:			
Basic	\$ (1.45)	\$ 0.77	\$ 0.66
Diluted	\$ (1.45)	\$ 0.77	\$ 0.65
EARNINGS (LOSS) PER SHARE FROM DISCONTINUED OPERATIONS:			
Basic	\$ (0.31)	\$ 0.13	\$ 0.03
Diluted	\$ (0.31)	\$ 0.13	\$ 0.03
EARNINGS (LOSS) PER SHARE:			
Basic	\$ (1.76)	\$ 0.90	\$ 0.69
Diluted	\$ (1.76)	\$ 0.90	\$ 0.68
WEIGHTED AVERAGE SHARES OUTSTANDING:			
Basic	31,538	32,300	33,303
Diluted	31,538	32,457	33,857

See notes to consolidated financial statements.

**NAUTILUS, INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)**  
**YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005**  
**(In Thousands)**

	<u>Common Stock</u>		<u>Unearned Stock Compensation</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Stockholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>				
BALANCES at JANUARY 1, 2005	33,148	\$ 10,682	\$ (1,204)	\$ 238,474	\$ 4,084	\$ 252,036
Net income	—	—	—	23,000	—	23,000
Foreign currency translation adjustment	—	—	—	—	(1,343)	(1,343)
Comprehensive income	—	—	—	—	—	21,657
Dividends paid \$0.40 per share	—	—	—	(13,351)	—	(13,351)
Unearned stock compensation	—	1,106	(1,106)	—	—	—
Amortization of unearned stock compensation	—	—	363	—	—	363
Options exercised	463	5,609	—	—	—	5,609
Stock repurchased	(831)	(15,636)	—	—	—	(15,636)
Tax benefit of exercise of nonqualified options	—	1,788	—	—	—	1,788
BALANCES at DECEMBER 31, 2005	32,780	3,549	(1,947)	248,123	2,741	252,466
Net income	—	—	—	29,100	—	29,100
Foreign currency translation adjustment	—	—	—	—	1,449	1,449
Comprehensive income	—	—	—	—	—	30,549
Dividends paid \$0.40 per share	—	—	—	(12,913)	—	(12,913)
Cumulative change from adoption of SFAS 123(R)	—	(1,947)	1,947	—	—	—
Share-based compensation	—	2,534	—	—	—	2,534
Options exercised	46	603	—	—	—	603
Stock repurchased	(1,344)	(3,761)	—	(12,892)	—	(16,653)
Tax benefit of exercise of nonqualified options	—	48	—	—	—	48
BALANCES at DECEMBER 31, 2006	31,482	1,026	—	251,418	4,190	256,634
Net loss	—	—	—	(55,613)	—	(55,613)
Foreign currency translation adjustment	—	—	—	—	2,897	2,897
Comprehensive loss	—	—	—	—	—	(52,716)
Dividends paid \$0.30 per share	—	—	—	(9,465)	—	(9,465)
Cumulative change from adoption of FIN 48	—	—	—	(1,319)	—	(1,319)
Share-based compensation	—	2,679	—	—	—	2,679
Restricted stock released	12	—	—	—	—	—
Options exercised	63	756	—	—	—	756
Tax benefit of exercise of nonqualified options	—	(115)	—	—	—	(115)
BALANCES at DECEMBER 31, 2007	<u>31,557</u>	<u>\$ 4,346</u>	<u>\$ —</u>	<u>\$ 185,021</u>	<u>\$ 7,087</u>	<u>\$ 196,454</u>

See notes to consolidated financial statements.

**NAUTILUS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005**  
(In Thousands)

	2007	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income (loss)	\$(55,613)	\$ 29,100	\$ 23,000
Income (loss) from discontinued operations	(9,801)	4,180	1,026
Income (loss) from continuing operations	(45,812)	24,920	21,974
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	15,686	15,154	15,245
Amortization of unearned stock compensation	—	—	363
Impairment of intangible assets	2,994	—	—
Impairment for terminated asset purchase agreement	19,364	—	—
Provision for long-term receivables	4,770	—	—
Share-based compensation	2,679	2,534	—
Litigation settlement	(18,300)	—	—
Loss on sale of property, plant and equipment	1,111	110	17
Tax benefit from exercise of nonqualified options	—	—	1,788
Excess tax benefit from stock-based compensation	(111)	(48)	—
Deferred income taxes	(18,261)	414	3,333
Foreign currency transaction gain	(976)	(869)	—
Changes in assets and liabilities, net of the effect of acquisition:			
Trade receivables	43,749	(21,184)	(18,321)
Inventories	(1,981)	29,396	(33,374)
Prepaid expenses and other current assets	10,986	(11,949)	(1,593)
Income taxes receivable	(11,382)	—	—
Trade payables	(13,221)	(1,723)	1,270
Accrued liabilities	13,921	1,956	2,186
Income taxes payable	(4,090)	907	(6,028)
Customer deposits	654	(1,158)	493
Net cash provided by (used in) operating activities of continuing operations	1,780	38,460	(12,647)
Net cash provided by (used in) operating activities of discontinued operations	6,724	(4,654)	3,001
Net cash provided by (used in) operating activities	8,504	33,806	(9,646)

(Continued)

**NAUTILUS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005**  
(In Thousands)

	2007	2006	2005
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of property, plant and equipment	\$(10,689)	\$(10,877)	\$ (31,428)
Proceeds from sale of property, plant and equipment, and assets held for sale	6,125	7,143	2,972
Expenditures related to Land America acquisition	(21,879)	—	—
Purchases of intangible assets	—	(8,455)	—
Net increase in other assets	—	(2,253)	(449)
Acquisitions, net of cash acquired	—	—	(74,931)
Purchases of short-term investments	—	—	(49,352)
Proceeds from maturities of short-term investments	—	—	134,671
Net increase in notes receivable	77	35	8
Net cash used in investing activities from continuing operations	(26,366)	(14,407)	(18,509)
Net cash provided by (used in) investing activities from discontinued operations	(1,027)	(720)	899
Net cash used in investing activities	(27,393)	(15,127)	(17,610)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Cash dividends paid on common stock	(9,465)	(12,913)	(13,351)
Proceeds from exercise of stock options	756	603	5,609
Excess tax benefit from stock-based compensation	111	48	—
Stock repurchases	—	(16,653)	(15,636)
Net increase of short-term borrowings	31,500	7,353	40,147
Principal payments on long-term debt	—	(1,341)	—
Net cash provided by (used in) financing activities from continuing operations	22,902	(22,903)	16,769
Net cash used in financing activities from discontinued operations	(178)	(559)	(300)
Net cash provided by (used in) financing activities	22,724	(23,462)	16,469
Net effect of foreign currency exchange rate changes	(186)	1,061	(495)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	3,649	(3,722)	(11,282)
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	4,262	7,984	19,266
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<u>\$ 7,911</u>	<u>\$ 4,262</u>	<u>\$ 7,984</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION -</b>			
Cash paid for income taxes	<u>\$ 8,859</u>	<u>\$ 10,594</u>	<u>\$ 16,067</u>
Cash paid for interest	<u>\$ 4,245</u>	<u>\$ 2,128</u>	<u>\$ 205</u>

(Concluded)

See notes to consolidated financial statements.



## NAUTILUS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**1. ORGANIZATION, BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization and Business** – Nautilus, Inc. (“Nautilus” or the “Company”) is a leading designer, developer, manufacturer and marketer of branded fitness products sold under such well-known brand names as Nautilus, Bowflex, Schwinn Fitness and StairMaster. Nautilus was founded in 1986 and incorporated in the State of Washington in 1993. The Company’s headquarters is located in Vancouver, Washington.

In the fourth quarter of 2007, management committed to a plan to sell the operations of our fitness apparel division. Our fitness apparel division consists of DashAmerica, Inc. d/b/a Pearl Izumi USA (“Pearl Izumi”) which designs, markets and sells branded fitness apparel and footwear sold primarily under the Pearl Izumi brand on a global basis. In February 2008, the Company entered into an agreement to sell Pearl Izumi and the Company expects to complete the sale late in the first quarter of 2008. Accordingly, all assets and liabilities and results of operations associated with Pearl Izumi have been presented in the consolidated financial statements as discontinued operations separate from continuing operations in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (“SFAS 144”). See Note 2 “Discontinued Operations.”

**Basis of Presentation** – The accompanying consolidated financial statements relate to Nautilus, Inc. and its wholly-owned subsidiaries as of December 31, 2007 and 2006, and for the twelve month periods ended December 31, 2007, 2006 and 2005. All intercompany transactions and balances have been eliminated in consolidation.

**Use of Estimates** – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“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. Actual results could differ from those estimates.

**Cash and Cash Equivalents** – The Company considers all highly liquid investments with maturities of three months or less at purchase to be cash equivalents. The Company maintains its cash in bank deposit accounts which at times may exceed federally insured limits. The Company has not experienced any historical losses in such accounts.

**Concentration of Credit Risk and Trade Receivables** – Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade receivables. The Company generally does not require collateral on its trade receivables. Credit risk on trade receivables is minimized as a result of the large and diverse nature of the Company’s customer base. The Company maintains allowances for losses based on the historical experience, the age of outstanding receivables, existing economic conditions, and the expected collectability of trade receivables. Creditworthiness of customers is periodically reviewed to help gauge collectability. If events or changes in circumstances indicate that specific receivable balances may be impaired, further consideration is given to the collectability of those balances and the allowance is adjusted accordingly. Past-due receivable balances are written-off when the Company’s internal collection efforts have been unsuccessful. For the years ended December 31, allowance for doubtful accounts receivable activity was as follows:

<u>(In Thousands)</u>	<u>Balance at Beginning of Year</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions*</u>	<u>Balance at End of Year</u>
Allowance for doubtful accounts:				
2007	\$ 3,726	\$ 8,388	\$ (7,624)	\$ 4,490
2006	3,977	1,292	(1,543)	3,726
2005	3,252	1,782	(1,057)	3,977

\* Deductions represent amounts written off against the allowance, net of recoveries.

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**Inventories** – Inventories are stated at the lower of cost or market. Cost is determined using a first-in, first-out cost method. The Company evaluates the need for inventory valuation adjustments associated with obsolete, slow-moving and not saleable inventory by reviewing current transactions and forecasted product demand on a quarterly basis.

**Property, Plant and Equipment, net** – Property, plant and equipment is stated net of accumulated depreciation. Improvements or betterments, which add new functionality or significantly extend the life of an asset, are capitalized and depreciated over the lesser of the lease term or the estimated useful life of the improvement. Expenditures for maintenance, repair costs and minor renewals are charged to expense as incurred. The cost of assets retired or otherwise disposed of and the related accumulated depreciation are removed from the accounts in the year of disposal. Gains and losses resulting from disposals of property and equipment are recognized in the period in which the property and equipment is disposed.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets or the lease term, whichever is shorter.

**Goodwill and Intangible Assets** – Goodwill and intangible assets primarily consist of license agreements, patents, trademarks and goodwill. Goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to annual impairment tests or when impairment indicators exist in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, (“SFAS 142”). Intangible assets that are deemed to have finite lives are amortized using the straight-line method over their estimated useful lives.

**Impairment of Long-lived and Intangible Assets** – Long-lived and intangible assets that are determined to have finite lives are measured for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, when events or circumstances indicate the carrying value may be impaired. In these cases, the Company estimates the future undiscounted cash flows to be derived from the asset to determine whether a potential impairment exists. If the carrying value exceeds the estimate of future undiscounted cash flows, the Company then calculates the amount of impairment charge as the excess of the carrying value of the asset over the estimate of its fair value.

The Company tests goodwill and indefinite-lived intangible assets for impairment annually, in the fourth quarter of each year or when events or changes in circumstances indicate that the carrying amount of such assets may be impaired, using the two-step process prescribed in SFAS No. 142. The first step is a screen for potential impairment, while the second step measures the amount of the impairment, if any.

As a result of performing the tests for impairment, the Company determined Pearl Izumi was impaired based on the current offer price as described in Note 2 and as a result the Company recorded as impairment charge of \$13.2 million in loss from discontinued operations during 2007.

Due to changes in strategic direction resulting in the determination to cease certain products or product development efforts, the Company determined certain of the intangible assets obtained from the legal settlement during the second quarter of 2007 were impaired during the fourth quarter of 2007 and recorded an impairment charge of \$3.0 million in general and administrative expenses in 2007.

**Revenue Recognition** – Revenue is recognized in accordance with Staff Accounting Bulletin (“SAB”) No. 104, *Revenue Recognition*, when products are shipped, persuasive evidence of an arrangement exists, the price to the buyer is fixed or determinable, collectability is reasonably assured or probable, title and risk of loss have passed, and there are no significant remaining obligations. Title generally passes upon shipment or upon receipt by the customer depending on the country of the sale and the agreement with the customer. Retail store revenues are recorded at the time of sale. Revenue for commercial products is recognized upon final installation of commercial equipment if the Company is responsible for installation. Revenue is recognized net of applicable

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promotional discounts, rebates, and return allowances. Return allowances are estimated using historical experience. In accordance with Emerging Issues Task Force (“EITF”) Issue 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)*, any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer is presented in the Statements of Operations on a net basis (excluded from revenues).

**Product Warranty** – The Company’s product warranty policy provides for coverage of defects in materials and workmanship and includes the cost to manufacture (raw materials, labor and overhead) or purchase warranty parts from suppliers as well as the cost to ship those parts to customers. The cost of labor to install a warranted part on commercial equipment is also included. The warranty reserve is based on the historical experience with each product and warranty expenses are charged to cost of sales when sales are recognized or as such estimates change, net of estimated cost recoveries from suppliers.

A warranty reserve is established for new products based on historical experience with similar products, adjusted for any technological advances in manufacturing or materials used. The warranty trends are evaluated periodically with respect to future claims volume and nature of likely claims. Any adjustments made to the warranty reserve are the result of judgment regarding the likely effect of the warranty trends on future claims.

The Company recorded an increase in warranty reserves (recorded in cost of goods sold) during 2007 related to the commercial TreadClimber product. In January 2008, the Company suspended sales of the commercial TreadClimber products as a result of product durability issues. The severity of the quality issues and costs related to either replacing or maintaining this product increased significantly during the fourth quarter of 2007, leading management to take specific action with this product. Management is currently evaluating alternatives for addressing this warranty issue and has recorded its best estimate of the cost to remediate the issues already identified.

For the years ended December 31, warranty reserve activity was as follows:

<u>(In thousands)</u>	<u>Balance at Beginning of Year</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions*</u>	<u>Balance at End of Year</u>
Warranty reserves:				
2007	\$ 9,699	\$ 27,304	\$ (11,818)	\$ 25,185
2006	10,210	11,067	(11,578)	9,699
2005	7,537	11,114	(8,441)	10,210

\* Deductions represent warranty claims paid out in the form of service costs and/or product replacements. Beginning in 2006, the Company was able to offset its warranty costs by recovering a portion of such costs from its suppliers.

Warranty reserves in 2007 include \$6.9 million of non-current warranty liability related to the long term portion of accrued warranty.

**Advertising and Promotion** – The Company expenses advertising costs as incurred, except for commercial advertising production costs which are expensed at the time the first commercial is shown on television. Advertising costs are included in selling and marketing expenses.

Total advertising and promotion expenses were \$85.1 million, \$83.2 million, and \$79.3 million for the years ended December 31, 2007, 2006 and 2005, respectively. Advertising and promotion expenditures recorded in prepaid expenses and other current assets totaled \$2.7 million and \$5.0 million at December 31, 2007 and 2006, respectively.

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**Shipping and Handling Costs** – Shipping and handling fees billed to customers are recorded as revenue in accordance with EITF Issue No. 00-10, *Accounting for Shipping and Handling Fees and Costs*. Direct costs associated with shipping goods and inventory planning, receiving and handling costs to customers are recorded as a component of cost of sales.

**Research and Development** – Internal research and development costs, which primarily consist of payroll, payroll related expenses and materials expenses relating to the development of new products, including significant improvements and refinements to existing products, are expensed as incurred and included separately in operating expenses. Third party research and development costs and preproduction royalties for products under development or being researched, if any, are expensed when the contracted work has been performed.

**Revision of Expense Classification** – We determined certain prior year amounts for royalty expense should have been revised and reported in cost of goods sold to conform to fiscal year 2007 presentation. Additionally, certain prior year amounts for preproduction royalty expense have been revised and included in research and development from a royalty expense line previously included in operating expenses. Preproduction royalties represent costs paid to utilize licensed patent technologies prior to a sellable product being available for manufacture and sale. These changes had no impact on previously reported operating income, net income or stockholders' equity. We believe the revised presentation provides consistency between our consolidated statements of operations for all periods presented.

We have concluded that the effect of these misstatements did not materially impact any previously issued financial statements, however we have revised prior period comparative information presented herein in order to present such information on a consistent basis. The effects of this revision are summarized in the table below.

(In thousands)	As Previously Reported(*)	Revision	As Adjusted	As Previously Reported(*)	Revision	As Adjusted
	Twelve Months ended December 31,		Twelve Months ended December 31,		Twelve Months ended December 31,	
	2006		2005		2005	
NET SALES	\$ 617,271	\$ —	\$ 617,271	\$ 607,274	\$ —	\$ 607,274
COST OF SALES	346,012	4,881	350,893	339,498	4,970	344,468
Gross profit	271,259	(4,881)	266,378	267,776	(4,970)	262,806
OPERATING EXPENSES:						
Selling and marketing	175,307		175,307	175,333		175,333
General and administrative	46,897		46,897	45,518		45,518
Research and development	8,761	655	9,416	10,012	383	10,395
Royalties	5,536	(5,536)	—	5,353	(5,353)	—
Total operating expenses	236,501	(4,881)	231,620	236,216	(4,970)	231,246
OPERATING INCOME	\$ 34,758	\$ —	\$ 34,758	\$ 31,560	\$ —	\$ 31,560

\* In the fourth quarter of 2007, management committed to a plan to sell the operations of Pearl Izumi. The results of operations have been presented as discontinued operations for all periods presented.

**Income Taxes** – The Company uses the asset and liability method of accounting for income taxes. Under this approach, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities, and are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period of the enactment. A valuation allowance may be recorded to reduce deferred tax assets to an amount for which realization is more likely than not. Any income tax contingencies are accounted for in accordance with FIN 48 – *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*.

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**Foreign Currency Translations and Transactions** – Accounts of the Company’s foreign operations are measured using the local currency as the functional currency. These accounts are then translated into U.S. dollars using the current rate method with translation gains and losses accumulated as the comprehensive income component of stockholders’ equity, except for gains or losses from transactions with the Company’s international subsidiaries which are recorded as part of other income/expense in the consolidated statements of operations.

**Fair Value of Financial Instruments** – The carrying amounts of the Company’s cash and cash equivalents, trade receivables, note receivable, trade payables, accrued liabilities, short-term borrowings, and customer deposits approximate their estimated fair values due to the short-term maturities of these financial instruments.

**Guarantees** – At times, the Company arranges for leases or other financing sources to enable sales of its commercial fitness equipment. While most of these financing arrangements are without recourse, in certain cases the Company provides a guarantee or other recourse provisions to an independent finance company for either all or a portion of the lease payments in order to facilitate the sale. In such situations, the Company ensures that the transaction between the independent leasing company and the commercial customer represents a sales-type lease. The Company accounts for such agreements in accordance with Financial Accounting Standard Board (“FASB”) Interpretation (“FIN”) No. 45, *Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* and therefore records a liability and a corresponding reduction of revenue for the estimated fair value of the guarantees. Revenue is recognized over the life of the lease obligation unless a loss is actually incurred related to such guarantee. The Company monitors the payment status of the lessee under these arrangements and provides a reserve in accordance with SFAS No. 5, *Accounting for Contingencies*, in situations when collection of the lease payments is not probable.

Generally, if the Company is required to fulfill its obligations under the guarantee, it has the right to repossess the products from the commercial customer. It is not practical to estimate the amount of proceeds that would be generated from the sale of these assets in such situations.

**Share-Based Compensation** – Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* (“SFAS 123(R)”) for its share-based compensation plans. SFAS 123(R) requires companies to recognize in the statement of operations the grant-date fair value of stock awards issued to employees and directors. The Company adopted SFAS 123(R) using the modified prospective transition method. In accordance with the modified prospective transition method, the Company’s consolidated financial statements for prior periods have not been restated to reflect the impact of SFAS 123(R). Therefore, the results for fiscal 2007 and 2006 are not directly comparable to prior years. The Company also adopted FASB Staff Position No. FAS 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards* (“FSP 123(R)-3”). Under FSP 123(R)-3, the Company elected not to use the short-cut method for determining the historical pool of windfall tax benefits for purposes of determining whether an excess tax benefit has been realized.

The Company previously accounted for the plan under the recognition and measurement principles of Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees* (“APB 25”) and related interpretations and disclosure requirements established by SFAS No. 123, *Accounting for Stock-Based Compensation*, and SFAS No. 148, *Accounting for Stock-Based Compensation — Transition and Disclosure*. In March 2005, the Securities and Exchange Commission (the “SEC”) issued SAB No. 107, *Share-Based Payment* (“SAB 107”), relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

Under APB 25, no expense was recorded in the income statement for the Company’s equity awards granted at fair market value. The pro-forma effect on income for equity awards was instead disclosed in a footnote to the financial statements. Expense was recorded in the income statement for equity awards granted below fair market value on the date of grant.

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Under SFAS 123(R), the Company recognizes compensation expense from share-based payments over the requisite service periods of the individual grants which generally equal the vesting periods. Consistent with prior years, the fair value of each equity award is estimated at the date of grant using the Black-Scholes-Merton option pricing model which requires extensive use of accounting judgment, including estimates of the expected volatility of the Company's common stock price over the expected term, the dividend yield, expected term option holders will retain their vested awards before exercising them, and the number of awards that will be forfeited prior to the completion of their vesting requirements. The fair value of the Company's equity awards was estimated utilizing the following assumptions:

	2007	2006	2005
Dividend yield	2.3%	2.7%	2.2%
Risk-free interest rate	4.4%	4.7%	4.2%
Expected volatility	45%	44%	65%
Expected life (years)	4.75	4.75	5.0

Expected life represents the period that the Company's equity awards are expected to be outstanding and was determined based on historical experience with similar awards giving consideration to the contractual terms and vesting schedules of the equity awards. Risk-free interest rate is based on the implied U.S. Treasury zero coupon yield curve in effect in the month of grant. Expected dividend yield is calculated based on the amount of quarterly dividends expected to be paid in the current year. Dividends paid in 2007 were \$0.30 per share and \$0.40 per share in 2006. Expected volatility utilized in the model is calculated using daily historical volatility of the Company's stock price. When estimating forfeitures, the Company considers terminations as well as anticipated retirements based on an analysis of historical data.

The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to its equity awards for the periods prior to adoption of SFAS 123(R):

<u>(In thousands, except per share amounts)</u>	<u>2005</u>
Net income, as reported	\$23,000
Add: Share-based employee compensation expense included in reported net income, net of tax	237
Deduct: Share-based employee compensation expense determined under fair value based method, net of tax	(1,854)
Net income, pro-forma	<u>\$21,383</u>
Basic earnings per share:	
As reported	\$ 0.69
Pro-forma	\$ 0.64
Diluted earnings per share:	
As reported	\$ 0.68
Pro-forma	\$ 0.63

Prior to the adoption of SFAS 123(R), the Company presented all tax benefits of deductions resulting from the exercise of stock options as an operating cash flow, in accordance with EITF Issue No. 00-15, *Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option*. SFAS 123(R) requires the Company to reflect the tax savings resulting from tax deductions in excess of expense reflected in its financial statements as a financing cash flow.

**Reclassifications** – In the fourth quarter of 2007, management committed to a plan to sell the operations of Pearl Izumi. The results of operations have been presented as discontinued operations for all periods presented.

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**New Accounting Pronouncements** – In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (“SFAS 159”), which gives entities the option to measure eligible financial assets, and financial liabilities at fair value on an instrument by instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability. Subsequent changes in fair value must be recorded in earnings. This statement is effective as of January 1, 2008. The Company does not expect the adoption of SFAS 159 to have a material impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (“SFAS 157”). This statement defines fair value, establishes a framework for measuring fair value in U.S. GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS 157 to have a material impact on its financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* (“FIN 48”). The Company adopted the provisions of this interpretation on January 1, 2007. The disclosure requirements and cumulative effect of the adoption of FIN 48 are presented in Note 9.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (“SFAS No. 141(R)”). SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree, and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. The Company is in the process of analyzing the impact of SFAS No. 141(R) on its financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51* (“SFAS No. 160”). SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent’s ownership interest, and the valuation of retained, noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The Company is in the process of analyzing the impact of SFAS No. 160 on its financial statements.

## **2. DISCONTINUED OPERATIONS**

In the fourth quarter of 2007, management committed to a plan to sell the operations of our fitness apparel division. Our fitness apparel division consists of Pearl Izumi which designs, markets and sells branded fitness apparel and footwear sold primarily under the Pearl Izumi brand on a global basis. In February 2008 the Company entered into an agreement to sell Pearl Izumi and the Company anticipates completing the sale of Pearl Izumi late in the first quarter of 2008. Accordingly, all assets and liabilities and results of operations associated with these assets have been presented in the consolidated financial statements as discontinued operations separate from continuing operations in accordance with SFAS 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”.

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Revenues, income (loss) before income taxes, income tax expense (benefit) and net gain (loss) generated from discontinued operations were as follows:

(In thousands)	Years Ended December 31,		
	2007	2006	2005
Revenue	\$67,172	\$63,024	\$24,036
Gain (loss) before income taxes	(7,743)	6,653	2,074
Income tax expense	2,058	2,473	1,048
Net gain (loss) from discontinued operations	\$ (9,801)	\$ 4,180	\$ 1,026

The carrying value of all assets and liabilities of the discontinued operations were adjusted to fair market value resulting in an impairment charge of \$13.2 million in the fourth quarter of 2007. No costs associated with exit or disposal activities as contemplated by SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities* ("SFAS 146") have been recorded.

The provision for income tax expense for discontinued operations was \$2.1 million in 2007 on a pretax loss of \$7.7 million. The change from book loss to taxable income is mainly related to the \$13.2 million impairment charge which is nondeductible for tax purposes.

Assets, including assets held for sale and liabilities associated with the Pearl Izumi operation have been segregated from continuing operations and presented as assets and liabilities of discontinued operations in the consolidated balance sheets for all periods presented. Depreciation and amortization related to assets held for sale ceased as of December 15, 2007. Assets and liabilities for the discontinued operations were as follows:

(In thousands)	December 31,	
	2007	2006
Current assets	\$28,660	\$ 30,595
Property and equipment, net	1,411	1,238
Goodwill	19,743	32,763
Intangible and other assets	23,957	24,862
Assets of discontinued operations	\$73,771	\$89,458
Current liabilities	\$ 5,332	\$ 5,325
Current portion of long-term debt	447	259
Long-term debt excluding current portion	3,797	4,158
Noncurrent deferred tax liabilities	6,291	6,288
Liabilities of discontinued operations	\$15,867	\$16,030

As part of the acquisition of Pearl Izumi, the Company became obligated on two non-interest bearing notes of \$4.4 million and \$0.9 million, net of imputed interest. The \$4.4 million note required payments of \$0.3 million in February 2006, and \$0.15 million per quarter beginning March 2007 through December 2016. The \$0.9 million note required payments of \$0.15 million per quarter beginning September 2005 through December 2006 and was paid off in January 2007.



### 3. INVENTORIES, net

Inventories, net consisted of the following at December 31:

<u>(In thousands)</u>	<u>2007</u>	<u>2006</u>
Finished goods	\$39,143	\$ 37,301
Work-in-process	1,261	1,012
Parts and components	8,422	7,796
Raw materials	10,084	9,439
Inventories, net	<u>\$58,910</u>	<u>\$55,548</u>

### 4. PROPERTY, PLANT AND EQUIPMENT, net

Property, plant and equipment, net included the following at December 31:

<u>(In thousands)</u>	<u>Estimated Useful Life (in years)</u>	<u>2007</u>	<u>2006</u>
Land	N/A	\$ 359	\$ 1,283
Buildings and improvements	5 to 31.5	20,451	25,480
Computer equipment	2 to 5	46,259	42,299
Machinery and equipment	3 to 5	28,031	26,144
Furniture and fixtures	5	4,423	4,522
Construction in process	N/A	2,441	1,352
Total property, plant and equipment		101,964	101,080
Accumulated depreciation		(59,673)	(49,660)
Property, plant and equipment, net		<u>\$ 42,291</u>	<u>\$ 51,420</u>

Construction in process consists of capitalizable costs associated with tooling being developed for new products and internally developed software that are not yet in service. Capitalized interest was not material for the years ended December 31, 2007, 2006 and 2005.

In 2006, as part of the plan to consolidate its production facilities for the cardiovascular line of equipment, the Company concluded its operations at its manufacturing facility in Tyler, Texas and started transitioning manufacturing of key products to other U.S. and Asian manufacturing facilities. At December 31, 2007, the facility and all related assets of \$1.7 million were for sale and have been classified as “Assets held for sale” in the Company’s balance sheet.

The Company sold its building located in Louisville, Colorado in the fourth quarter of 2007 for \$6.3 million and deferred the gain on the sale of \$0.3 million into the second quarter of 2008 when the Company anticipates exiting the building.

Depreciation expense was \$13.0 million, \$14.1 million and \$14.2 million, in fiscal 2007, 2006 and 2005, respectively.

## 5. GOODWILL

Changes in the carrying amount of goodwill were as follows:

<u>(In thousands)</u>	<u>Fitness Equipment</u>
Balance as of January 1, 2006	\$ 32,269
Currency exchange differences	5
Balance as of December 31, 2006	32,274
Currency exchange differences	469
Balance as of December 31, 2007	<u>\$ 32,743</u>

The International Equipment Business reportable segment did not have goodwill at December 31, 2007 or 2006.

## 6. INTANGIBLE AND OTHER ASSETS, net

Intangible assets and other assets, net consisted of the following at December 31:

<u>(In Thousands)</u>	<u>Estimated Useful Life (in years)</u>	<u>2007</u>	<u>2006</u>
Intangible assets:			
Indefinite life trademarks	N/A	\$17,519	\$17,519
Patents	1 to 19	23,007	7,701
Non-compete agreements	3	1,957	1,648
Total intangible assets		42,483	26,868
Accumulated amortization:			
Patents		(2,826)	(730)
Non-compete agreements		(1,740)	(916)
Total accumulated amortization		(4,566)	(1,646)
Intangible assets, net		37,917	25,222
Other assets		1,169	6,402
Intangible and other assets, net		<u>\$39,086</u>	<u>\$31,624</u>

The Company settled litigation with ICON Health & Fitness, Inc. during 2007 which allows the Company to use a variety of fitness equipment patents and technologies. The settlement was valued at \$18.3 million with the value of the fitness equipment patents and technologies being recorded as patents. The litigation settlement is described in more detail in Note 14. This intangible asset value will be amortized over the useful life of the technologies granted through this settlement. Later in 2007, the Company determined the intangible assets were impaired as the result of changes in the strategic direction of the Company and recorded an impairment charge of \$3.0 million in general and administrative expenses.

Amortization expense of intangible and other assets, which is included in cost of sales and general and administrative expenses, for the next five full succeeding years is estimated at \$3.0 million, \$2.8 million, \$2.8 million, \$2.8 million, and \$2.8 million and \$6.2 million thereafter. Amortization expense was \$2.7 million, \$1.1 million and \$1.1 million, in fiscal 2007, 2006 and 2005, respectively.

During 2006, the Company determined that the life of the Schwinn trademark was indefinite and therefore discontinued its amortization. Prior to 2006 the acquisition value of the trademark was amortized over a period of twenty years. The Company believes the indefinite life is appropriate as the Schwinn product line continues to be

profitable and is expected to grow. The Company also evaluated the carrying value of the trademark for impairment and determined that no impairment existed at December 31, 2007.

## **7. ACCRUED LIABILITIES**

Accrued liabilities in excess of five percent of total current liabilities consisted of accrued warranty expense of \$18.3 million and \$9.7 million at December 31, 2007 and 2006.

## **8. BORROWINGS**

In February 2007, the Company entered into a revolving credit agreement (the “Facility”) with several financing institutions. The Facility provided for an unsecured revolving credit facility to include revolving loans and a \$10 million swing line, for a maximum commitment amount of \$125 million with an option to increase the facility to \$175 million. The interest rate on the amount of borrowings outstanding at December 31, 2007 ranged between 6.75% and 7.38%. On October 5, 2007, the Company and Pearl Izumi entered into a Security and Pledge Agreement under the Facility which covers substantially all of the domestic United States based personal property assets and secured the Facility, which had previously been unsecured.

The Company entered into an amendment and waiver of the Facility on October 12, 2007 which waived compliance with certain financial covenants through December 31, 2007. As of December 31, 2007, the Company entered into a forbearance and amendment agreement on the Facility in which the lenders agreed to forbear from exercising certain rights and remedies arising from existing or anticipated defaults under the Facility through and including January 14, 2008 and reduced the Facility from \$125 million to \$100 million.

On January 16, 2008 the Company and its subsidiary Nautilus International S.A. entered into a Loan and Security Agreement (the “Loan Agreement”) with Bank of America N.A., as agent for the lenders party thereto, providing for a \$100 million revolving secured credit line including a secured term loan in the principal amount of \$18.5 million. The Loan Agreement, which replaced the Facility, will be available for letters of credit, working capital and general corporate purposes, including acquisition financing. The Company had \$79.0 million of borrowings outstanding on the Facility at December 31, 2007 which were rolled into the new agreement in January 2008. On February 29, 2008, the Company entered into the First Amendment to the Loan Agreement which modified minimum EBITDA covenants, revised the exclusion of certain non-cash charges and unusual expense items from the calculation of EBITDA, and reduced the Loan Agreement to \$70 million upon the sale of Pearl Izumi.

The revolving credit facility under the Loan Agreement is available for a five year term. All amounts outstanding under the revolving credit facility are payable January 16, 2013. The \$18.5 million term loan matures and becomes payable upon the earlier to occur of (i) March 31, 2008, (ii) the consummation of a sale of certain subsidiaries or assets of the Company or (iii) the consummation of a financing pursuant to which a third party takes a first priority lien in certain intellectual property assets of the Company. The interest rate on amounts outstanding under the revolving credit facility will be either (a) the prime rate announced by Bank of America N.A. from time to time plus zero to 75 basis points or (b) LIBOR plus 150 to 325 basis points, depending on the Company’s fixed charge coverage ratio each quarter. The credit facility is collateralized by a first priority perfected lien on substantially all of the Company’s assets. In addition, the Company’s subsidiary, Pearl Izumi, has guaranteed the Company’s obligations under the revolving credit facility and secured such guarantee by a pledge of substantially all its assets. The Loan Agreement contains customary covenants, including, but not limited to, covenants relating to minimum EBITDA and fixed charge coverage ratios, as well as limitations on capital expenditures, mergers and acquisitions, indebtedness, liens, dispositions, dividends, and investments. The Loan Agreement also contains customary events of default. Upon an event of default, the lenders would have the option of accelerating all obligations under the Loan Agreement.

The Company had \$2.9 million in standby letters of credit with Asian vendors which reduced the balance available under the credit facility at December 31, 2007.

## 9. INCOME TAXES

The Company's income (loss) from continuing operations before income taxes for the years ended December 31, 2007, 2006 and 2005 consisted of the following components:

<u>(In thousands)</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
United States	<u>\$ (74,077)</u>	<u>\$32,163</u>	<u>\$33,224</u>
Foreign	<u>2,049</u>	<u>1,853</u>	<u>(5)</u>
Total	<u><u>\$ (72,028)</u></u>	<u><u>\$34,016</u></u>	<u><u>\$33,219</u></u>

The income tax expense (benefit) from continuing operations consisted of the following:

<u>(In thousands)</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Current:			
Federal	\$ (8,481)	\$ 9,847	\$11,303
State	(656)	(2,438)	973
Foreign	1,183	1,227	763
Total current	<u>(7,954)</u>	<u>8,636</u>	<u>13,039</u>
Deferred:			
Federal	(16,837)	1,020	(1,317)
State	(1,636)	(154)	92
Foreign	211	(406)	(569)
Total deferred	<u>(18,262)</u>	<u>460</u>	<u>(1,794)</u>
Total income tax expense (benefit)	<u><u>\$ (26,216)</u></u>	<u><u>\$ 9,096</u></u>	<u><u>\$11,245</u></u>

The components of the net deferred taxes at December 31 were as follows:

<u>(In thousands)</u>	<u>2007</u>	<u>2006</u>
Assets:		
Accrued liabilities	\$ 11,982	\$ 5,539
Allowance for doubtful accounts	1,011	1,030
Inventory valuation	1,509	733
Uniform capitalization	414	245
Share-based compensation expense	1,269	799
Net operating loss carryforward	787	136
Basis difference on subsidiary held for sale	4,885	—
Special and non-recurring charges	7,299	—
Other	1,326	650
Valuation Allowance	(5,249)	—
	<u>25,233</u>	<u>9,132</u>
Liabilities:		
Prepaid advertising	(963)	(1,800)
Other prepaids	(781)	(787)
Basis difference on long-lived assets	(8,803)	(10,986)
Undistributed earnings of foreign subsidiaries	(694)	(694)
	<u>(11,241)</u>	<u>(14,267)</u>
Net deferred tax asset (liability)	<u><u>\$ 13,992</u></u>	<u><u>\$ (5,135)</u></u>

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Deferred taxes are presented in the consolidated balance sheets as follows at December 31:

<u>(In thousands)</u>	<u>2007</u>	<u>2006</u>
Current deferred tax assets	\$18,615	\$ 5,052
Non-current deferred tax assets	500	317
Non-current deferred tax liabilities	(5,123)	(10,504)
Net deferred tax asset (liability)	<u>\$13,992</u>	<u>\$ (5,135)</u>

A reconciliation of the U.S. statutory federal income tax rate with the Company's effective income tax rate from continuing operations is as follows:

<u>(In thousands)</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
U.S. statutory income tax rate	35.0%	35.0%	35.0%
State tax, net of federal benefit	2.8	2.0	1.8
Nondeductible incentive stock option expense	(0.3)	0.9	—
Tax benefit related to U.S. export sales	—	(0.3)	(0.6)
Qualified domestic production activity deduction	—	(0.3)	(0.5)
Penalties	—	—	1.0
Impact of foreign results	0.6	0.5	0.6
Nondeductible operational expenses	(0.2)	0.5	0.4
Tax exempt interest	—	—	(1.2)
Research and development credit	0.4	(0.5)	(0.9)
Change in deferred tax measurement rate	(0.3)	0.3	0.4
Change in tax contingency reserve	0.1	(11.1)	(1.0)
Other	(1.7)	(0.3)	(1.1)
Effective tax rate	<u>36.4%</u>	<u>26.7%</u>	<u>33.9%</u>

At December 31, 2007, the Company did not provide for the U.S. income taxes or foreign withholding taxes for a cumulative total of \$4.0 million of undistributed income from certain non-U.S. subsidiaries that will be permanently reinvested outside the United States. Should the Company repatriate foreign earnings, the Company would have to adjust the income tax provision in the period management determined that the Company would repatriate earnings.

The Company has net operating loss carryforwards in a number of states. The tax benefit of these net operating losses is \$0.4 million. These state net operating losses expire in 2013 and later if not utilized. The Company has net operating loss carryforwards in foreign countries. The tax benefit of these net operating losses is \$0.4 million. These foreign net operating losses expire in 2013 and later if not utilized. The Company has recorded a valuation allowance of \$0.4 million related to the foreign net operating loss carryforwards due to the uncertainty of the ability to utilize the carryforwards prior to their expiration.

During 2007, the Company recorded a \$4.9 million deferred tax asset related to the excess of tax basis over the book investment of its Pearl Izumi subsidiary which was held for sale at the end of the year. The Company has recorded a valuation allowance of \$4.9 million related to the basis difference due to the uncertainty of the ability to utilize the capital loss which will be generated from the basis difference. If the Company is able to utilize the capital loss carryforward in future years, the valuation allowance will be released and be recorded as a current tax benefit in the year the losses are utilized.

The Company adopted the provisions of FIN 48 – *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*, on January 1, 2007. As a result of the implementation of FIN 48, the Company made a comprehensive review of its portfolio of uncertain tax positions in accordance with recognition standards established by FIN 48. In this regard, an uncertain tax position represents the Company's expected

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treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return, that has not been reflected in measuring income tax expense for financial reporting purposes. As a result of this review, the Company adjusted the estimated value of its uncertain tax positions by recognizing additional liabilities totaling \$1.3 million through a charge to retained earnings. Upon the adoption of FIN 48, the estimated value of the Company's uncertain tax positions was a liability of \$3.2 million resulting from unrecognized tax benefits, including penalties and interest of \$0.8 million.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits (which does not include penalties and interest) is as follows:

<u>(In thousands)</u>	
Balance at January 1, 2007	\$2,442
Increases due to tax positions taken in previous periods	109
Decreases due to tax positions taken in previous periods	(33)
Increases due to tax positions taken in the current period	312
Decreases due to settlements with taxing authorities	(39)
Decreases due to lapse of statute of limitations	(625)
Balance at December 31, 2007	<u>\$2,166</u>

As of December 31, 2007, the estimated value of the Company's uncertain tax positions was a liability of \$3.0 million resulting from unrecognized tax benefits, including \$0.4 million for the payment of tax-related interest and \$0.4 million for tax-related penalties. The Company recognizes accrued interest and penalties related to uncertain tax positions in federal, state, and foreign income tax expense. If the Company's positions are sustained by the taxing authority in favor of the Company, approximately \$2.4 million would reduce the Company's effective tax rate.

The Company's federal income tax returns for 2004 through 2007 are open tax years. The Company's state tax returns are open from 2001 through 2007 depending on each state's statute of limitation. In addition, the Company files in numerous foreign jurisdictions with varying statutes of limitation.

The Company believes it is reasonably possible that, within the next 12 months, \$1.0 million of previously unrecognized tax benefits related to domestic filing positions, of which \$0.7 million would reduce the Company's effective tax rate, will be recorded primarily as a result of the expiration of state statutes of limitation.

## **10. STOCKHOLDERS' EQUITY**

### **Common Stock**

As of December 31, 2007, the Company had 75.0 million authorized shares of common stock, no par value, of which 31.6 million were issued and outstanding, and 3.1 million shares were reserved for future issuance upon exercise of stock options and issuance of restricted stock, and payment of awards under share-based compensation plans. During fiscal 2007, the Company paid quarterly cash dividends on its common stock of \$0.10 per share in each of the first three calendar quarters. The dividend was suspended in the fourth quarter of 2007.

In March 2005, the Company's Board of Directors authorized the repurchase of up to \$100 million of the Company's common stock in open-market transactions at times and in such amounts as management deems appropriate depending on market conditions and other factors. The authorization expires on March 31, 2008 unless extended by the Board of Directors. The repurchase program does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time. No shares of common stock were repurchased during the year ended December 31, 2007. During the year ended December 31, 2006, the

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Company acquired 1.3 million shares of common stock at an average price of \$12.42 per share for a total cost of \$16.7 million. During 2005, the Company acquired 0.8 million shares of common stock at an average price of \$18.82 per share for a total cost of \$15.6 million.

### Share-Based Compensation

In July 2003, certain stock options were granted to the Company's former President and Chief Executive Officer at a per share exercise price that was \$2.00 per share below the market price on the day of the grant. The Company recognized compensation expense of \$0.5 million, \$0.3 million, and \$0.4 million related to these stock options in 2007, 2006, and 2005, respectively. This arrangement was amended December 31, 2005 to eliminate the original discount per share. Included in the compensation expense for 2007 is an additional \$0.3 million of compensation expense for the accelerated vesting of these options upon the departure of the former President and Chief Executive Officer.

### 2005 Long-Term Incentive Plan

In 2005, the Company's shareholders approved the 2005 Long-Term Incentive Plan (the "2005 Plan"). The 2005 Plan permits flexibility in types of awards and specific terms of awards, which allow future awards to be based on then-current objectives for aligning compensation with increasing long-term shareholder value. The aggregate number of shares of common stock authorized for issuance as awards under the 2005 Plan is 4.0 million, plus any shares of common stock that were previously reserved for issuance under the Company's Stock Option Plan and were not subject to grant on June 6, 2005, or as to which the stock based compensation award is forfeited on or after June 6, 2005. The maximum aggregate number of shares of common stock subject to stock options, stock appreciation rights, restricted stock or performance unit awards which may be granted to any one participant in any one year under the 2005 Plan is 1.0 million. The aggregate number of shares available for issuance under the 2005 Plan is reduced by two shares for each share delivered in settlement of any stock appreciation rights, restricted stock, stock unit or performance unit award, and one share for each share delivered in settlement of a stock option award. At December 31, 2007, 2.9 million shares were available for future issuance under the 2005 Plan.

### Stock Options

Stock option awards are granted with an exercise price equal to the closing market price of the Company's common stock on the date preceding the grant date. Stock option awards generally vest based on four years of continuous service and, starting with the adoption of the 2005 Plan, have a seven year contractual term (options issued prior to the adoption of the 2005 Plan have a ten year term). The fair value of each award was estimated on the grant date using the Black-Scholes-Merton option pricing model with the weighted-average assumptions described in Note 1 to these consolidated financial statements.

A summary of the Company's stock option plan activity is as follows:

<u>(In thousands, except exercise price)</u>	<u>Total Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Life (in years)</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at December 31, 2006	2,568	\$ 16.44		
Granted	1,240	11.62		
Forfeited or cancelled	(589)	17.10		
Expired	(352)	22.28		
Exercised	(63)	11.97		\$ 364
Outstanding at December 31, 2007	2,804	\$ 13.54	5.15	\$ 0
Exercisable at December 31, 2007	1,104	\$ 14.85	3.44	\$ 0

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The weighted average grant-date fair value of stock options granted was \$4.25 and \$5.54 for stock options granted in fiscal 2007 and 2006, respectively. The total fair value of options vested was \$0.9 million and \$2.2 million for fiscal 2007 and 2006, respectively. The total unrecognized compensation cost related to nonvested options was \$4.6 million at December 31, 2007. This cost is expected to be recognized over a weighted-average period of 2.69 years.

The following table summarizes information about stock options outstanding at December 31, 2007:

(In thousands, except life and exercise price)

Range of Exercise Prices	Number Outstanding	Options Outstanding		Options Exercisable	
		Weighted Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number of Shares Exercisable	Weighted-Average Exercise Price
\$5.09 – \$6.26	484	9.30	\$ 6.14	—	\$ —
\$8.28 – \$9.53	58	6.59	8.43	—	—
\$10.39	725	1.44	10.39	547	10.39
\$12.04 – \$15.15	513	4.92	14.62	157	14.31
\$15.25 – \$16.10	543	5.98	15.97	102	15.66
\$16.17 – \$28.91	481	5.71	22.42	298	23.04
\$5.09 – \$28.91	<u>2,804</u>	<u>5.15</u>	<u>\$ 13.54</u>	<u>1,104</u>	<u>\$ 14.85</u>

### Performance Units

The Company granted 45,000, 49,000, and 125,000 performance unit awards to members of its executive team during the years ended December 31, 2007, 2006, and 2005, respectively. The performance unit awards vest if the Company meets earnings targets set by the Compensation Committee of the Board of Directors. The fair value of the performance units is based on the closing market price of the Company's common stock on the date preceding the grant date and is amortized over the estimated requisite service period when it becomes probable that the performance targets are expected to be met. The amount of share-based compensation expense is based on the number of performance unit awards ultimately expected to vest, and therefore has been reduced for estimated forfeitures.

At December 31, 2007, there was approximately \$0.8 million of total unrecognized share-based compensation costs related to performance units. At December 31, 2007, 2006, and 2005, the performance units had an intrinsic value of approximately \$0.2 million, \$0, and \$0.1 million, respectively. None of the performance units were vested at December 31, 2007, 2006, and 2005. The Company did not record any compensation expense related to the performance unit awards in the years ended December 31, 2007, 2006, and 2005. A summary of the Company's performance unit activity for the year ended December 31, 2007 is as follows:

(In thousands, except fair value amounts)	Performance Units	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2007	174	\$ 16.71
Awarded	45	16.12
Released	—	—
Forfeited	(171)	16.84
Outstanding at December 31, 2007	<u>48</u>	<u>\$ 15.68</u>

### Restricted Stock

The Company granted 297,000 restricted shares to members of its management team during the year ended December 31, 2007. Most of the restricted stock was granted as part of a retention program focused on key



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employees while the Company focused on restructuring activities. The restricted stock grant has a two year cliff vesting period. In addition, the Company hired an interim chief executive officer and issued a restricted stock grant for 4,000 shares per month during the interim agreement which vested at the conclusion of the interim role on October 17, 2007.

The following table summarizes the restricted stock activity for the year ended December 31, 2007:

<u>(In thousands, except fair value amounts)</u>	<u>Number of Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Outstanding at January 1, 2007	—	—
Awarded	297	\$ 9.22
Vested	(12)	8.91
Forfeited	(19)	9.23
Outstanding at December 31, 2007 (1)	<u>266</u>	<u>\$ 9.23</u>

(1) Outstanding awards of restricted stock are all nonvested at December 31, 2007.

Restricted stock compensation expense for the year ended December 31, 2007 was \$0.3 million. At December 31, 2007, unrecognized costs related to restricted stock totaled approximately \$1.0 million and are expected to be recognized over a weighted average period of 1.62 years. The restricted stock had an intrinsic value of \$1.3 million at December 31, 2007. There was not any restricted stock issued and outstanding at December 31, 2006.

## 11. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is computed on the basis of the weighted average number of common shares outstanding. Diluted earnings (loss) per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options calculated using the treasury stock method. Net income (loss) for the calculation of both basic and diluted earnings per share is the same as reported net income (loss) for all periods.

Calculation of the basic and diluted weighted-average number of outstanding shares and the corresponding amounts of earnings (loss) per share for the three years ended December 31 is as follows:

<u>(In thousands, except per share amounts)</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Basic shares outstanding	31,538	32,300	33,303
Dilutive effect of stock options and restricted stock*	—	157	554
Diluted shares outstanding	<u>31,538</u>	<u>32,457</u>	<u>33,857</u>
Antidilutive stock options and restricted stock**	<u>2,931</u>	<u>1,802</u>	<u>704</u>
Net income (loss)	<u>\$(55,613)</u>	<u>\$29,100</u>	<u>\$23,000</u>
Earnings (loss) per share:			
Basic	\$ (1.76)	\$ 0.90	\$ 0.69
Diluted	\$ (1.76)	\$ 0.90	\$ 0.68

\* No stock options or restricted stock have been included in the calculation of diluted loss per share for the year ended December 31, 2007 because their inclusion would be antidilutive (i.e. reduce the loss per share).

\*\* Stock options and restricted stock not included in the calculation of diluted earnings per share because they would be antidilutive.

## 12. EMPLOYEE BENEFIT PLAN

The Company adopted a 401(k) plan in 1999 covering substantially all employees over the age of 18. Each participant may contribute up to 50% of eligible compensation during any calendar year, subject to certain limitations. The 401(k) plan provides for Company matching contributions of up to 50% of the first 6% of eligible contributions made by all participants. All participants must have completed one year of service before becoming eligible for the Company matching contributions. Matching contributions vest 25% per year and thus are fully vested after four years of service. For the years ended December 31, 2007, 2006 and 2005, the Company's contributions to the 401(k) plan were \$0.8 million, \$0.7 million and \$0.5 million, respectively.

## 13. REPORTABLE SEGMENTS AND RELATED INFORMATION

The Company's segment information is prepared on the same basis that the Company's management reviews financial information for decision-making purposes. The Company's Chief Executive Officer is the Chief Operating Decision Maker as defined by SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. The Company's business segments are Fitness Equipment Business and International Equipment Business. Accounting policies used by each segment are the same as those disclosed in Note 1. In February 2008, the Company entered into an agreement to sell Pearl Izumi and the Company expects to complete the sale late in the first quarter of 2008. Accordingly all assets and liabilities and results of operations associated with these assets have been presented in the consolidated financial statements as discontinued operations separate from continuing operations. As such, the results of operations associated with Pearl Izumi are not included in the segment information below.

The Fitness Equipment Business is responsible for the design, production, marketing and selling of branded fitness equipment sold under the Nautilus, Bowflex, Schwinn Fitness, and StairMaster brand names and is responsible for servicing customers within the Americas, which includes North and South America.

The International Equipment Business is responsible for the marketing and selling of branded fitness equipment sold under the Nautilus, Bowflex, Schwinn Fitness, and StairMaster brand names and is responsible for servicing customers outside of the Americas.

The reportable segments are supported by teams that provide services to support the entire entity including finance and reporting, legal, and other centralized functions. Management does not allocate expenses from the centralized functions to the reportable segments; instead, all such costs are included in the results of operations of the Fitness Equipment Business. As a result, the segments' operating results are reviewed based on revenue and gross profit. Also included in the Fitness Equipment Business are the assets and liabilities of discontinued operations related to Pearl Izumi.

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The following table presents information about the Company's reportable segments:

(In thousands)			
<b>Year ended December 31, 2007:</b>			
	<b>Fitness Equipment(*)</b>	<b>International(*)</b>	<b>Total</b>
Net sales	\$ 423,928	\$ 77,543	\$501,471
Gross profit	158,640	20,723	179,363
Depreciation and amortization expense	15,414	272	15,686
Litigation settlement	(18,300)	—	(18,300)
Interest expense, net	4,357	293	4,650
Income tax expense (benefit) from continuing operations	(27,266)	1,050	(26,216)
Income (loss) from continuing operations	(45,977)	165	(45,812)
Total assets	346,268	44,572	390,840
Additions to property, plant and equipment	10,263	426	10,689
<b>Year ended December 31, 2006:</b>			
Net sales	\$ 553,394	\$ 63,877	\$617,271
Gross profit	250,463	15,915	266,378
Depreciation and amortization expense	15,016	138	15,154
Interest expense, net	1,554	312	1,866
Income tax expense (benefit) from continuing operations	9,208	(112)	9,096
Income (loss) from continuing operations	25,044	(124)	24,920
Total assets	387,890	37,052	424,942
Additions to property, plant and equipment	10,651	226	10,877
<b>Year ended December 31, 2005:</b>			
Net sales	\$ 554,159	\$ 53,115	\$607,274
Gross profit	249,110	13,696	262,806
Depreciation and amortization expense	15,104	141	15,245
Interest income, net	1,156	6	1,162
Income tax expense from continuing operations	10,870	375	11,245
Income (loss) from continuing operations	22,452	(478)	21,974
Total assets	381,982	31,304	413,286
Additions to property, plant and equipment	31,287	141	31,428

(\*) Certain income tax expense amounts have been reclassified in this schedule to separate the Pearl Izumi discontinued operations. In addition, a portion of royalty expense was reclassified into cost of goods sold for all periods presented which reduced gross profit as previously presented in this table.

Net sales in the U.S. represented approximately 79%, 83%, and 88% of consolidated net sales for the years ended December 31, 2007, 2006, and 2005, respectively. The geographic distribution of the Company's international net sales is mostly concentrated in Switzerland, United Kingdom, Germany and Canada. Sales outside the U.S. represented approximately 21%, 17% and 12% of consolidated net sales for the years ended December 31, 2007, 2006 and 2005, respectively. Long-lived assets attributable to operations in the U.S., which are comprised of property, plant and equipment, goodwill and intangible assets were \$108.4 million, \$104.4 million, and \$102.7 million for the years ended December 31, 2007, 2006 and 2005, respectively. Long-lived assets outside the U.S. were approximately \$4.5 million, \$4.5 million, and \$4.9 million at December 31, 2007, 2006 and 2005, respectively.

## 14. COMMITMENTS AND CONTINGENCIES

### *Operating Leases*

The Company has operating leases for the U.S. and international properties used for warehousing, distribution, product development, administration, and product sales. The Company also has operating leases for certain equipment mainly consisting of product delivery trucks used in its commercial fitness equipment business, and product service vans used for warranty related matters. These leases expire at various times through June 2015. Rent expense under all leases was \$6.0 million, \$7.0 million, and \$5.1 million in fiscal 2007, 2006, and 2005, respectively. Future minimum lease payments under the noncancellable operating leases are as follows:

<u>(In thousands)</u>	
2008	\$ 6,808
2009	5,104
2010	4,841
2011	4,545
2012	3,078
Thereafter	7,522
Minimum lease payments	<u>\$31,898</u>

### *Guarantees and Commitments*

As further discussed in Note 8, at December 31, 2007, the Company had approximately \$2.9 million in outstanding commercial letters of credit expiring through December 31, 2008.

The Company has long lead times for inventory purchases and therefore needs to secure factory capacity from its vendors in advance. At December 31, 2007, the Company had approximately \$43.9 million in purchase obligations, all of which was for inventory purchases.

### *Legal Matters*

We are involved in various claims, lawsuits and other proceedings from time to time. Such litigation involves uncertainty as to possible losses we may ultimately realize when one or more future events occur or fail to occur. We accrue and charge to income estimated losses from contingencies when it is probable that a liability had been incurred and the amount of loss can be reasonably estimated. Differences between estimates recorded and actual amounts determined in subsequent periods are treated as changes in accounting estimates. The Company estimates the probability of losses on legal contingencies based on the advice of internal and external counsels, outcomes from similar litigation, the status of the lawsuits (including settlement initiatives), legislative developments, and other factors. Due to numerous variables associated with these judgments and assumptions, both the precision and reliability of the resulting estimates of the related loss contingencies are subject to substantial uncertainties. We regularly monitor our estimated exposure to these contingencies and, as additional information becomes known, may change our estimates significantly. A significant change in our estimates, or a result that materially differs from our estimates, could have a significant impact on our financial position, results of operations and cash flows.

On April 26, 2007, the Company and ICON Health & Fitness ("ICON") settled a series of pending lawsuits between the parties. This settlement included a number of claims and lawsuits between ICON and the Company going back to 2002-2003, and which were pending in federal courts in Salt Lake City, Utah and Seattle, Washington, and before the Federal Circuit Court of Appeals. Both the Company and ICON have filed dismissals of their respective lawsuits against each other. This settlement and dismissals cleared the previous contingent liability claim of \$8.1 million against the Company following a trial in November 2005 in Salt Lake City, and ICON granted the Company use of certain intellectual property for the Company's use in product development and enhancement valued at \$18.3 million.

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In October 2006, the Company filed a complaint in the Superior Court for Clark County, Washington against Gately's LLC seeking damages in the amount of \$5.1 million plus interest, attorney's fees and costs, for collection of outstanding accounts receivable for product purchased by Gately's. This case has been dismissed and refiled by the Company in state court in Boulder County, Colorado. In its answer to the complaint, Gately's has asserted defenses to payment and counterclaims against the Company in an unspecified amount. In September 2007, Gately's filed a petition for bankruptcy which has stayed the litigation in Colorado. In September 2007, as a result of the bankruptcy filing, the Company reserved the remaining \$4.8 million of this receivable.

On October 17, 2007 the Company entered into a series of agreements (the "Land America Agreements") under which the Company or its wholly-owned subsidiaries were to acquire or lease substantially all of the assets of Land America Health & Fitness Co. Ltd. ("Land America") and Treuriver Investments, Ltd. ("Treuriver"). Land America is primarily engaged in the manufacture of products for the Company in a manufacturing facility located in Xiamen, People's Republic of China, and Treuriver is Land America's related trading company. The Land America Agreements were entered into following the exercise, on June 29, 2007, of purchase options set forth in Purchase Option Agreements which the Company entered into on February 1, 2007. The Company had previously paid Land America and Treuriver non-refundable deposits of \$18.5 million in connection with the purchase agreements.

On January 19, 2008, the Company gave written notice to Land America and Treuriver exercising its rights to terminate the Land America Agreements on the basis that (i) all of the conditions to closing set forth in the Land America Agreements had not been satisfied or waived, and/or (ii) the Closing (as defined in the Land America Agreements) had not occurred prior to the Termination Date (as defined in the Land America Agreements).

By letter dated January 21, 2008, legal counsel to Land America and Treuriver notified the Company that Land America and Treuriver consider the Company to be in breach of certain duties set forth in the Asset Purchase Agreements and that Land America and Treuriver have incurred unspecified economic damages as a result of such alleged breach.

The Company recorded a \$19.4 million charge in general and administrative expenses for the year ended December 31, 2007 for the suspended acquisition of Land America and Treuriver, which includes the non-refundable deposits and costs incurred during due diligence efforts. The Company has \$5.0 million remaining in an escrow account at December 31, 2007 related to the acquisition which is included in prepaid expenses. The deposit was returned to the Company in the first quarter of 2008.

On October 29, 2007, Sue Repenning, individually and on behalf of a group of allegedly similarly situated individuals, filed a suit against the Company for violation of the federal Fair Credit and Accurate Transaction Act ("FACTA"). The case, filed in federal court in Cleveland, Ohio, alleges that the Company was not compliant with certain aspects of FACTA as regards the proper display of credit card information for customers who place an order for products on the Company's website. Plaintiff seeks the statutory penalty set forth in FACTA for each violation which ranges from \$100 to \$1000 per violation, as well as punitive damages, and attorneys fees and costs.

The case is in the early stages of discovery and has not yet been certified as a class action. The Company denies any liability under FACTA and believes that its procedures and protocols comply with applicable law, including FACTA and further denies that the case is certifiable as a class action. The Company is vigorously defending the matter.

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

## 15. SUPPLEMENTARY INFORMATION—QUARTERLY RESULTS OF OPERATIONS (unaudited)

In the fourth quarter of 2007, Nautilus, Inc. management committed to a plan to sell the operations of Pearl Izumi. Within the next year, the Company expects to sell Pearl Izumi and accordingly all assets and liabilities and results of operations associated with these assets have been presented in the consolidated financial statements as discontinued operations. As such, the assets and liabilities and results of operations associated with Pearl Izumi are separated and included as discontinued operations in each of the quarterly periods presented below.

The following table summarizes Company's unaudited quarterly financial data for the past two years ended December 31:

(In thousands except per share)	QUARTER ENDED				
	March 31	June 30	September 30	December 31	Total
<b>2007:</b>					
Net sales	\$ 136,973	\$ 102,534	\$ 115,257	\$ 146,707	\$501,471
Gross profit	62,515	38,229	43,338	35,280	179,363
Operating income (loss)	755	1,561	(23,247)	(47,681)	(68,612)
Income (loss) from continuing operations	(26)	671	(14,639)	(31,818)	(45,812)
Gain (loss) from discontinued operations, net of tax	2,488	439	1,193	(13,921)	(9,801)
Net income (loss)	2,462	1,110	(13,446)	(45,739)	(55,613)
Net Income (loss) per share:					
Basic	0.08	0.04	(0.43)	(1.45)	(1.76)
Diluted	0.08	0.04	(0.43)	(1.45)	(1.76)
<b>2006:</b>					
Net sales	\$ 165,557	\$ 123,781	\$ 142,841	\$ 185,092	\$617,271
Gross profit	69,577	53,439	63,602	79,760	266,378
Operating income	5,900	273	9,136	19,448	34,758
Income from continuing operations	2,405	1,701	8,148	12,666	24,920
Gain (loss) from discontinued operations, net of tax	2,796	(30)	1,228	186	4,180
Net income	5,201	1,671	9,376	12,852	29,100
Net Income per share:					
Basic	0.16	0.05	0.29	0.41	0.90
Diluted	0.16	0.05	0.29	0.41	0.90

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

None.

### Item 9A. Controls and Procedures

#### MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

##### Disclosure Controls and Procedures

As of December 31, 2007, 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

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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, 2007 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 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, the Company's Chief Executive Officer and Chief 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 the assets of the Company;
- 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 of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- 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. 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***

With the participation of the Chief Executive Officer and the Chief Financial Officer, our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this evaluation, management has concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2007 as a result of a material weakness in internal controls as described below. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

In connection with the preparation of the Company's consolidated financial statements for the quarter and year ended December 31, 2007, and the related audit by the Company's independent auditors, the Company and its auditors determined that the Company had one internal control deficiency that constituted a "material weakness" as defined by the Public Company Accounting Oversight Board ("PCAOB") Auditing Standard No. 5.

Management determined the controls around the review of significant non-routine transactions and the review of significant management estimates and reserves did not operate effectively, resulting in audit adjustments to the 2007 consolidated financial statements. These deficiencies, if left unremediated, could result in the failure to prevent or detect a material misstatement in the Company's consolidated financial statements.

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### *Remediation Efforts on the Internal Controls Surrounding Management's Review of Significant Non-Routine Transactions and Review of Significant Estimates and Reserves.*

The following remedial actions have or will be undertaken to address the material weakness in the controls around the review of significant non-routine transactions and the review of significant management estimates and reserves:

- Key positions of the accounting department are in the process of being filled, including the Corporate Controller.
- Additional training will be provided to accounting personnel for specific technical areas of high risk.
- Key accounting and finance personnel will be assigned to perform monthly review of all significant non-routine transactions and significant management estimates and reserves.

Our management, including our Chief Executive Officer and our Chief Financial Officer, do not expect that our disclosure controls and procedures or our internal control over financial reporting are or will be capable of preventing or detecting all errors or all fraud. Any control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements, due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns may occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of control effectiveness to future periods are subject to risk. The Company's internal control over financial reporting as of December 31, 2007 has been audited by Deloitte & Touche LLP an independent registered public accounting firm, as stated in their report that is included below.

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

There were no changes in internal control over financial reporting during the fourth quarter of fiscal 2007.



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited Nautilus, Inc. and subsidiaries' (the "Company's") internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment: Management determined the controls around the review of significant non-routine transactions and the review of significant management estimates and reserves did not operate effectively. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements as of and for the year ended December 31, 2007, of the Company and this report does not affect our report on such financial statements.

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In our opinion, because of the effect of the material weakness identified above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2007, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2007, of the Company and our report dated March 17, 2008 expressed an unqualified opinion on those financial statements and included an explanatory paragraph regarding the Company's adoption of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*, on January 1, 2007.

DELOITTE & TOUCHE LLP

Portland, Oregon

March 17, 2008

**Item 9B. Other Information**

None.

**PART III**

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

The information required by this item is included under the captions *Election of Directors*, *Section 16(a) Beneficial Ownership Reporting Compliance*, *Executive Officers* and *Information Concerning the Board of Directors* in the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

**Item 11. Executive Compensation**

The information required by this item is included under the caption *Executive Compensation* in the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

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

The information required by this item is included under the caption *Stock Ownership* in the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

**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 the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

The information required by this item is included under the caption *Appointment of Registered Independent Public Accounting Firm* for 2008 in the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

**(a)(1) Financial Statements**

See the Consolidated Financial Statements in Item 8.

**(a)(2) Financial Statement Schedule**

There are no financial statement schedules filed as part of this annual report, since the required information is included in the consolidated financial statements, including the notes thereto, or the circumstances requiring inclusion of such schedules are not present.

**(a)(3) Exhibit Index**

See the Exhibit Index beginning on page 59 for a description of the documents that are filed as Exhibits to this Annual Report on Form 10-K or incorporated herein by reference.

## 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.

Date: March 17, 2008

NAUTILUS, INC.

By: /s/ ROBERT S. FALCONE  
**Robert S. Falcone,**  
**Chief Executive Officer and President**  
**(Principal Executive Officer)**

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 March 17, 2008.

<u>Signature</u>	<u>Title</u>
<hr/> * Edward J. Bramson	Chairman
<hr/> /s/ ROBERT S. FALCONE Robert S. Falcone	Chief Executive Officer and President (Principal Executive Officer)
<hr/> /s/ WILLIAM D. MEADOWCROFT William D. Meadowcroft	Chief Financial Officer, Treasurer and Secretary (Principal Financial Officer)
<hr/> * Ronald P. Badie	Director
<hr/> * Gerard L. Eastman	Director
<hr/> * Richard A. Horn	Director
<hr/> * Marvin G. Siegert	Director
<hr/> * Michael A. Stein	Director

\*By: /s/ WILLIAM D. MEADOWCROFT March 17, 2008  
**William D. Meadowcroft**  
*Attorney-In-Fact*

## EXHIBIT INDEX

Exhibit No.	Description
2.1	Stock Purchase Agreement dated as of February 15, 2008 by and among the Company, DashAmerica, Inc. d/b/a/ Pearl Izumi USA, Inc. and Shimano American Corporation – Incorporated by reference to Exhibit 2.1 of the Company’s Current Report on Form 8-K as filed with the Commission on February 22, 2008.
3.1	Articles of Incorporation, as Amended – Incorporated by reference to Exhibits 3.1, 3.2 and 3.3 of the Company’s Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
3.2	Amendment to Articles of Incorporation – Incorporated by reference to Exhibit 3 to the Company’s Quarterly Report on Form 10-Q for the three months ended June 30, 2000, as filed with the Commission on August 10, 2000.
3.3	Amendment to Articles of Incorporation– Incorporated by reference to Exhibit 3.1 to the Company’s Quarterly Report on Form 10-Q for the three months ended June 30, 2002, as filed with the Commission on August 14, 2002.
3.4	Amendment to Articles of Incorporation – Incorporated by reference to Exhibit 3.1 to the Company’s Current Report on Form 8-K, as filed with the Commission on March 14, 2005.
3.5	Amended and Restated Bylaws – Incorporated by reference to Exhibit 3.1 of the Company’s Current Report on Form 8-K, as filed with the Commission on April 5, 2005.
3.6	Amendment to Amended and Restated Bylaws of the Company – Incorporated by reference to Exhibit 3.1 the Company’s Current Report on Form 8-K, as filed with the Commission on January 31, 2007.
10.1*	Company Stock Option Plan, as amended – Incorporated by reference to Exhibit 10.1 to the Company’s Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
10.2*	Amendment to Company Stock Option Plan – Incorporated by reference to Exhibit 10 to the Company’s Quarterly Report on Form 10-Q for the three months ended June 30, 2000, as filed with the Commission on August 10, 2000.
10.3*	Company 2005 Long-Term Incentive Plan – Incorporated by reference to Exhibit 10.1 of the Company’s Current Report on Form 8-K, as filed with the Commission on June 10, 2005.
10.4*	First Amendment to the Company 2005 Long-Term Incentive Plan – Incorporated by reference to Exhibit 10.2 to the Company’s Quarterly Report on Form 10-Q for the three months ended September 30, 2006, as filed with the Commission on November 9, 2006.
10.5*	Form of Employee Incentive Stock Option Agreement under the Company Stock Option Plan – Incorporated by reference to Exhibit 10.3 to the Company’s Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Commission on March 16, 2005.
10.6*	Form of Nonstatutory Stock Option Agreement under the Company Stock Option Plan – Incorporated by reference to Exhibit 10.4 to the Company’s Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Commission on March 16, 2005.
10.7*	Form of Nonstatutory Stock Option Agreement – Incorporated by reference to Exhibit 10 of the Company’s Current Report on Form 8-K, as filed with the Commission on July 29, 2005.
10.8*	Form of Non-Employee Director Nonstatutory Stock Option Agreement – Incorporated by reference to Exhibit 10 of the Company’s Current Report on Form 8-K, as filed with the Commission on August 19, 2005.

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<u>Exhibit No.</u>	<u>Description</u>
10.9*	Executive Employment Agreement, dated January 14, 2004, by and between the Company and Darryl Thomas – Incorporated by reference to Exhibit 10.14 to the Company’s Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Commission on March 16, 2005.
10.10*	Executive Employment Agreement, dated March 31, 2005, by and between the Company and William D. Meadowcroft – Incorporated by reference to Exhibit 99.2 to the Company’s amended Current Report on Form 8-K/A, as filed with the Commission on April 6, 2005.
10.11*	Executive Employment Agreement, dated June 30, 2005, by and between the Company and Juergen Eckmann – Incorporated by reference to Exhibit 10.22 to the Company’s Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the Commission on March 16, 2006.
10.12*	Executive Employment Agreement, dated October 17, 2007, by and between the Company and Robert S. Falcone. Incorporated by reference to the Company’s Current Report of Form 8-K, as filed with the Commission on October 23, 2007.
10.13*	Amendment to Executive Employment Agreement, dated December 31, 2007, by and between the Company and Robert S. Falcone.
10.14*	2006 Equity Compensation of Executive Officers – Incorporated by reference to the Company’s Current Report on Form 8-K, as filed with the Commission on February 2, 2006.
10.17*	2007 Compensation of Executive Officers – Incorporated by reference to the Company’s Current Report on Form 8-K, as filed with the Commission on January 31, 2007.
10.18*	2006 Amendment to Compensation Package for Non-employee Directors – Incorporated by reference to the Company’s Form 8-K, as filed with the Commission on May 12, 2006.
10.19*	2007 Amendment to Compensation Package for Non-employee Directors – Incorporated by reference to the Company’s Form 8-K, as filed with the Commission on October 29, 2007.
10.20*	Summary of 2006 Bonus Plan – Incorporated by reference to the Company’s Current Report on Form 8-K, as filed with the Commission on February 2, 2006.
10.21*	Summary of Pearl Izumi Retention Bonus Plan – Incorporated by reference to the Company’s Current Report on Form 8-K, as filed with the Commission on October 29, 2007.
10.22*	Form of Performance Unit Agreement – Incorporated by reference to Exhibit 10.3 to the Company’s Quarterly Report on Form 10-Q for the three months ended June 30, 2006, as filed with the Commission on August 9, 2006.
10.23*	Summary of Performance Unit Award – Incorporated by reference to Exhibit 10.1 to the Company’s Quarterly Report on Form 10-Q for the three months ended September 30, 2006, as filed with the Commission on November 9, 2006.
10.24	Trademark License Agreement, dated September 20, 2001, by and between Pacific Direct, LLC and the Company – Incorporated by reference to Exhibit 2.1 of the Company’s Quarterly Report on Form 10-Q for the three months ended September 30, 2001, as filed with the Commission on November 14, 2001.
10.25	License Agreement, dated April 26, 1999, as amended, between the Company and Gary D. Piaget – Incorporated by reference to Exhibit 10.10 to the Company’s Annual Report on Form 10-K for the year ended December 31, 2003, as filed with the Commission on March 15, 2004.
10.26	Lease Agreement, dated November 23, 2004, between Columbia Tech Center LLC and the Company – Incorporated by reference to Exhibit 99.1 of the Company’s Form 8-K, as filed with the Commission on November 30, 2004.

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<u>Exhibit No.</u>	<u>Description</u>
10.27	Third Amended and Restated Merchant Agreement, dated January 17, 2005, between the Company and Household Bank (SB), N.A. – Incorporated by reference to Exhibit 10.1 of the Company’s Form 8-K, as filed with the Commission on January 21, 2005.
10.28	Loan and Security Agreement, dated January 16, 2008, by and among the Company, Nautilus International, S.A. and Bank of America N.A., the lead agent.
10.29	Forbearance Agreement, dated February 15, 2008, by and among the Company, Nautilus International, S.A. and Bank of America N.A., the lead agent under the Loan and Security Agreement, dated January 16, 2008.
10.30	First Amendment to Loan and Security Agreement and Waiver, dated February 29, 2008, by and among the Company, Nautilus International, S.A. and Bank of America N.A., the lead agent.
10.31	Supply Agreement, dated June 30, 2006, with Action Fast Associates Limited, Land America Health and Fitness Co., LTD, and Xiamen World Gear Sporting Goods, LTD. [Confidential treatment has been requested for certain portions of this exhibit.] – Incorporated by reference to Exhibit 10.2 to the Company’s Quarterly Report on Form 10-Q for the three months ended June 30, 2006, as filed with the Commission on August 9, 2006.
10.32	Purchase Option Agreement, dated January 31, 2007, by and between the Company and Treuriver Investments Limited – Incorporated by reference to Exhibit 10.36 of the Company’s Annual Report for the year ended December 31, 2006 filed with the Commission on March 16, 2007. [Confidential treatment has been requested for certain portions of this exhibit.]
10.33	Purchase Option Agreement, dated January 31, 2007, by and between the Company and Land America Health & Fitness Co., Ltd. Incorporated by reference to Exhibit 10.37 of the Company’s Annual Report for the year ended December 31, 2006 filed with the Commission on March 16, 2007. [Confidential treatment has been requested for certain portions of this exhibit.]
10.34	Asset Purchase Agreement dated as of October 17, 2007 by and among Nautilus, Inc., Land America Health & Fitness Co., LTD., Michael C. Bruno and Yang Lin Qing – Incorporated by reference to Exhibit 10.3 of the Company’s Form 10-Q for the three months ended October 31, 2007 as filed with the Commission on November 9, 2007.
10.35	Asset Purchase Agreement dated as of October 17, 2007 by and among Nautilus, Inc., Treuriver Investments Limited, Michael C. Bruno and Yang Lin Qing – Incorporated by reference to Exhibit 10.4 of the Company’s Form 10-Q for the three months ended October 31, 2007 as filed with the Commission on November 9, 2007.
10.36	First Amendment to Escrow Agreement dated as of October 17, 2007 by and among Nautilus, Inc., Treuriver Investments Limited, Michael C. Bruno and U.S. Bank National Association, as Escrow Agent – Incorporated by reference to Exhibit 10.5 of the Company’s Form 10-Q for the three months ended October 31, 2007 as filed with the Commission on November 9, 2007.
10.37	Post-Closing Audit Agreement dated as of October 17, 2007 by and among Nautilus, Inc., Land America Health & Fitness Co., LTD., Michael C. Bruno and Yang Lin Qing - Incorporated by reference to Exhibit 10.6 of the Company’s Form 10-Q as filed with the Commission on November 9, 2007.
21	Subsidiaries of the Company.
23	Consent of Independent Registered Public Accounting Firm.
24	Powers of Attorney.
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.



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<u>Exhibit No.</u>	<u>Description</u>
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Indicates management contract, compensatory agreement or arrangement, in which the Company's directors or executive officers may participate.

**NAUTILUS, INC.**  
**AMENDMENT**  
**TO**  
**EXECUTIVE EMPLOYMENT AGREEMENT**

This AMENDMENT TO EXECUTIVE EMPLOYMENT AGREEMENT (this "Amendment") is made and entered into as of December 31, 2007, between Nautilus, Inc. a Washington corporation (the "Company"), and Robert S. Falcone ("Executive").

**RECITALS**

- A. The Company and Executive are parties to the Executive Employment Agreement dated as of October 17, 2007 (the "Agreement"), pursuant to which Executive is employed as the President and Chief Executive Officer of the Company.
- B. The Company and Executive desire to amend the Agreement as set forth herein.
- C. Unless otherwise defined herein, capitalized terms used herein shall have the meanings assigned thereto in the Agreement.

**AGREEMENT**

NOW, THEREFORE, in consideration of the premises and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

**1. Amendments to Executive Employment Agreement**

The Company and Executive hereby modify and amend the Agreement as follows:

- (a) By deleting in its entirety the second sentence of Section 1.1 and by substituting in lieu thereof the following sentence:
- "Executive shall serve as Chairman of the Company's Board of Directors during his employment hereunder other than at any time the Board of Directors designates an executive or a nonexecutive Chairman."
- (b) By deleting from the first sentence of Section 1.2 the clause ", or their designee,".

(c) By deleting in its entirety existing clause (iii) from the definition of “Good Reason” in Section 4.5 and by substituting in lieu of such clause the following:

“(iii) removal from any of Executive’s positions as President, CEO or Chairman of the Board of Directors (other than removal as Chairman for the sole purpose of designating an executive or a nonexecutive chairman of the Board of Directors immediately thereafter, in which case such removal shall not constitute a breach of this Agreement);

## **2. Effect on Executive Employment Agreement**

Except as specifically amended and modified by this Amendment, the terms and provisions of the Agreement remain unchanged and in full force and effect. All references in the Agreement or otherwise to the Agreement shall hereinafter refer to the Agreement as amended and modified by this Amendment.

## **3. Miscellaneous**

(a) This Amendment shall be interpreted, construed and enforced in all respects in accordance with the laws of the State of Washington without reference to its conflict of laws rule.

(b) The descriptive headings contained in this Amendment are included for convenience of reference only and shall not affect in any way the meaning or interpretation of this Amendment.

(c) This Amendment may be signed in two or more counterparts, and by the different parties hereto in separate counterparts, each of which shall be deemed an original, and all of which, taken together, shall be deemed one and the same document.

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

**COMPANY:**

NAUTILUS, INC.

By: \_\_\_\_\_  
Title:

**EXECUTIVE:**

\_\_\_\_\_  
Robert S. Falcone

**NAUTILUS, INC.**

and

**NAUTILUS INTERNATIONAL S.A.,**

as Borrowers

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**LOAN AND SECURITY AGREEMENT**

Dated as of January 16, 2008

\$100,000,000

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**CERTAIN FINANCIAL INSTITUTIONS,**

as Lenders

and

**BANK OF AMERICA, N.A.,**

as Agent

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## LOAN AND SECURITY AGREEMENT

**THIS LOAN AND SECURITY AGREEMENT** is dated as of January 16, 2008, among NAUTILUS, INC., a Washington corporation ("US Borrower"), NAUTILUS INTERNATIONAL S.A., a Swiss private share company ("Swiss Borrower", and together with US Borrower, collectively, "Borrowers"), the financial institutions party to this Agreement from time to time as lenders (collectively, "Lenders"), and BANK OF AMERICA, N.A., a national banking association, as agent for the Lenders ("Agent").

### R E C I T A L S:

Borrowers have requested that Lenders provide a credit facility to Borrowers to finance their mutual and collective business enterprise. Lenders are willing to provide the credit facility on the terms and conditions set forth in this Agreement.

**NOW, THEREFORE**, for valuable consideration hereby acknowledged, the parties agree as follows:

### **SECTION 1. DEFINITIONS; RULES OF CONSTRUCTION**

**1.1 Definitions.** As used herein, the following terms have the meanings set forth below:

Account: as defined in the UCC, including all rights to payment for goods sold or leased, or for services rendered.

Account Debtor: a Person who is obligated under an Account, Chattel Paper or General Intangible.

Accounts Formula Amount: 85% of the Value of Eligible Accounts of US Borrower and DashAmerica; provided, however, that such percentage shall be reduced by 1.0% for each whole percentage point (or portion thereof) that the Dilution Percent exceeds 5%.

Acquisition: any transaction, or any series of related transactions, consummated on or after the Closing Date, by which any Obligor (a) acquires any going business or all or substantially all of the assets of any Person, whether through purchase of assets, merger or otherwise, or (b) directly or indirectly acquires (in one transaction or as the most recent transaction in a series of transactions) at least a majority (in number of votes) of the Equity Interests of a Person which has ordinary voting power for the election of directors or other similar management personnel of a Person (other than Equity Interests having such power only by reason of the happening of a contingency) or a majority of the outstanding Equity Interests of a Person.

Affiliate: with respect to any Person, another Person that directly, or indirectly through one or more intermediaries, Controls or is Controlled by or is under common Control with the Person specified; provided that with respect to Borrowers, Affiliate will not include Persons that would otherwise be Affiliates solely because of common Control by US Borrower's shareholders if such Persons are portfolio companies independently operated by such shareholders, in each case unless objected to by Agent in writing. "Control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of a Person, whether through the ability to exercise voting power, by contract or otherwise. "Controlling" and "Controlled" have correlative meanings.

Agent Indemnitees: Agent and its officers, directors, employees, Affiliates, agents and attorneys.

**Agent Professionals:** attorneys, accountants, appraisers, auditors, business valuation experts, environmental engineers or consultants, turnaround consultants, and other professionals and experts retained by Agent.

**Allocable Amount:** as defined in **Section 5.11.3**.

**Anti-Terrorism Laws:** any laws relating to terrorism or money laundering, including the Patriot Act.

**Applicable Law:** all laws, rules, regulations and governmental guidelines applicable to the Person, conduct, transaction, agreement or matter in question, including all applicable statutory law, common law and equitable principles, and all provisions of constitutions, treaties, statutes, rules, regulations, permits, orders (including consent decrees and administrative orders) and decrees of Governmental Authorities.

**Applicable Margin:** with respect to (a) Base Rate Term Loans, 1.50%, (b) LIBOR Term Loans, 3.75%, and (c) any Type of Revolver Loan, the margin set forth below, as determined by the Fixed Charge Coverage Ratio for the last Fiscal Quarter:

Level	Fixed Charge Coverage Ratio	Base Rate Revolver Loans	LIBOR Revolver Loans
I	Greater than 1.45 to 1.0	0.00%	1.50%
II	Less than or equal to 1.45 to 1.0 and greater than 1.3 to 1.0	0.25%	2.00%
III	Less than or equal to 1.3 to 1.0 and greater than 1.15 to 1.0	0.50%	2.75%
IV	Less than or equal to 1.15 to 1.0	0.75%	3.25%

Until receipt by Agent pursuant to **Section 10.1.2** of the financial statements and corresponding Compliance Certificate for the Fiscal Quarter ended June 30, 2008, margins shall be determined as if Level III were applicable. Thereafter, the margins shall be subject to increase or decrease upon receipt by Agent pursuant to **Section 10.1.2** of the financial statements and corresponding Compliance Certificate for the last Fiscal Quarter, which change shall be effective on the first day of the calendar month following receipt. If, by the first day of a month, any financial statements and Compliance Certificate due with respect to the preceding Fiscal Quarter have not been received, then the margins shall be determined as if Level IV were applicable, from such day until the first day of the calendar month following actual receipt. If any Compliance Certificate is subsequently determined to be incorrect in any material respect, Agent may reduce or increase the Applicable Margin retroactively to the beginning of the relevant calendar month to the extent that such error caused the Applicable Margin to be different from the Applicable Margin that would have been in effect if the error was not made.

**Approved Fund:** any Person (other than a natural person) that is engaged in making, purchasing, holding or otherwise investing in commercial loans and similar extensions of credit in its ordinary course of activities, and is administered or managed by a Lender, an entity that administers or manages a Lender, or an Affiliate of either.

**Asset Disposition:** a sale, lease, license, consignment, transfer or other disposition of Property of an Obligor, including a disposition of Property in connection with a sale-leaseback transaction or synthetic lease.

**Assignment and Acceptance:** an assignment agreement between a Lender and Eligible Assignee, in the form of **Exhibit C**.

**Availability:** the Borrowing Base minus the principal balance of all Revolver Loans.

**Availability Block:** a block in the amount of \$3,000,000 in effect from the Closing Date through either (i) the funding of the Proposed IP Financing, or (ii) if the Proposed IP Financing is not consummated, such time after June 30, 2008 as Borrowers have demonstrated to Agent's reasonable satisfaction that Borrowers will have ongoing liquidity sufficient to meet its obligations, including all remaining payment obligations due and owing in connection with the LandAmerica Acquisition.

**Availability Reserve:** the sum (without duplication) of (a) the Inventory Reserve; (b) the Rent and Charges Reserve (including, without limitation, a reserve in an amount determined appropriate by Agent in its discretion (in an amount not to exceed \$50,000 if the Lien Waiver delivered in connection with such location on or around the Closing Date remains in full force and effect) in connection with the Bolingbrook, Illinois location of US Borrower, which reserve shall be in effect during any period beginning 180 days after the Closing Date that Borrower maintains Inventory or Equipment at that location); (c) the LC Reserve; (d) the Bank Product Reserve; (e) all accrued Royalties, whether or not then due and payable by a Borrower, unless Agent determines in its discretion that such Royalties are not necessary or useful to the liquidation or other disposition of any Collateral; (f) the aggregate amount of liabilities (other than inchoate liabilities) secured by Liens upon Collateral that are senior to Agent's Liens (but imposition of any such reserve shall not waive an Event of Default arising therefrom); (g) the Availability Block; (h) the Books and Records Block; (i) an environmental reserve in an initial amount of (A) with respect to the US Borrower's owned Real Estate located in Tyler, Texas, \$260,000, as the same may be adjusted by Agent in its discretion, including a reduction or deletion of such environmental reserve in the event that US Borrower conducts remediation or US Borrower's owned Real Estate located in Tyler, Texas is sold pursuant to a Disposition permitted under this Agreement and the portion of the Real Estate Formula Amount is reduced by the Net Proceeds received by US Borrower in connection with such sale, and (B) with respect to the US Borrower's owned Real Estate located in Independence, Virginia, \$140,000, as the same may be adjusted by Agent in its discretion, including a reduction or deletion of such environmental reserve in the event that US Borrower conducts remediation or US Borrower's owned Real Estate located in Independence, Virginia is sold pursuant to a Disposition permitted under this Agreement and the portion of the Real Estate Formula Amount is reduced by the Net Proceeds received by US Borrower in connection with such sale; (j) the Disclosed Sale Reserve; and (k) such additional reserves, in such amounts and with respect to such matters, as Agent in its discretion may elect to impose from time to time.

**Bank of America:** Bank of America, N.A., a national banking association, and its successors and assigns.

**Bank of America Indemnities:** Bank of America and its officers, directors, employees, Affiliates, agents and attorneys.

**Bank Product:** (a) Cash Management Services extended to any Borrower or Subsidiary by any Lender or any of its Affiliates; provided, however, that for Cash Management Services to be included as an "Obligation" for purposes of a distribution under **Section 5.6.1**, the applicable Secured Party and Obligor must have previously provided written notice to Agent of (i) the existence of such Bank Product,

(ii) the maximum dollar amount of obligations arising thereunder to be included as a Bank Product Reserve (“**Bank Product Amount**”), and (iii) the methodology to be used by such parties in determining the Bank Product Debt owing from time to time; or (b) (i) products under Hedging Agreements, (ii) commercial credit card and merchant card services, and (iii) other banking products or services as may be requested by any Borrower or Subsidiary, other than Letters of Credit, in each case to the extent extended to any Borrower or Subsidiary by Bank of America or any of its Affiliates.

**Bank Product Amount:** as defined in the definition of Bank Product. The Bank Product Amount may be changed from time to time upon written notice to Agent by the Secured Party and Obligor. No Bank Product Amount may be established or increased at any time that a Default or Event of Default exists, or if a reserve in such amount would cause an Overadvance.

**Bank Product Debt:** Debt and other obligations of an Obligor relating to Bank Products.

**Bank Product Reserve:** the aggregate amount of reserves established by Agent from time to time in its discretion in respect of Bank Product Debt.

**Bankruptcy Code:** Title 11 of the United States Code.

**Base Rate:** the rate of interest announced by Bank of America from time to time as its prime rate. Such rate is a rate set by Bank of America based upon various factors including its costs and desired return, general economic conditions and other factors, and is used as a reference point for pricing some loans, which may be priced at, above or below such announced rate. Any change in such rate announced by Bank of America shall take effect at the opening of business on the day specified in the public announcement of such change.

**Base Rate Loan:** any Loan that bears interest based on the Base Rate.

**Base Rate Revolver Loan:** a Revolver Loan that bears interest based on the Base Rate.

**Board of Governors:** the Board of Governors of the Federal Reserve System.

**Books and Records Block:** a block in the amount of (a) \$5,000,000, during the period from the Closing Date through the date of receipt by Agent of a field examination in form and substance satisfactory to Agent, (b) \$1,000,000, during the period from the date of Agent’s receipt of such field examination through the date of the Disclosed Sale, and (c) \$0 thereafter.

**Borrowed Money:** with respect to any Obligor, without duplication, its (a) Debt that (i) arises from the lending of money by any Person to such Obligor, (ii) is evidenced by notes, drafts, bonds, debentures, credit documents or similar instruments, (iii) accrues interest or is a type upon which interest charges are customarily paid (excluding trade payables owing in the Ordinary Course of Business or customer or trade contracts which accrue interest under contingent circumstances), or (iv) was issued or assumed as full or partial payment for Property; (b) Capital Leases; (c) reimbursement obligations with respect to letters of credit; and (d) guaranties of any Debt of the foregoing types owing by another Person.

**Borrower Agent:** as defined in **Section 4.5**.

**Borrowing:** a group of Loans of one Type that are made on the same day or are converted into Loans of one Type on the same day.

**Borrowing Base:** on any date of determination, an amount equal to the lesser of (a) the aggregate amount of Revolver Commitments, minus the LC Reserve; or (b) the sum of (i) the Accounts Formula Amount, plus (ii) the Inventory Formula Amount, plus (iii) the Foreign Assets Formula Amount, plus (iv) the Equipment Formula Amount, plus (v) the Real Estate Formula Amount, minus (vi) the Availability Reserve.

**Borrowing Base Certificate:** a certificate, in form and substance satisfactory to Agent, by which Borrowers certify calculation of the Borrowing Base.

**Business Day:** any day other than a Saturday, Sunday or other day on which commercial banks are authorized to close under the laws of, or are in fact closed in, North Carolina and California, and if such day relates to a LIBOR Loan, any such day on which dealings in Dollar deposits are conducted between banks in the London interbank Eurodollar market.

**Capital Expenditures:** all liabilities incurred, expenditures made or payments due (whether or not made) by a Borrower or Subsidiary for the acquisition of any fixed assets, or any improvements, replacements, substitutions or additions thereto with a useful life of more than one year, including the principal portion of Capital Leases; provided that the LandAmerica Acquisition payments permitted hereunder and payments made in connection with Permitted Acquisitions shall not constitute Capital Expenditures for purposes of this definition.

**Capital Lease:** any lease that is required to be capitalized for financial reporting purposes in accordance with GAAP.

**Cash Collateral:** cash, and any interest or other income earned thereon, that is delivered to Agent to Cash Collateralize any Obligations.

**Cash Collateral Account:** a demand deposit, money market or other account established by Agent at such financial institution as Agent may select in its discretion, which account shall be subject to Agent's Liens for the benefit of Secured Parties.

**Cash Collateralize:** the delivery of cash to Agent, as security for the payment of Obligations, in an amount equal to (a) with respect to LC Obligations, 105% of the aggregate LC Obligations, and (b) with respect to any contingent or other Obligations (including Obligations arising under Bank Products), Agent's good faith estimate of the amount due or reasonably likely to become due, including all fees and other amounts relating to such Obligations. "**Cash Collateralization**" has a correlative meaning.

**Cash Equivalents:** (a) marketable obligations issued or unconditionally guaranteed by, and backed by the full faith and credit of, the United States government, maturing within 12 months of the date of acquisition; (b) certificates of deposit, time deposits and bankers' acceptances maturing within 12 months of the date of acquisition, and overnight bank deposits, in each case which are issued by a commercial bank organized under the laws of the United States or any state or district thereof, rated A-1 (or better) by S&P or P-1 (or better) by Moody's at the time of acquisition, and (unless issued by a Lender) not subject to offset rights; (c) repurchase obligations with a term of not more than 30 days for underlying investments of the types described in clauses (a) and (b) entered into with any bank meeting the qualifications specified in clause (b); (d) commercial paper rated A-1 (or better) by S&P or P-1 (or better) by Moody's, and maturing within nine months of the date of acquisition; and (e) shares of any money market fund that has substantially all of its assets invested continuously in the types of investments referred to above, has net assets of at least \$500,000,000 and has the highest rating obtainable from either Moody's or S&P.

Cash Management Services: any services provided from time to time by a Lender or any of its Affiliates to any Borrower or Subsidiary in connection with operating, collections, payroll, trust, or other depository or disbursement accounts, including automated clearinghouse, e-payable, electronic funds transfer, wire transfer, controlled disbursement, overdraft, depository, information reporting, lockbox and stop payment services.

Change in Law: the occurrence, after the date hereof, of (a) the adoption or taking effect of any law, rule, regulation or treaty; (b) any change in any law, rule, regulation or treaty or in the administration, interpretation or application thereof by any Governmental Authority; or (c) the making or issuance of any request, guideline or directive (whether or not having the force of law) by any Governmental Authority.

Change of Control: an event or series of events by which:

(a) any “person” or “group” (as such terms are used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, but excluding any employee benefit plan of such person or its subsidiaries, and any person or entity acting in its capacity as trustee, agent or other fiduciary or administrator of any such plan) becomes the “beneficial owner” (as defined in Rules 13d-3 and 13d-5 under the Securities Exchange Act of 1934, except that a person or group shall be deemed to have “beneficial ownership” of all Equity Interests that such person or group has the right to acquire, whether such right is exercisable immediately or only after the passage of time (such right, an “option right”)), directly or indirectly, of thirty-five (35%) of the Equity Interests of US Borrower entitled to vote for members of the board of directors or equivalent governing body of US Borrower on a fully diluted basis (and taking into account all such securities that such person or group has the right to acquire pursuant to any option right);

(b) during any period of 24 consecutive months, a majority of the members of the board of directors or other equivalent governing body of US Borrower cease to be composed of individuals (i) who were members of that board or equivalent governing body on the first day of such period, (ii) whose election or nomination to that board or equivalent governing body was approved by individuals referred to in clause (i) above constituting at the time of such election or nomination at least a majority of that board or equivalent governing body or (iii) whose election or nomination to that board or other equivalent governing body was approved by individuals referred to in clauses (i) and (ii) above constituting at the time of such election or nomination at least a majority of that board or equivalent governing body (excluding, in the case of both clause (ii) and clause (iii), any individual whose initial nomination for, or assumption of office as, a member of that board or equivalent governing body occurs as a result of an actual or threatened solicitation of proxies or consents for the election or removal of one or more directors by any person or group other than a solicitation for the election of one or more directors by or on behalf of the board of directors);

(c) any Person or two or more Persons acting in concert shall acquire by contract or otherwise, or enter into a contract or arrangement that, upon consummation thereof, will result in its or their acquisition of the power to exercise, directly or indirectly, a controlling influence over the management or policies of the Borrower, or control over the Voting Stock of the Borrower on a fully-diluted basis (and taking into account all such Voting Stock that such Person or group has the right to acquire pursuant to any option right) representing thirty-five (35%) or more of the combined voting power of such Voting Stock;

(d) US Borrower ceases to own and control, beneficially and of record, 100% of the Equity Interests of Nautilus International Holdings S.A. or Nautilus International Holdings S.A. ceases to own and control, beneficially and of record, 100% of the Equity Interests of Swiss Borrower; or



(e) all or substantially all of a Borrower's assets are sold or transferred, other than sale or transfer to another Borrower.

**Claims:** all liabilities, obligations, losses, damages, penalties, judgments, proceedings, interest, costs and expenses of any kind (including remedial response costs, reasonable attorneys' fees and Extraordinary Expenses) at any time (including after Full Payment of the Obligations, resignation or replacement of Agent, or replacement of any Lender) incurred by or asserted against any Indemnitee in any way relating to (a) any Loans, Letters of Credit, Loan Documents, or the use thereof or transactions relating thereto, (b) any action taken or omitted to be taken by any Indemnitee in connection with any Loan Documents, (c) the existence or perfection of any Liens, or realization upon any Collateral, (d) exercise of any rights or remedies under any Loan Documents or Applicable Law, or (e) failure by any Obligor to perform or observe any terms of any Loan Document, in each case including all costs and expenses relating to any investigation, litigation, arbitration or other proceeding (including an Insolvency Proceeding or appellate proceedings), whether or not the applicable Indemnitee is a party thereto.

**Closing Date:** as defined in **Section 6.1**.

**Code:** the Internal Revenue Code of 1986.

**Collateral:** all Property described in **Section 7.1**, all Property described in any Security Documents as security for any Obligations, and all other Property that now or hereafter secures (or is intended to secure) any Obligations; provided that Collateral shall not include (and the security interest granted in Section 7.1 shall not extend to) Excluded Collateral.

**Commitment:** for any Lender, the aggregate amount of such Lender's Revolver Commitment and Term Loan Commitment. "**Commitments**" means the aggregate amount of all Revolver Commitments and Term Loan Commitments.

**Commitment Termination Date:** the earliest to occur of (a) the Revolver Termination Date; (b) the date on which Borrowers terminate the Revolver Commitments pursuant to **Section 2.1.4**; or (c) the date on which the Revolver Commitments are terminated pursuant to **Section 11.2**.

**Compliance Certificate:** a certificate, in form and substance satisfactory to Agent, by which Borrowers certify compliance with **Sections 10.2.3** and **10.3** and calculate the applicable Level for the Applicable Margin.

**Contingent Obligation:** any obligation of a Person arising from a guaranty, indemnity or other assurance of payment or performance of any Debt, lease, dividend or other obligation ("**primary obligations**") of another obligor ("**primary obligor**") in any manner, whether directly or indirectly, including any obligation of such Person under any (a) guaranty, endorsement, co-making or sale with recourse of an obligation of a primary obligor; (b) obligation to make take-or-pay or similar payments regardless of nonperformance by any other party to an agreement; and (c) arrangement (i) to purchase any primary obligation or security therefor, (ii) to supply funds for the purchase or payment of any primary obligation, (iii) to maintain or assure working capital, equity capital, net worth or solvency of the primary obligor, (iv) to purchase Property or services for the purpose of assuring the ability of the primary obligor to perform a primary obligation, or (v) otherwise to assure or hold harmless the holder of any primary obligation against loss in respect thereof. The amount of any Contingent Obligation shall be deemed to be the stated or determinable amount of the primary obligation (or, if less, the maximum amount for which such Person may be liable under the instrument evidencing the Contingent Obligation) or, if not stated or determinable, the maximum reasonably anticipated liability with respect thereto.

Copyright Security Agreement: each copyright security agreement pursuant to which an Obligor grants to Agent, for the benefit of Secured Parties, a Lien on such Obligor's interests in its owned copyrights, as security for the Obligations.

DashAmerica: DashAmerica, Inc., a Colorado corporation.

Debt: as applied to any Person, without duplication, (a) all items that would be included as liabilities on a balance sheet in accordance with GAAP, including Capital Leases, but excluding trade payables incurred and being paid in the Ordinary Course of Business; (b) all Contingent Obligations; (c) all reimbursement obligations in connection with letters of credit issued for the account of such Person; and (d) in the case of a Borrower, the Obligations. The Debt of a Person shall include any recourse Debt of any partnership in which such Person is a general partner or joint venturer.

Default: an event or condition that, with the lapse of time or giving of notice, would constitute an Event of Default.

Default Rate: for any Obligation (including, to the extent permitted by law, interest not paid when due), 2% plus the interest rate otherwise applicable thereto.

Deposit Account: any deposit account (as such term is defined in the UCC).

Deposit Account Control Agreements: the deposit account control agreements to be executed by each institution maintaining a Deposit Account (other than Excluded Accounts) for a Borrower, in favor of Agent, for the benefit of Secured Parties, as security for the Obligations.

Dilution Percent: the percent, determined for Borrowers' most recent twelve months then ended, equal to (a) bad debt write-downs or write-offs, discounts, returns, promotions, credits, credit memos and other dilutive items with respect to Accounts, divided by (b) gross sales.

Disclosed Sale: the sale to a third party of certain assets or Subsidiaries previously disclosed in writing to Agent.

Disclosed Sale Reserve: a reserve arising after the Closing Date as follows: (a) on February 15, 2008, in the amount of \$2,500,000 unless a fully executed letter of intent between US Borrower and a third party purchaser (in form and substance reasonably satisfactory to Agent) has been delivered to Agent on or before such date, which reserve, to the extent applicable in accordance with the foregoing clause, shall remain in effect until the closing of the Disclosed Sale, and (b) on March 7, 2008, in the amount of \$2,500,000 (in addition to the reserve set forth in **clause (a)** above, if applicable) unless a fully executed definitive sale agreement between US Borrower and a third party purchaser has been delivered to Agent on or before such date, which reserve, to the extent applicable in accordance with the foregoing clause, shall remain in effect until the closing of the Disclosed Sale.

Distribution: any declaration or payment of a distribution, interest or dividend on any Equity Interest (other than payment-in-kind); any distribution, advance or repayment of Debt to a holder of Equity Interests; or any purchase, redemption, or other acquisition or retirement for value of any Equity Interest.

Dollars: lawful money of the United States.

**Dominion Account:** a special account established by Borrowers at Bank of America or another bank acceptable to Agent, over which Agent has exclusive control for withdrawal purposes during each Trigger Period and into which proceeds of Accounts shall be deposited.

**EBITDA:** determined on a consolidated basis for Borrowers and Subsidiaries, net income, calculated before (in each case, to the extent included in determining net income and to the extent incurred or attributable during the applicable measurement period) (i) interest expense, (ii) provision for income taxes, (iii) depreciation and amortization expense, (iv) gains or losses arising from the sale of capital assets, (v) gains arising from the write-up of assets, and (vi) any extraordinary gains, (vii) fees incurred by Borrowers in connection with entering into this Agreement and the Loan Documents in an aggregate amount not to exceed \$563,000, (viii) legal fees and expenses incurred by US Borrower during the fourth Fiscal Quarter of 2007 or the first Fiscal Quarter of 2008 in connection with the proxy dispute between US Borrower, its directors and Sherborne Investors, L.P. in an aggregate amount not to exceed \$2,975,000 (no more than \$500,000 of which amount shall be incurred in the first Fiscal Quarter of 2008), (ix) a write-down of Intellectual Property and associated goodwill taken on or before the last day of the first Fiscal Quarter of 2008 in connection with the Disclosed Sale in an amount not to exceed \$10,000,000, (x) a non-cash inventory write-down taken on or before the last day of the fourth Fiscal Quarter of 2007 in an amount not to exceed \$400,000, (xi) up to \$600,000 in expenses (no more than \$150,000 of which expenses shall be cash expenses) incurred during the first Fiscal Quarter of 2008 in connection with closure of Borrowers' Australia direct operations, (xii) up to \$1,000,000 in expenses incurred during the first Fiscal Quarter of 2008 in connection with closure of Borrowers' Italy operations, (xiii) up to \$1,000,000 in expenses (no more than \$400,000 of which expenses shall be cash expenses) incurred during the first and second Fiscal Quarters of 2008 in connection with closure of Borrowers' Bolingbrook, Illinois distribution center, (xiv) a non-cash write-off of up to \$1,100,000 taken during the fourth Fiscal Quarter of 2007 in connection with the abandonment of the License with Lance Armstrong, (xv) a non-cash charge of up to \$1,500,000 taken during the fourth Fiscal Quarter of 2007 in connection with the elimination of Borrowers' EV9.16 product line, (xvi) a non-cash charge of up to \$500,000 taken during the fourth Fiscal Quarter of 2007 in connection with the elimination of Borrowers' fitness advisor product, (xvii) up to \$1,000,000 in expenses actually incurred during the first and second Fiscal Quarters of 2008 in connection with Borrowers' future employee reductions, (xviii) a non-cash charge of up to \$1,290,000 taken during the fourth Fiscal Quarter of 2007 in connection with the elimination of Borrowers' TC9.16 product line, (xix) a non-cash warranty accrual taken during the fourth Fiscal Quarter of 2007 relating to discontinued items in an amount up to \$1,000,000, (xx) a non-cash write-off of up to \$2,500,000 taken during the fourth Fiscal Quarter of 2007 in connection with the abandonment or non-use of certain ICON patents; and (xxi) an accrual taken in the first Fiscal Quarter of 2008 in connection with future warranty costs resulting from outsourcing of warranty processing in an amount up to \$3,000,000.

**Eligible Account:** an Account owing to a Borrower or DashAmerica that arises in the Ordinary Course of Business from the sale of goods, is payable in Dollars (or, with respect to Accounts of Swiss Borrower, an Equivalent Amount of Euros or Swiss francs) and is deemed by Agent, in its discretion, to be an Eligible Account. Without limiting the foregoing, no Account shall be an Eligible Account if (a) it is unpaid for more than 60 days after the original due date, or more than 90 days after the original invoice date (provided that (i) in the case of Accounts arising from direct sales to consumers, such Accounts shall not be Eligible Accounts if they are outstanding more than 13 days after the original invoice date, and (ii) in the case of Accounts with stated invoice terms of 31 days or greater, such Accounts shall not be ineligible as a result of this **clause (a)** if they are no more than 120 days after the original invoice date and no more than 30 days after their original due date (provided further that Eligible Accounts that fall within this **clause (ii)** shall not at any time provide Availability in an aggregate amount greater than \$3,000,000)); (b) 50% or more of the Accounts owing by the Account Debtor are not Eligible Accounts under the foregoing clause; (c) when aggregated with other Accounts owing by the Account Debtor, it exceeds (i) in the case of Dick's Sporting Goods or The Sports Authority, so long as such Account

Debtors remain investment grade (defined as rated at least BBB- (or its equivalent) by S&P or Ba2 (or its equivalent) by Moody's), 25% of the aggregate of Eligible Accounts (or such higher percentage as Agent may establish for the Account Debtor from time to time), or (ii) in the case of all other Account Debtors (and of either Dick's Sporting Goods or The Sports Authority if such Account Debtor is not investment grade), 15% of the aggregate Eligible Accounts (or such higher percentage as Agent may establish for the Account Debtor from time to time); (d) it does not conform with a covenant or representation in **Section 9.1.7** (or otherwise relating to Eligible Accounts); (e) it is owing by a creditor or supplier, or is otherwise subject to a right of offset (including, without limitation, a direct sale offset), counterclaim, dispute, deduction, discount, recoupment, reserve (including, without limitation, a warranty reserve), defense, chargeback, credit or allowance (but ineligibility shall be limited to the amount thereof); (f) an Insolvency Proceeding has been commenced by or against the Account Debtor; or the Account Debtor has failed, has suspended or ceased doing business, is liquidating, dissolving or winding up its affairs, or is not Solvent; (g) the Account Debtor is organized or has its principal offices or assets outside (i) in the case of US Borrower and DashAmerica, the United States or Canada (other than with respect to HSBC, which shall be required to have created the Accounts and billed the Accounts from an address of HSBC located in the United States or Canada), or (ii) in the case of Accounts of Swiss Borrower, the European Union (unless such foreign Accounts of Swiss Borrower are secured by letters of credit in form and substance satisfactory to Agent in its discretion); (h) it is owing by a Government Authority, unless the Account Debtor is the United States or any department, agency or instrumentality thereof and the Account has been assigned to Agent in compliance with the Assignment of Claims Act; (i) it is not subject to a duly perfected, first priority Lien in favor of Agent, or is subject to any other Lien; (j) the goods giving rise to it have not been delivered to and accepted by the Account Debtor, the services giving rise to it have not been accepted by the Account Debtor, or it otherwise does not represent a final sale; (k) it is evidenced by Chattel Paper or an Instrument of any kind, or has been reduced to judgment; (l) its payment has been extended, the Account Debtor has made a partial payment, or it arises from a sale on a cash-on-delivery basis; (m) it arises from a sale to an Affiliate, or from a sale on a bill-and-hold, guaranteed sale, sale-or-return, sale-on-approval, consignment, or other repurchase or return basis; (n) it represents a progress billing or retainage; (o) it includes a billing for interest, fees or late charges, but ineligibility shall be limited to such amounts; or (p) it arises from a retail sale to a Person who is purchasing for personal, family or household purposes and the Account Debtor with respect to such Account is a consumer (provided that Accounts arising from the retail sale to a Person who is purchasing for personal, family or household purposes that otherwise would not be ineligible pursuant to this **clause (p)** shall not be eligible if there has been termination of or default by any Obligor under any contracts between an Obligor and such Account Debtor or its Affiliates). In calculating delinquent portions of Accounts under clauses (a) and (b), credit balances more than 90 days old will be excluded.

Eligible Assignee: a Person that is (a) a Lender, U.S.-based Affiliate of a Lender or Approved Fund; (b) any other financial institution approved by Agent and Borrower Agent (which approval by Borrower Agent shall not be unreasonably withheld or delayed, and shall be deemed given if no objection is made within three Business Days after notice of the proposed assignment), that is organized under the laws of the United States or any state or district thereof, has total assets in excess of \$5 billion, extends asset-based lending facilities in its ordinary course of business and whose becoming an assignee would not constitute a prohibited transaction under Section 4975 of the Code or any other Applicable Law; and (c) during any Event of Default, any Person acceptable to Agent in its discretion.

Eligible Equipment: equipment owned by US Borrower hereafter approved by Agent as part of the Equipment Formula Amount, which equipment meets each of the following requirements: (a) US Borrower has good title to such equipment; (b) US Borrower has the right to subject such equipment to a Lien in favor of Agent; (c) such equipment is subject to a first priority perfected Lien in favor of Agent and is free and clear of all other Liens of any nature whatsoever (except for Permitted Liens which do not have priority over the Lien in favor of Agent); (d) the full purchase price for such equipment has been

paid by US Borrower; (e) such equipment is located on premises (i) owned by US Borrower, or (ii) leased by US Borrower where the lessor has delivered to Agent a Lien Waiver or a Rent and Charges Reserve with respect to such facility has been established by Agent in its discretion; (f) such equipment is in good working order and condition (ordinary wear and tear excepted) and is used or held for use by US Borrowers in the Ordinary Course of Business; (g) such equipment is not subject to any agreement which restricts the ability of US Borrower to use, sell, transport or dispose of such equipment or which restricts Agent's ability to take possession of, sell or otherwise dispose of such equipment; and (h) such equipment does not constitute "fixtures" under the applicable statutory laws or common law of the jurisdiction in which such equipment is located.

**Eligible In-Transit Inventory:** Inventory owned by a Borrower or DashAmerica that would be Eligible Inventory if it were not subject to a Document and in transit from a foreign location to a location of US Borrower or DashAmerica, as applicable, within the United States, and that Agent, in its discretion, deems to be Eligible In-Transit Inventory. Without limiting the foregoing, no Inventory shall be Eligible In-Transit Inventory unless it (a) is subject to a negotiable Document showing Agent (or, with the consent of Agent, US Borrower or DashAmerica, as applicable) as consignee, which Document is in the possession of Agent or such other Person as Agent shall approve; (b) is fully insured in a manner satisfactory to Agent; (c) has been identified to the applicable sales contract and title has passed to US Borrower or DashAmerica, as applicable; (d) is not sold by a vendor that has a right to reclaim, divert shipment of, repossess, stop delivery, claim any reservation of title or otherwise assert Lien rights against the Inventory, or with respect to whom any Obligor is in default of any obligations; (e) is subject to purchase orders and other sale documentation satisfactory to Agent; (f) is shipped by a common carrier that is not affiliated with the vendor; and (g) is being handled by a customs broker, freight-forwarder or other handler that has delivered a Lien Waiver.

**Eligible Inventory:** Inventory owned by a Borrower or DashAmerica that Agent, in its discretion, deems to be Eligible Inventory. Without limiting the foregoing, no Inventory shall be Eligible Inventory unless it (a) is finished goods or raw materials, and not work-in-process, packaging or shipping materials, labels, samples, display items, bags, replacement parts, service parts, components or manufacturing supplies; (b) is not held on consignment, nor subject to any deposit, downpayment or vendor rebate; (c) is in new and saleable condition and is not damaged, defective, shopworn or otherwise unfit for sale; (d) is not slow-moving, obsolete or unmerchantable, and does not constitute returned (unless returned unused in its original packaging (or repackaged) in new saleable form) or repossessed goods; (e) meets all material standards imposed by any Governmental Authority, including all standards under Environmental Laws with respect to Hazardous Materials; (f) conforms with the covenants and representations herein; (g) is subject to Agent's duly perfected, first priority Lien, and no other Lien; (h) is within the continental United States (or, in the case of Inventory of Swiss Borrower, is within The Netherlands), is not in transit except between locations of US Borrower, Swiss Borrower or DashAmerica, as applicable, and is not consigned to any Person; (i) is not subject to any warehouse receipt or negotiable Document unless bailee agreements and other documentation acceptable to Agent have been entered into, which documentation establishes a perfected first priority security interest in (including possession, if required) the Inventory subject to such warehouse receipt or negotiable Document; (j) is not subject to any License or other arrangement that restricts such Borrower's (or DashAmerica's, if applicable) or Agent's right to dispose of such Inventory, unless Agent has received an appropriate Lien Waiver; (k) is not located on leased premises or in the possession of a warehouseman, processor, repairman, mechanic, shipper, freight forwarder or other Person, unless the lessor or such Person has delivered a Lien Waiver or an appropriate Rent and Charges Reserve has been established; (l) is not subject to retention of title or similar rights or interests of sellers of such Inventory to Borrowers or DashAmerica; and (m) is reflected in the details of a current perpetual inventory report.

**Enforcement Action:** any action to enforce any Obligations or Loan Documents or to realize upon any Collateral (whether by judicial action, self-help, notification of Account Debtors, exercise of setoff or recoupment, or otherwise).

**Environmental Laws:** all Applicable Laws relating to pollution or protection of the environment (including any emission, discharge, seepage or release to air, land, surface water or groundwater of any Hazardous Materials), the preservation or reclamation of natural resources, the presence, management, transportation, storage, treatment, use, or release of, or exposure to Hazardous Materials, or to the protection of human health and safety from exposure to Hazardous Materials (including tort claims, but excluding occupational safety and health, to the extent specifically regulated by OSHA), including but not limited to, the Comprehensive Environmental Response, Compensation and Liability Act (42 U.S.C. § 9601 *et seq.*) (“CERCLA”), the Hazardous Materials Transportation Act (49 U.S.C. § 5101 *et seq.*), the Resource Conservation and Recovery Act (42 U.S.C. § 6901 *et seq.*) (“RCRA”), the Clean Water Act (33 U.S.C. § 1251 *et seq.*) (“CWA”), the Clean Air Act (42 U.S.C. § 7401 *et seq.*) (“CAA”), the Safe Drinking Water Act 42 U.S.C. § 300f *et seq.*) (“SDWA”), the Toxic Substances Control Act 15. U.S.C. 2601 *et seq.*) (“TSCA”), and the Federal Insecticide, Fungicide and Rodenticide Act (7 U.S.C. § 136 *et seq.*) and each of their state and local counterparts or equivalents.

**Environmental Notice:** a written notice, correspondence, complaint, summons, citation, order, claim, request for information, request for correction, settlement demand, remediation demand, notice of inspection or notice of violation from any Governmental Authority or other Person to any Obligor of any noncompliance with, investigation of a possible violation of, litigation relating to, or potential fine or liability under any Environmental Law, including with respect to any Environmental Release, environmental pollution or Hazardous Materials (including any tort or personal injury alleged therefrom).

**Environmental Release:** a reportable release as defined in CERCLA or under any other Environmental Law of any Hazardous Materials.

**Equipment Formula Amount:** as of any date of determination, (a) on the Closing Date, \$3,450,000 (b) thereafter, \$3,450,000 minus \$35,937.50 for each full calendar month elapsed since December 31, 2007; provided that the Equipment Formula Amount shall be reduced by an amount equal to 100% the Net Proceeds of any disposition of part or all of the US Borrower’s Equipment described on **Schedule 1.1(b)** hereto; provided further that upon request by US Borrower, Agent may agree in its discretion to the addition of new Eligible Equipment to the Equipment Formula Amount (an “Equipment Formula Amount Reload”) if (i) the Equipment Formula Amount has not previously been adjusted pursuant to an Equipment Formula Amount Reload, (ii) such Equipment Formula Amount Reload is in an amount not greater than \$3,000,000 and the total Equipment Formula Amount after giving effect to such Equipment Formula Amount Reload does not exceed \$5,000,000, (iii) no Default or Event of Default has occurred and is continuing, (iv) the amount of such Equipment Formula Amount Reload does not exceed 80% of US Borrower’s invoiced cost of the new Eligible Equipment, (v) following such Equipment Formula Amount Reload, the Equipment Formula Amount shall decrease on a monthly basis by 1/96<sup>th</sup> of the resulting Equipment Formula Amount following such Equipment Formula Amount Reload, and (vi) after the Equipment Formula Amount Reload, Agent in its discretion may reduce the Equipment Formula Amount based on the results of annual appraisals of US Borrower’s equipment conducted pursuant to **Section 10.1.1(b)**.

**Equity Interest:** the interest of any (a) shareholder in a corporation; (b) partner in a partnership (whether general, limited, limited liability or joint venture); (c) member in a limited liability company; or (d) other Person having any other form of equity security or ownership interest.

**Equivalent Amount:** on any date, the amount of Dollars into which an amount of Euros or Swiss Francs, as applicable, may be converted on the amount of Euros or Swiss Francs, as applicable, into which an amount of Dollars may be converted, in either case, at (i) in the case of Swiss Borrower, Agent's spot buying rate in Geneva, Switzerland as at approximately 12:00 noon (Geneva, Switzerland time) on such date, and (ii) in the case of US Borrower, Agent's spot buying rate in Pasadena, California as at approximately 12:00 noon (Pasadena, California time).

**ERISA:** the Employee Retirement Income Security Act of 1974.

**ERISA Affiliate:** any trade or business (whether or not incorporated) under common control with an Obligor within the meaning of Section 414(b) or (c) of the Code (and Sections 414(m) and (o) of the Code for purposes of provisions relating to Section 412 of the Code).

**ERISA Event:** (a) a Reportable Event with respect to a Pension Plan; (b) a withdrawal by any Obligor or ERISA Affiliate from a Pension Plan subject to Section 4063 of ERISA during a plan year in which it was a substantial employer (as defined in Section 4001(a)(2) of ERISA) or a cessation of operations that is treated as such a withdrawal under Section 4062(e) of ERISA; (c) a complete or partial withdrawal by any Obligor or ERISA Affiliate from a Multiemployer Plan or notification that a Multiemployer Plan is in reorganization under Section 4241 of ERISA; (d) the filing of a notice of intent to terminate, the treatment of a Pension Plan amendment as a termination under Section 4041 or 4041A of ERISA, or the commencement of proceedings by the PBGC to terminate a Pension Plan or Multiemployer Plan; (e) the failure by any Obligor or ERISA Affiliate to meet any funding obligations with respect to any Pension Plan or Multiemployer Plan; (f) an event or condition which constitutes grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any Pension Plan or Multiemployer Plan; or (g) the imposition of any material liability under Title IV of ERISA, other than for PBGC premiums due but not delinquent under Section 4007 of ERISA, upon any Obligor or ERISA Affiliate.

**Euros:** lawful money of the European Union.

**Event of Default:** as defined in **Section 11**.

**Excess Availability:** Availability net of any payables unpaid for more than 60 days after the original invoice date and book overdrafts.

**Excluded Accounts:** Deposit Accounts maintained by the Obligors (i) that are exclusively used for payroll, payroll taxes, employee benefits or are held in trust for employees or (ii) which contain no more than \$50,000 in any such Deposit Account at any time and no more than \$500,000 in the aggregate in all such Deposit Accounts under this clause (ii).

**Excluded Collateral:** (a) building fixtures (as opposed to trade fixtures) located on premises leased by any Obligor to the extent the pledge thereof or grant of a security interest therein is (i) validly prohibited by the lease governing such premises and (ii) would result in the forfeiture of any Obligor's right, title or interest thereunder under Applicable Law, provided, however, that at such time as any such grant of a security interest in any such fixtures shall not result in a forfeiture under Applicable Law, such fixtures shall (without any further act or delivery by any Person) constitute Collateral hereunder; (b) in the case of the Swiss Borrower, types of Property for which security interest grants and pledges may not be validly granted as a matter of Swiss law; (c) any Investment Property or General Intangibles or assets governed thereby (including any license, contract, permit, lease or franchise to the extent deemed a General Intangible), now or hereafter held or owned by any Grantor (which in no event shall include any assets that are included in the computation of the Borrowing Base), to the extent, in each case, that (i) a

security interest may not be granted by a Grantor in such Investment Property or General Intangibles as a matter of law or (i) a security interest may not be granted under the express terms of the governing documents applicable to such General Intangible or Investment Property, without the consent of one or more applicable parties thereto; (d) equipment acquired after the Closing Date pursuant to Capital Leases to the extent that the agreements with respect thereto prohibit the inclusion of such equipment as Collateral; and (e) any intent-to-use trademark application to the extent and for so long as creation by a Obligor of a security interest therein would result in the abandonment, invalidation or unenforceability thereof, provided, however, that Excluded Collateral shall not include any proceeds, substitutions or replacements of any Excluded Collateral referred to in this clause (e) (unless such proceeds, substitutions or replacements would constitute Excluded Collateral referred to in this clause (e)).

Excluded Tax: with respect to Agent, any Lender, Issuing Bank or any other recipient of a payment to be made by or on account of any Obligation, (a) taxes imposed on or measured by its overall net income (however denominated), and franchise taxes imposed on it (in lieu of net income taxes), by the jurisdiction (or any political subdivision thereof) under the laws of which such recipient is organized or in which its principal office is located or, in the case of any Lender, in which its applicable Lending Office is located; and (b) in the case of a Foreign Lender, any withholding tax attributable to such Foreign Lender's failure or inability (other than as a result of a Change in Law) to comply with **Section 5.10**, except to the extent that such Foreign Lender (or its assignor, if any) was entitled, at the time of designation of a new Lending Office (or assignment), to receive additional amounts from the Borrower with respect to such withholding tax.

Exempt Lender: a Lender which is able at the date of this Agreement under the domestic law of Switzerland to receive payments from a Borrower free from any withholding tax (including, where applicable, special tax-at-source) imposed by that jurisdiction.

Extraordinary Expenses: all costs, expenses or advances that Agent may incur during a Default or Event of Default, or during the pendency of an Insolvency Proceeding of an Obligor, including those relating to (a) any audit, inspection, repossession, storage, repair, appraisal, insurance, manufacture, preparation or advertising for sale, sale, collection, or other preservation of or realization upon any Collateral; (b) any action, arbitration or other proceeding (whether instituted by or against Agent, any Lender, any Obligor, any representative of creditors of an Obligor or any other Person) in any way relating to any Collateral (including the validity, perfection, priority or avoidability of Agent's Liens with respect to any Collateral), Loan Documents, Letters of Credit or Obligations, including any lender liability or other Claims; (c) the exercise, protection or enforcement of any rights or remedies of Agent in, or the monitoring of, any Insolvency Proceeding; (d) settlement or satisfaction of any taxes, charges or Liens with respect to any Collateral; (e) any Enforcement Action; (f) negotiation and documentation of any modification, waiver, workout, restructuring or forbearance with respect to any Loan Documents or Obligations; and (g) Protective Advances. Such costs, expenses and advances include transfer fees, Other Taxes, storage fees, insurance costs, permit fees, utility reservation and standby fees, legal fees, appraisal fees, brokers' fees and commissions, auctioneers' fees and commissions, accountants' fees, environmental study fees, wages and salaries paid to employees of any Obligor or independent contractors in liquidating any Collateral, and reasonable travel expenses.

Fee Letter: the fee letter agreement between Agent and Borrowers.

Fiscal Quarter: each period of three months, commencing on the first day of a Fiscal Year.

Fiscal Year: the fiscal year of Borrowers and Subsidiaries for accounting and tax purposes, ending on December 31 of each year.



Fixed Charge Coverage Ratio: the ratio, determined on a consolidated basis for Borrowers and Subsidiaries for the most recent four Fiscal Quarters, of (a) EBITDA to (b) Fixed Charges.

Fixed Charges: the sum of Capital Expenditures (except those financed with Borrowed Money other than Revolver Loans and those made with casualty insurance proceeds received and spent to replace destroyed or damaged equipment during the measurement period in an aggregate amount not to exceed \$5,000,000 during any measurement period), cash taxes paid, interest expense (other than payment-in-kind), principal payments made on Borrowed Money (other than repayments of the Revolving Loans, revolving working capital facilities permitted under **Section 10.2.1(i)** or intercompany loans permitted under **Section 10.2.7(d)**), mandatory prepayments of Term Loans made pursuant to the terms of this Agreement, payments made on Debt permitted by **clause (b)** or **(d)** of **Section 10.2.1** in connection with the issuance of Refinancing Debt (to the extent made with the proceeds of such Refinancing Debt), mandatory prepayments required under the terms of the definitive documentation relating to the Proposed IP Financing, payments of Term Loans to the extent such payments are made with proceeds of the Disclosed Sale or the Proposed IP Financing or Refinancing Debt and payment of the Promissory Note in the amount of \$6,600,000 dated February 22, 2005 made by DashAmerica payable to Pearl Izumi, Inc. if such note is paid in full with the proceeds of the Disclosed Sale), and Distributions made.

FLSA: the Fair Labor Standards Act of 1938.

Foreign Assets Formula Amount: the lesser of (a) \$12,000,000 or (b) the sum of (i) 85% of Eligible Accounts of Swiss Borrower (provided, however, that such percentage shall be reduced by 1.0% for each whole percentage point (or portion thereof) that the Dilution Percent exceeds 5%) and (ii) the lesser of (A) 70% of the Value of Eligible Inventory of Swiss Borrower; or (iii) 85% of the NOLV Percentage of the Value of Eligible Inventory of Swiss Borrower.

Foreign Lender: any Lender that is organized under the laws of a jurisdiction other than the laws of the United States, or any state or district thereof.

Foreign Plan: any employee benefit plan or arrangement (a) maintained or contributed to by any Obligor or Subsidiary that is not subject to the laws of the United States; or (b) mandated by a government other than the United States for employees of any Obligor or Subsidiary.

Foreign Subsidiary: a Subsidiary that is a “controlled foreign corporation” under Section 957 of the Code.

Full Payment: with respect to any Obligations, (a) the full cash payment of the Obligations (other than indemnity claims that are unasserted and not reasonably likely to be asserted), including any interest, fees and other charges accruing during an Insolvency Proceeding (whether or not allowed in the proceeding); (b) if such Obligations are LC Obligations or contingent in nature (other than indemnity claims that are unasserted and not reasonably likely to be asserted), Cash Collateralization thereof (or delivery of a standby letter of credit acceptable to Agent in its discretion, in the amount of required Cash Collateral); and (c) a release of any Claims of Obligors against Agent, Lenders and Issuing Bank arising on or before the payment date. No Loans shall be deemed to have been paid in full until all Commitments related to such Loans have expired or been terminated.

GAAP: generally accepted accounting principles in effect in the United States from time to time.

Governmental Approvals: all authorizations, consents, approvals, licenses and exemptions of, registrations and filings with, and required reports to, all Governmental Authorities.

**Governmental Authority:** any federal, state, municipal, foreign or other governmental department, agency, commission, board, bureau, court, tribunal, instrumentality, political subdivision, or other entity or officer exercising executive, legislative, judicial, regulatory or administrative functions for or pertaining to any government or court, in each case whether associated with the United States, a state, district or territory thereof, or a foreign entity or government.

**Guarantor Payment:** as defined in **Section 5.11.3**.

**Guarantors:** DashAmerica and each other Person who executes a Guaranty.

**Guaranty:** each guaranty agreement executed by a Guarantor in favor of Agent in form and substance satisfactory to Agent.

**Guidelines:** the guidelines S-02.122.1 in relation to bonds of April 1999 as issued by the Swiss Federal Tax Administration (Merkblatt "Obligationen" vom April 1999 der Eidg. Steuerverwaltung) and S-02.128 in relation to syndicated credit facilities of January 2000 as issued by the Swiss Federal Tax Administration (Merkblatt "Steuerliche Behandlung von Konsortialkrediten, Schuldscheindarlehen, Wechseln und Unterbeteiligungen" vom Januar 2000 der Eidg. Steuerverwaltung).

**Hazardous Material(s):** any material or substance including any chemical, compound, solid, gas, liquid, or product, that, whether by its nature or use, is now or hereafter defined as a hazardous waste, hazardous substance, pollutant or contaminant under any Environmental Law, or which is toxic, explosive, corrosive, flammable, infectious, radioactive, carcinogenic, mutagenic or otherwise hazardous (including without limitation asbestos, PCB's or lead in any form or condition) and which is now or hereafter regulated under any Environmental Law, or which contains mold or petroleum (including crude oil or any fraction thereof), gasoline, diesel fuel or another petroleum hydrocarbon product.

**Hedging Agreement:** an agreement relating to any swap, cap, floor, collar, option, forward, cross right or obligation, or combination thereof or similar transaction, with respect to interest rate, foreign exchange, currency, commodity, credit or equity risk.

**HSBC Agreements:** Third Amended and Restated Merchant Agreement dated as of January 17, 2005 between HSBC Bank Nevada, National Association (formerly known as Household Bank (SB), N.A.) and US Borrower, as amended from time to time prior to the date of this Agreement including by the Second Amendment to Third Amended and Restated Merchant Agreement dated December 17, 2007.

**Indemnified Taxes:** Taxes other than Excluded Taxes.

**Indemnitees:** Agent Indemnitees, Lender Indemnitees, Issuing Bank Indemnitees and Bank of America Indemnitees.

**Insolvency Proceeding:** any case or proceeding commenced by or against a Person under any state, federal or foreign law for, or any agreement of such Person to, (a) the entry of an order for relief under the Bankruptcy Code, or any other insolvency, debtor relief or debt adjustment law; (b) the appointment of a receiver, trustee, liquidator, administrator, conservator or other custodian for such Person or any part of its Property; or (c) an assignment or trust mortgage for the benefit of creditors.

**Intellectual Property:** all intellectual and similar Property of a Person, including inventions, designs, patents, copyrights, trademarks, service marks, trade names, trade secrets, confidential or proprietary information, customer lists, know-how, software and databases; all embodiments or fixations thereof and all related documentation, applications, registrations and franchises; all licenses or other rights to use any of the foregoing; and all books and records relating to the foregoing.

**Intellectual Property Claim:** any claim or assertion (whether in writing, by suit or otherwise) that a Borrower's or Subsidiary's ownership, use, marketing, sale or distribution of any Inventory, Equipment, Intellectual Property or other Property violates another Person's Intellectual Property.

**Interest Period:** as defined in **Section 3.1.3**.

**Inventory:** as defined in the UCC, including all goods intended for sale, lease, display or demonstration; all work in process; and all raw materials, and other materials and supplies of any kind that are or could be used in connection with the manufacture, printing, packing, shipping, advertising, sale, lease or furnishing of such goods, or otherwise used or consumed in a Borrower's business (but excluding Equipment).

**Inventory Formula Amount:** the lesser of

(a) \$50,000,000; or

(b)(i) the lesser of (A) 70% of the Value of Eligible Inventory or (B) 85% of the NOLV Percentage of the Value of Eligible Inventory, plus (ii) the lesser of (A) \$7,000,000 or (B) 70% of the Value of Eligible In-Transit Inventory.

**Inventory Reserve:** reserves established by Agent to reflect factors that may negatively impact the Value of Inventory, including change in salability, obsolescence, seasonality, theft, shrinkage, imbalance, change in composition or mix, markdowns and vendor chargebacks.

**Investment:** any acquisition of all or substantially all assets of a Person; any acquisition of record or beneficial ownership of any Equity Interests of a Person; or any advance or capital contribution to or other investment in a Person.

**IP Limitations:** as set forth in **Section 7.8**.

**IRS:** the United States Internal Revenue Service.

**Issuing Bank:** Bank of America or an Affiliate of Bank of America.

**Issuing Bank Indemnities:** Issuing Bank and its officers, directors, employees, Affiliates, agents and attorneys.

**LandAmerica Acquisition:** the consummation of both the Asset Purchase Agreement by and among Nautilus, Inc., and Land America Health & Fitness Co., Ltd., Michael C. Bruno, Yang Lin Qing dated October 17, 2007, and the Asset Purchase Agreement by and among Nautilus, Inc., and Treuiver Investments Limited, Michael C. Bruno, Yang Lin Qing dated October 17, 2007; provided that the Obligor shall not make payments to the sellers under such Asset Purchase Agreements or to any other Person in connection with the LandAmerica Acquisition in excess of \$49,500,000 in the aggregate, the timing of which payments shall be limited as follows: (a) during the period between the Closing Date and the closing of the Disclosed Sale, such payments shall not exceed \$5,000,000 (which amount shall be paid from the escrow account set up in connection with the LandAmerica Acquisition or from the proceeds of such escrow account, provided that in the event the proceeds of the escrow account have been commingled with other assets of Borrowers and their Subsidiaries, such payment shall only be permitted

if no Event of Default has occurred and is continuing or would result therefrom and after giving effect to such payment Borrowers have Excess Availability not less than \$15,000,000), (b) upon the closing of the Disclosed Sale, an additional \$22,000,000 payment may be made, and (c) on or after October 1, 2008, an additional \$22,500,000 payment may be made if (i) the Borrowers have obtained the Proposed IP Financing, (ii) no Event of Default has occurred and is continuing or would result therefrom, and (iii) after giving effect to the payment set forth in this **clause (c)** Borrowers have Excess Availability not less than \$15,000,000.

LC Application: an application by Borrower Agent to Issuing Bank for issuance of a Letter of Credit, in form and substance satisfactory to Issuing Bank.

LC Conditions: the following conditions necessary for issuance of a Letter of Credit: (a) each of the conditions set forth in **Section 6.2**; (b) after giving effect to such issuance, total LC Obligations do not exceed the Letter of Credit Subline, no Overadvance exists and, if no Revolver Loans are outstanding, the LC Obligations do not exceed the Borrowing Base (without giving effect to the LC Reserve for purposes of this calculation); (c) the expiration date of such Letter of Credit is (i) no more than 365 days from issuance, in the case of standby Letters of Credit (subject to automatic renewal provisions to the extent approved by the Issuing Bank at the time of issue), (ii) no more than 120 days from issuance, in the case of documentary Letters of Credit, and (iii) at least 10 Business Days prior to the Revolver Termination Date; (d) the Letter of Credit and payments thereunder are denominated in Dollars; and (e) the form of the proposed Letter of Credit is satisfactory to Agent and Issuing Bank in their discretion.

LC Documents: all documents, instruments and agreements (including LC Requests and LC Applications) delivered by Borrowers or any other Person to Issuing Bank or Agent in connection with issuance, amendment or renewal of, or payment under, any Letter of Credit.

LC Obligations: the sum (without duplication) of (a) all amounts owing by Borrowers for any drawings under Letters of Credit; (b) the stated amount of all outstanding Letters of Credit; and (c) all fees and other amounts owing with respect to Letters of Credit.

LC Request: a request for issuance of a Letter of Credit, to be provided by Borrower Agent to Issuing Bank, in form satisfactory to Agent and Issuing Bank.

LC Reserve: the aggregate of all LC Obligations, other than (a) those that have been Cash Collateralized; and (b) if no Default or Event of Default exists, those constituting charges owing to the Issuing Bank.

Lender Indemnities: Lenders and their officers, directors, employees, Affiliates, agents and attorneys.

Lenders: as defined in the preamble to this Agreement, including Agent in its capacity as a provider of Swingline Loans and any other Person who hereafter becomes a "Lender" pursuant to an Assignment and Acceptance.

Lending Office: the office designated as such by the applicable Lender at the time it becomes party to this Agreement or thereafter by notice to Agent and Borrower Agent.

Letter of Credit: any standby or documentary letter of credit issued by Issuing Bank for the account of a Borrower, or any indemnity, guarantee, exposure transmittal memorandum or similar form of credit support issued by Agent or Issuing Bank for the benefit of a Borrower, and shall include the standby letters of credit issued by Bank of America for the benefit of US Borrower and outstanding on the Closing Date.

Letter of Credit Subline: \$25,000,000.

LIBOR: for any Interest Period with respect to a LIBOR Loan, the per annum rate of interest (rounded upward, if necessary, to the nearest 1/8th of 1%), determined by Agent at approximately 11:00 a.m. (London time) two Business Days prior to commencement of such Interest Period, for a term comparable to such Interest Period, equal to (a) the British Bankers Association LIBOR Rate ("BBA LIBOR"), as published by Reuters (or other commercially available source designated by Agent); or (b) if BBA LIBOR is not available for any reason, the interest rate at which Dollar deposits in the approximate amount of the LIBOR Loan would be offered by Bank of America's London branch to major banks in the London interbank Eurodollar market. If the Board of Governors imposes a Reserve Percentage with respect to LIBOR deposits, then LIBOR shall be the foregoing rate, divided by 1 minus the Reserve Percentage.

LIBOR Loan: each set of LIBOR Revolver Loans or LIBOR Term Loans having a common length and commencement of Interest Period.

LIBOR Revolver Loan: a Revolver Loan that bears interest based on LIBOR.

LIBOR Term Loan: a Term Loan that bears interest based on LIBOR.

License: any license or agreement under which an Obligor is authorized to use Intellectual Property in connection with any manufacture, marketing, distribution or disposition of Collateral, any use of Property or any other conduct of its business (other than software licenses and other similar licenses used in the Ordinary Course of Borrower's business that are not necessary or appropriate for realization on any material portion of the Collateral).

Licensor: any Person from whom an Obligor obtains the right to use any Intellectual Property.

Lien: any Person's interest in Property securing an obligation owed to, or a claim by, such Person, whether such interest is based on common law, statute or contract, including liens, security interests, pledges, hypothecations, statutory trusts, reservations, exceptions, encroachments, easements, rights-of-way, covenants, conditions, restrictions, leases, and other title exceptions and encumbrances affecting Property.

Lien Waiver: an agreement, in form and substance reasonably satisfactory to Agent, by which (a) for any material Collateral located on leased premises, the lessor waives or subordinates any Lien it may have on the Collateral, and agrees to permit Agent to enter upon the premises and remove the Collateral or to use the premises to store or dispose of the Collateral; (b) for any Collateral held by a warehouseman, processor, shipper, customs broker or freight forwarder, such Person waives or subordinates any Lien it may have on the Collateral, agrees to hold any Documents in its possession relating to the Collateral as agent for Agent, and agrees to deliver the Collateral to Agent upon request; (c) for any Collateral held by a repairman, mechanic or bailee, such Person acknowledges Agent's Lien, waives or subordinates any Lien it may have on the Collateral, and agrees to relinquish possession of the Collateral to Agent upon request; and (d) for any Collateral subject to a Licensor's Intellectual Property rights, the Licensor grants to Agent the right, vis-à-vis such Licensor, to enforce Agent's Liens with respect to the Collateral, including the right to dispose of it with the benefit of the Intellectual Property, whether or not a default exists under any applicable License.

Loan: a Revolver Loan or Term Loan.

Loan Account: the loan account established by each Lender on its books pursuant to **Section 5.8**.

Loan Documents: this Agreement, Other Agreements and Security Documents.

Loan Year: each calendar year commencing on the Closing Date and on each anniversary of the Closing Date.

Margin Stock: as defined in Regulation U of the Board of Governors.

Material Adverse Effect: the effect of any event or circumstance that, taken alone or in conjunction with other events or circumstances, (a) has or could be reasonably expected to have a material adverse effect on the business, operations, Properties or condition (financial or otherwise) of US Borrower, individually, of Swiss Borrower, individually (but taking into account rights of contribution), or of the Borrowers and their Subsidiaries taken as a whole, on the value of any material Collateral, on the enforceability of any Loan Documents, or on the validity or priority of Agent's Liens on any Collateral; (b) impairs the ability of any Obligor to perform any obligations under the Loan Documents, including repayment of any Obligations; or (c) otherwise impairs the ability of Agent or any Lender to enforce or collect any Obligations or to realize upon a material portion of the Collateral.

Material Contract: any agreement or arrangement to which a Borrower or Subsidiary is party (other than the Loan Documents) (a) that relates to disposition of or affects the ability of Agent to realize upon (or otherwise exercise remedies with respect to) a material portion of the Collateral; (b) for which breach, termination, nonperformance or failure to renew could reasonably be expected to have a Material Adverse Effect; or (c) that relates to Subordinated Debt, or Debt in an aggregate amount of \$5,000,000 or more.

Moody's: Moody's Investors Service, Inc., and its successors.

Mortgage: each mortgage, deed of trust or deed to secure debt pursuant to which a Borrower grants to Agent, for the benefit of Secured Parties, Liens upon the Real Estate owned by such Borrower, as security for the Obligations.

Multiemployer Plan: any employee benefit plan of the type described in Section 4001(a)(3) of ERISA, to which any Obligor or ERISA Affiliate makes or is obligated to make contributions, or during the preceding five plan years, has made or been obligated to make contributions.

Net Proceeds: with respect to an Asset Disposition, proceeds (including, when received, any deferred or escrowed payments) received by a Borrower or Subsidiary in cash from such disposition, net of (a) reasonable and customary costs and expenses actually incurred in connection therewith, including legal fees and sales commissions; (b) amounts applied to repayment of Debt secured by a Permitted Lien senior to Agent's Liens on Collateral sold; (c) transfer or similar taxes; and (d) reserves for indemnities, until such reserves are no longer needed.

NOLV Percentage: the net orderly liquidation value of Inventory, expressed as a percentage, expected to be realized at an orderly, negotiated sale held within a reasonable period of time, net of all liquidation expenses, as determined from the most recent appraisal of Borrowers' Inventory performed by an appraiser and on terms satisfactory to Agent.

Notes: each Revolver Note, Term Note or other promissory note executed by a Borrower to evidence any Obligations.

Notice of Borrowing: a Notice of Borrowing to be provided by Borrower Agent to request a Borrowing of Revolver Loans, in form reasonably satisfactory to Agent.

Notice of Conversion/Continuation: a Notice of Conversion/Continuation to be provided by Borrower Agent to request a conversion or continuation of any Loans as LIBOR Loans, in form reasonably satisfactory to Agent.

Obligations: all (a) principal of and premium, if any, on the Loans, (b) LC Obligations and other obligations of Obligor with respect to Letters of Credit, (c) interest, expenses, fees and other sums payable by Obligor under Loan Documents, (d) obligations of Obligor under any indemnity for Claims, (e) Extraordinary Expenses, (f) Bank Product Debt, and (g) other Debts, obligations and liabilities of any kind owing by Obligor pursuant to the Loan Documents, whether now existing or hereafter arising, whether evidenced by a note or other writing, whether allowed in any Insolvency Proceeding, whether arising from an extension of credit, issuance of a letter of credit, acceptance, loan, guaranty, indemnification or otherwise, and whether direct or indirect, absolute or contingent, due or to become due, primary or secondary, or joint or several.

Obligor: each Borrower or Guarantor.

Ordinary Course of Business: the ordinary course of business of any Borrower or Subsidiary, consistent with past practices and undertaken in good faith.

Organic Documents: with respect to any Person, its charter, certificate or articles of incorporation, bylaws, articles of organization, limited liability agreement, operating agreement, members agreement, shareholders agreement, partnership agreement, certificate of partnership, certificate of formation, voting trust agreement, or similar agreement or instrument governing the formation or operation of such Person.

OSHA: the Occupational Safety and Hazard Act of 1970.

Other Agreement: the Fee Letter and each Note; LC Document; Lien Waiver; Real Estate Related Document; Borrowing Base Certificate, Compliance Certificate, financial statement or report delivered hereunder; or other document, instrument or agreement (other than this Agreement or a Security Document) now or hereafter executed and delivered by an Obligor or other Person to Agent or a Lender in connection with any transactions relating hereto.

Other Taxes: all present or future stamp or documentary taxes or any other excise or property taxes, charges or similar levies arising from any payment made under any Loan Document or from the execution, delivery or enforcement of, or otherwise with respect to, any Loan Document.

Overadvance: as defined in **Section 2.1.5**.

Overadvance Loan: a Base Rate Revolver Loan made when an Overadvance exists or is caused by the funding thereof.

Participant: as defined in **Section 13.2**.

Patent Security Agreement: each patent collateral assignment agreement pursuant to which an Obligor grants to Agent, for the benefit of Secured Parties, a Lien on such Obligor's interests in its owned patents, as security for the Obligations.

Patriot Act: the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (2001).

Payment Item: each check, draft or other item of payment payable to a Borrower, including those constituting proceeds of any Collateral.

PBGC: the Pension Benefit Guaranty Corporation.

Pension Plan: any employee pension benefit plan (as such term is defined in Section 3(2) of ERISA), other than a Multiemployer Plan, that is subject to Title IV of ERISA and is sponsored or maintained by any Obligor or ERISA Affiliate or to which the Obligor or ERISA Affiliate contributes or has an obligation to contribute, or in the case of a multiple employer or other plan described in Section 4064(a) of ERISA, has made contributions at any time during the preceding five plan years.

Permitted Acquisition: any Acquisition by any Obligor in a transaction that satisfies each of the following requirements: (a) such Acquisition is not a hostile acquisition or contested by the company to be acquired; (b) the business acquired in connection with such Acquisition is not primarily engaged, directly or indirectly, in any line of business other than the businesses in which the Loan Parties are engaged on the Closing Date and any business activities that are substantially similar or incidental thereto; (c) both before and after giving effect to such Acquisition and the Loans (if any) requested to be made in connection therewith, each of the representations and warranties in the Loan Documents is true and correct (except (i) any such representation or warranty which relates to a specified prior date and (ii) to the extent Agent and the Lenders have been notified in writing by the Obligors that any representation or warranty is not correct and the Required Lenders have explicitly waived in writing compliance with such representation or warranty) and no Default or Event of Default exists, will exist, or would result therefrom; (d) as soon as available, but not less than fifteen days prior to such Acquisition, the Borrowers have provided the Lenders (i) notice of such Acquisition and (ii) a copy of all available business and financial information reasonably requested by Agent including pro forma financial statements, statements of cash flow, and Availability projections; (e) the aggregate purchase price (whether in cash, notes or any other form of non-equity consideration) of all Acquisitions made during the term of this Agreement shall not exceed \$5,000,000; (f) if such Acquisition is an acquisition of the Equity Interests of a Person, the Acquisition is structured so that the acquired Person shall become a wholly-owned Subsidiary of a Borrower and, in accordance with **Section 10.1.9**, an Obligor pursuant to the terms of this Agreement; (g) if such Acquisition is an acquisition of assets, the Acquisition is structured so that an Obligor (or a newly organized Subsidiary that becomes an Obligor) shall acquire such assets; (h) if such Acquisition is an acquisition of Equity Interests, such Acquisition will not result in any violation of Regulation U; (i) no Obligor shall, as a result of or in connection with any such Acquisition, assume or incur any direct or contingent liabilities (whether relating to environmental, tax, litigation, or other matters) that could reasonably be expected to have a Material Adverse Effect; (j) in connection with an Acquisition of the Equity Interests of any Person, all Liens (other than Permitted Liens which were not created in contemplation of such Acquisition) on property of such Person shall be terminated unless Agent in its sole discretion consents otherwise, and in connection with an Acquisition of the assets of any Person, all Liens (other than Permitted Liens which were not created in contemplation of such Acquisition) on such assets shall be terminated; (k) there are no Term Loans outstanding on the date of consummation of any such Acquisition; and (l) both before and after giving effect to any such Acquisition, Borrowers maintain Excess Availability not less than \$15,000,000. In no event will assets acquired pursuant to a Permitted Acquisition constitute Eligible Accounts, Eligible Inventory or Eligible Equipment prior to completion of a field examination and other due diligence acceptable to Agent in its discretion.



**Permitted Asset Disposition:** as long as no Default or Event of Default exists and all Net Proceeds are deposited into the Dominion Account, an Asset Disposition that is (a) a sale of Inventory in the Ordinary Course of Business; (b) a disposition of Equipment that, in the aggregate during any 12 month period, has a fair market or book value (whichever is more) of \$3,000,000 or less; (c) a disposition of Inventory that is obsolete, unmerchantable or otherwise unsalable in the Ordinary Course of Business; (d) termination of a lease of real or personal Property that is not necessary for the Ordinary Course of Business, could not reasonably be expected to have a Material Adverse Effect and does not result from an Obligor's default; (e) the Disclosed Sale; (f) to the extent constituting an Asset Disposition, investments not prohibited under **Section 10.2** hereof; (g) licenses, sublicenses, leases or subleases granted to others not interfering in any material respect with the business of the Borrowers and their Subsidiaries and which could not reasonably be expected to have a Material Adverse Effect, (h) sales or dispositions of cash and Cash Equivalents in the Ordinary Course of Business; (i) abandonment of Intellectual Property of the Borrowers and their Subsidiaries that is immaterial, unnecessary or no longer used in the Ordinary Course of Business, the abandonment of which Intellectual Property could not reasonably be expected to have a Material Adverse Effect; (j) transfers of assets to US Borrower, or from non-Obligors to non-Obligors or to Obligors; (k) Dispositions of Accounts not constituting Eligible Accounts in the Ordinary Course of Business in connection with the collection or compromise thereof; (l) sale or Disposition of US Borrower's real Property located at 12032 Highway 155N, Tyler, Texas for Net Proceeds not less than \$1,700,000 (which Net Proceeds shall reduce the Real Estate Formula Amount as set forth in the definition of such term); and (m) approved in writing by Agent and Required Lenders.

**Permitted Contingent Obligations:** Contingent Obligations (a) arising from endorsements of Payment Items for collection or deposit in the Ordinary Course of Business; (b) arising from Hedging Agreements permitted hereunder; (c) existing on the Closing Date, and any extension or renewal thereof that does not increase the amount of such Contingent Obligation when extended or renewed; (d) incurred in the Ordinary Course of Business with respect to surety, appeal or performance bonds, or other similar obligations; (e) arising from customary indemnification obligations in favor of purchasers in connection with Permitted Asset Dispositions if such obligations could not reasonably be expected to have a Material Adverse Effect; (f) arising under the Loan Documents; (g) guarantees by Obligors of another Obligor's Debt or other obligations incurred in the Ordinary Course of Business in each case to the extent that such Debt or other obligations are permitted hereunder and if such guarantees could not reasonably be expected to have a Material Adverse Effect; or (h) in an aggregate amount of \$5,000,000 or less at any time.

**Permitted Lien:** as defined in **Section 10.2.2**.

**Permitted Purchase Money Debt:** Purchase Money Debt of Borrowers and Subsidiaries that is unsecured or secured only by a Purchase Money Lien, as long as the aggregate amount does not exceed \$5,000,000 at any time and its incurrence does not violate **Section 10.2.3**.

**Person:** any individual, corporation, limited liability company, partnership, joint venture, joint stock company, land trust, business trust, unincorporated organization, Governmental Authority or other entity.

**Plan:** any employee benefit plan (as such term is defined in Section 3(3) of ERISA) established by an Obligor or, with respect to any such plan that is subject to Section 412 of the Code or Title IV of ERISA, an ERISA Affiliate.

**Pro Rata:** with respect to any Lender, a percentage (carried out to the ninth decimal place) determined (a) while Revolver Commitments are outstanding, by dividing the amount of such Lender's Revolver Commitment and Term Loan by the aggregate amount of all Revolver Commitments and Term Loans; and (b) at any other time, by dividing the amount of such Lender's Loans and LC Obligations by the aggregate amount of all outstanding Loans and LC Obligations.

**Properly Contested:** with respect to any obligation of an Obligor, (a) the obligation is subject to a bona fide dispute regarding amount or the Obligor's liability to pay; (b) the obligation is being properly contested in good faith by appropriate proceedings promptly instituted and diligently pursued; (c) appropriate reserves have been established in accordance with GAAP; (d) non-payment could not have a Material Adverse Effect, nor result in forfeiture or sale of any assets of the Obligor; (e) no Lien is imposed on assets of the Obligor, unless bonded and stayed to the satisfaction of Agent; and (f) if the obligation results from entry of a judgment or other order, such judgment or order is stayed pending appeal or other judicial review.

**Property:** any interest in any kind of property or asset, whether real, personal or mixed, or tangible or intangible.

**Proposed IP Financing:** Debt in an aggregate amount of at least \$30,000,000 (or such lesser amount as may be acceptable to Agent in its discretion) to a third party that is secured by a first priority Lien on US Borrower's Intellectual Property.

**Protected Party:** the Agent, any Lender or any Issuing Bank which is or will be subject to any liability, or required to make any payment, for or on account of Tax in relation to a sum received or receivable (or any sum deemed for the purposes of Tax to be received or receivable) under the Loan Documents.

**Protective Advances:** as defined in **Section 2.1.6**.

**Purchase Money Debt:** (a) Debt (other than the Obligations) for payment of any of the purchase price of fixed assets; (b) Debt (other than the Obligations) incurred within 20 days before or after acquisition of any fixed assets, for the purpose of financing any of the purchase price thereof; and (c) any renewals, extensions or refinancings (but not increases) thereof.

**Purchase Money Lien:** a Lien that secures Purchase Money Debt, encumbering only the fixed assets acquired with such Debt and constituting a Capital Lease or a purchase money security interest under the UCC.

**Qualifying Bank:** a bank or financial institution that is qualified as bank and subject to the banking regulations as in force from time to time in the jurisdiction in which that entity is incorporated and effectively conducts banking activities with its own infrastructure and staff as principal business purpose in such jurisdiction.

**Qualifying Beneficiary:** the Agent, any Lender or any Issuing Bank which is beneficially entitled to interest payable to that Lender in respect of an advance under the Loan Documents and is an Exempt Lender or a Treaty Lender.

**Real Estate:** all right, title and interest (whether as owner, lessor or lessee) in any real Property or any buildings, structures, parking areas or other improvements thereon.

**Real Estate Formula Amount:** as of any date of determination, (a) on the Closing Date, \$5,100,000 (b) thereafter, \$5,100,000 minus \$53,125.00 for each full calendar month elapsed since December 31, 2007; provided that the Real Estate Formula Amount shall be reduced by an amount equal to 100% the Net Proceeds of any disposition of part or all of the US Borrower's Real Estate described on **Schedule 1.1(c)** hereto and in the event that the US Borrower's Real Estate located in Tyler Texas is sold or otherwise Disposed of and the US Borrower receives Net Proceeds of such sale in an amount less than \$2,100,000, the Real Estate Formula Amount shall be automatically reduced on the date of consummation of such sale by an amount equal to the difference between \$2,100,000 and the Net Proceeds of such sale.

**Refinancing Conditions:** the following conditions for Refinancing Debt: (a) it is in an aggregate principal amount that does not exceed the principal amount of the Debt being extended, renewed or refinanced (or, in the case of refinancings of Subordinated Debt, the principal amount of the Subordinated Debt that was outstanding at the time that the subordination agreement relating to such Debt was entered into with Agent, provided that a subordination agreement in form and substance satisfactory to Agent is entered into between Agent and the replacement subordinated lender); (b) it has a final maturity no sooner than, and a weighted average life no less than, the Debt being extended, renewed or refinanced; (c) it has an interest rate acceptable to Agent; (d) it is subordinated to the Obligations at least to the same extent as the Debt being extended, renewed or refinanced (or in a manner otherwise acceptable to Agent); (e) the representations, covenants and defaults applicable to it are no less favorable to Borrowers than those applicable to the Debt being extended, renewed or refinanced; (f) no additional Lien is granted to secure it; (g) no additional Person is obligated on such Debt; and (h) upon giving effect to it, no Default or Event of Default exists.

**Refinancing Debt:** Borrowed Money that is the result of an extension, renewal or refinancing of Debt permitted under **Section 10.2.1(b)** or **(d)**.

**Reimbursement Date:** as defined in **Section 2.3.2**.

**Related Real Estate Documents:** with respect to any Real Estate subject to a Mortgage, the following, in form and substance satisfactory to Agent and received by Agent for review at least 15 days prior to the effective date of the Mortgage: (a) a mortgagee title policy (or binder therefor) covering Agent's interest under the Mortgage, in a form and amount and by an insurer acceptable to Agent, which must be fully paid on such effective date; (b) such assignments of leases, estoppel letters, attornment agreements, consents, waivers and releases as Agent may reasonably require with respect to other Persons having an interest in the Real Estate, provided that Borrowers are required to use commercially reasonable efforts to obtain the documents in this **clause (b)** from third parties; (c) a current, as-built survey of the Real Estate, containing a metes-and-bounds property description and flood plain certification, and certified by a licensed surveyor acceptable to Agent; (d) flood insurance in an amount, with endorsements and by an insurer acceptable to Agent, if the Real Estate is within a flood plain; (e) a current appraisal of the Real Estate, prepared by an appraiser acceptable to Agent, and in form and substance satisfactory to Required Lenders; (f) a Phase I environmental assessment, prepared by environmental engineers acceptable to Agent, and accompanied by such certificates, studies or data as Agent may reasonably require in connection with or as a result of such Phase I, which shall all be in form and substance satisfactory to Required Lenders; and (g) such other documents, instruments or agreements as Agent may reasonably require with respect to any environmental risks regarding the Real Estate.

**Rent and Charges Reserve:** the aggregate of (a) all past due rent and other amounts owing by an Obligor to any landlord, warehouseman, processor, repairman, mechanic, shipper, freight forwarder, broker or other Person who possesses any Collateral or could assert a Lien on any Collateral; and (b) a reserve at least equal to three months rent and other charges that could be payable to any such Person, unless it has executed a Lien Waiver; provided that with respect to the US Borrower's location in Louisville, Colorado, no Rent and Charges Reserve is in effect as of the Closing Date and none will be implemented prior to April 1, 2008 if US Borrower has at all time during that period prepaid rent in an amount remaining of not less than two months' rent.

Report: as defined in **Section 12.2.3**.

Reportable Event: any of the events set forth in Section 4043(c) of ERISA, other than events for which the 30 day notice period has been waived.

Required Lenders: Lenders (subject to **Section 4.2**) having (a) Revolver Commitments and Term Loans in excess of 50% of the aggregate Revolver Commitments and Term Loans; and (b) if the Revolver Commitments have terminated, Loans in excess of 50% of all outstanding Loans.

Reserve Percentage: the reserve percentage (expressed as a decimal, rounded upward to the nearest 1/8th of 1%) applicable to member banks under regulations issued from time to time by the Board of Governors for determining the maximum reserve requirement (including any emergency, supplemental or other marginal reserve requirement) with respect to Eurocurrency funding (currently referred to as "Eurocurrency liabilities").

Restricted Investment: any Investment by a Borrower or Subsidiary, other than (a) Investments in Subsidiaries to the extent existing on the Closing Date; (b) Cash Equivalents that are subject to Agent's Lien and control, pursuant to documentation in form and substance satisfactory to Agent; (c) loans and advances permitted under **Section 10.2.7**; (d) the LandAmerica Acquisition; (e) the endorsement of instruments for collection or deposit in the Ordinary Course of Business; (f) loans and advances by an Obligor or its Subsidiaries to employees of such Obligor or Subsidiary for reasonable and necessary relocation expenses of such employees or for reasonable and necessary work-related travel or other expenses incurred by such employees in connection with their work for such Obligor or Subsidiary in an aggregate amount not to exceed \$2,000,000 outstanding at any time; (g) stock or obligations issued to any Obligor or its Subsidiaries by any Person (or the representative of such Person) in respect of Debt or other trade obligations of such Person owing to such Obligor or Subsidiary in connection with the insolvency, bankruptcy, receivership or reorganization of such Person or a composition, readjustment or settlement of the debts of such Person or in respect of a settlement of a dispute with such Person, provided, that the original of any such stock or instrument evidencing such obligations owing to an Obligor shall be promptly delivered to Agent, upon Agent's request, together with such stock power, assignment or endorsement by such Obligor as Agent may request; (h) the Investments in existence on the Closing Date set forth on **Schedule 10.2.5**; (i) securities, instruments or other investments that an Obligor or its Subsidiaries may acquire in connection with Permitted Asset Disposition, provided that the original of any such securities or instruments owned by an Obligor evidencing such investments shall be promptly delivered to Agent, upon Agent's request, together with such stock power or endorsement by such Obligor as Agent may request; (j) guarantees of Indebtedness or ordinary course obligations to the extent permitted under **Section 10.2.1**; (k) Permitted Acquisitions; (l) Hedging Agreements entered into in the Ordinary Course of Business for non speculative purposes; (m) earnest money deposits required in connection with Permitted Acquisitions; (o) the creation of new Subsidiaries subject to the provisions of **Section 10.1.9** hereof; (p) Investments not otherwise permitted hereunder not to exceed \$5,000,000 at any one time, provided that (i) no Default or Event of Default has occurred at the time of such Investments or would result therefrom, (ii) the Term Loans have been repaid, and (iii) Borrowers have Excess Availability not less than \$15,000,000 after giving effect to such Investments; and (q) other Investments consented to by the Required Lenders.

Restrictive Agreement: an agreement (other than a Loan Document) that conditions or restricts the right of any Borrower, Subsidiary or other Obligor to incur or repay Borrowed Money, to grant Liens on any assets, to declare or make Distributions, to modify, extend or renew any agreement evidencing Borrowed Money, or to repay any intercompany Debt.

**Revolver Commitment:** for any Lender, its obligation to make Revolver Loans and to participate in LC Obligations up to the maximum principal amount shown on **Schedule 1.1**, or as hereafter determined pursuant to each Assignment and Acceptance to which it is a party. “**Revolver Commitments**” means the aggregate amount of such commitments of all Lenders. Following the Closing Date, the Revolver Commitments shall be automatically increased on the date of any repayment of any portion of the Term Loans to include the amount of such repayment; provided that (i) unless the aggregate Revolver Commitments have been increased pursuant to **Section 2.1.7**, the Revolver Commitments shall not exceed \$100,000,000, and (ii) in the event the Revolver Commitments have been increased pursuant to **Section 2.1.7**, the Revolver Commitments shall not exceed at any time \$125,000,000.

**Revolver Loan:** a loan made pursuant to **Section 2.1**, and any Swingline Loan, Overadvance Loan or Protective Advance.

**Revolver Note:** a promissory note to be executed by Borrowers in favor of a Lender in the form of **Exhibit A**, which shall be in the amount of such Lender’s Revolver Commitment and shall evidence the Revolver Loans made by such Lender.

**Revolver Termination Date:** January 16, 2013.

**Royalties:** all royalties, fees, expense reimbursement and other amounts payable by a Borrower under a License.

**S&P:** Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc., and its successors.

**Secured Parties:** Agent, Issuing Bank, Lenders and providers of Bank Products.

**Security Documents:** the Copyright Security Agreements, Guaranties, Mortgages, Stock Pledge Agreement, Patent Security Agreements, Trademark Security Agreements, Deposit Account Control Agreements, and all other documents, instruments and agreements now or hereafter securing (or given with the intent to secure) any Obligations.

**Senior Officer:** the chairman of the board, president, chief executive officer or chief financial officer of a Borrower or, if the context requires, an Obligor.

**Settlement Report:** a report delivered by Agent to Lenders summarizing the Revolver Loans and participations in LC Obligations outstanding as of a given settlement date, allocated to Lenders on a Pro Rata basis in accordance with their Revolver Commitments.

**Solvent:** as to any Person, such Person (a) owns Property whose fair salable value is greater than the amount required to pay all of its debts (including contingent, subordinated, unmatured and unliquidated liabilities to the extent reasonably likely to become liabilities); (b) owns Property whose present fair salable value (as defined below) is greater than the probable total liabilities (including contingent, subordinated, unmatured and unliquidated liabilities to the extent reasonably likely to become liabilities) of such Person as they become absolute and matured; (c) is able to pay all of its debts as they mature; (d) has capital that is not unreasonably small for its business and is sufficient to carry on its business and transactions and all business and transactions in which it is about to engage; (e) is not “insolvent” within the meaning of Section 101(32) of the Bankruptcy Code; and (f) has not incurred (by

way of assumption or otherwise) any obligations or liabilities (contingent or otherwise) under any Loan Documents, or made any conveyance in connection therewith, with actual intent to hinder, delay or defraud either present or future creditors of such Person or any of its Affiliates. “Fair salable value” means the amount that could be obtained for assets on a going concern basis within a reasonable time, either through sale under ordinary selling conditions by a capable and diligent seller to an interested buyer who is willing (but under no compulsion) to purchase.

Stock Pledge Agreement: a stock pledge agreement in form and substance satisfactory to Agent, pursuant to which US Borrower pledges to Agent for the benefit of Lenders 100% of its Equity Interests in its Subsidiaries that are organized under the laws of the United States or a State thereof, and 65% of its Equity Interests in its Foreign Subsidiaries.

Subordinated Debt: Debt incurred by a Borrower that is expressly subordinate and junior in right of payment to Full Payment of all Obligations, and is on terms (including maturity, interest, fees, repayment, covenants and subordination) satisfactory to Agent.

Subsidiary: any entity at least 50% of whose voting securities or Equity Interests is owned by a Borrower or any combination of Borrowers (including indirect ownership by a Borrower through other entities in which the Borrower directly or indirectly owns 50% of the voting securities or Equity Interests).

Swingline Loan: any Borrowing of Base Rate Revolver Loans funded with Agent’s funds, until such Borrowing is settled among Lenders pursuant to **Section 4.1.3**.

Swiss Obligor: any Obligor incorporated in Switzerland.

Swiss Withholding Tax: any withholding tax in accordance with the Swiss Federal Law on Withholding Tax of October 13, 1965 (Bundesgesetz über die Verrechnungssteuer).

Tax Credit: a credit against, relief or remission for, or repayment of any Tax and includes a full or partial refund of any Tax for or on account of any Tax Deduction made.

Tax Deduction: a deduction or withholding for or on account of Tax from a payment under the Loan Documents.

Taxes: all present or future taxes, levies, imposts, duties, deductions, withholdings, assessments, fees or other charges imposed by any Governmental Authority, including any interest, additions to tax or penalties applicable thereto.

Term Loan: a loan made pursuant to **Section 2.2**, the availability of which Loan shall be based on the appraised value of Intellectual Property owned by US Borrower on the Closing Date.

Term Loan Commitment: for any Lender, the obligation of such Lender to make a Term Loan hereunder, up to the principal amount shown on **Schedule 1.1**. “Term Loan Commitments” means the aggregate amount of such commitments of all Lenders.

Term Loan Maturity Date: the earliest to occur of (a) March 31, 2008, (b) the date of consummation of the Disclosed Sale, or (c) the closing date of the Proposed IP Financing.

**Term Note:** a promissory note to be executed by Borrowers in favor of a Lender in the form of **Exhibit B**, which shall be in the amount of such Lender's Term Loan Commitment and shall evidence the Term Loan made by such Lender.

**Trademark Security Agreement:** each trademark security agreement pursuant to which an Obligor grants to Agent, for the benefit of Secured Parties, a Lien on such Obligor's interests in its owned trademarks, as security for the Obligations.

**Transferee:** any actual or potential Eligible Assignee, Participant or other Person acquiring an interest in any Obligations.

**Treaty:** a double taxation agreement.

**Treaty Lender:** a Lender which (i) is entitled to receive payment under the Loan Documents either without a Tax Deduction pursuant to a Treaty (subject to the completion of any necessary procedural formalities), or if a Tax Deduction has to be made in respect of such a payment, is entitled to a Tax Credit in respect thereof pursuant to the Treaty; (ii) is treated as a resident of a Treaty State for the purposes of the Treaty; and (iii) does not carry on a business in Switzerland through a permanent establishment with which that Lender's participation in the Loan is effectively connected.

**Treaty State:** a jurisdiction having a double taxation agreement with Switzerland which makes provision either for full exemption from tax on payments under this Agreement (including tax-at-source) imposed by Switzerland or, if a Tax Deduction has to be made in respect of such a payment, entitlement to a Tax Credit in respect thereof pursuant to the Treaty.

**Trigger Period:** the period (a) commencing on the day that (i) an Event of Default occurs, (ii) Excess Availability is less than \$15,000,000 for three consecutive Business Days or (iii) Excess Availability is less than \$12,500,000 at any time; and (b) continuing until the day on which the Borrowers have maintained Excess Availability in excess of \$20,000,000 for a period of 90 consecutive days.

**Type:** any type of a Loan (i.e., Base Rate Loan or LIBOR Loan) that has the same interest option and, in the case of LIBOR Loans, the same Interest Period.

**UCC:** the Uniform Commercial Code as in effect in the State of California or, when the laws of any other jurisdiction govern the perfection or enforcement of any Lien, the Uniform Commercial Code of such jurisdiction.

**Unfunded Pension Liability:** the excess of a Pension Plan's benefit liabilities under Section 4001(a)(16) of ERISA, over the current value of that Pension Plan's assets, determined in accordance with the assumptions used for funding the Pension Plan pursuant to Section 412 of the Code for the applicable plan year.

**Upstream Payment:** a Distribution by a Subsidiary of a Borrower to such Borrower or to another Subsidiary of such Borrower.

**Value:** (a) for Inventory, its value determined on the basis of the lower of cost or market, calculated on a first-in, first-out basis, and excluding any portion of cost attributable to intercompany profit among Borrowers and their Affiliates; and (b) for an Account, its face amount, net of any returns, rebates, discounts (calculated on the shortest terms), credits, allowances or Taxes (including sales, excise or other taxes) that have been or could be claimed by the Account Debtor or any other Person.

**Voting Stock:** with respect to any Person, Equity Interests issued by such Person the holders of which are ordinarily, in the absence of contingencies, entitled to vote for the election of directors (or persons performing similar functions) of such Person, even though the right so to vote has been suspended by the happening of such a contingency.

**1.2 Accounting Terms.** Under the Loan Documents (except as otherwise specified herein), all accounting terms shall be interpreted, all accounting determinations shall be made, and all financial statements shall be prepared, in accordance with GAAP applied on a basis consistent with the most recent audited financial statements of Borrowers delivered to Agent before the Closing Date and using the same inventory valuation method as used in such financial statements, except for any change required or permitted by GAAP if Borrowers' certified public accountants concur in such change, the change is disclosed to Agent, and **Section 10.3** is amended in a manner satisfactory to Required Lenders to take into account the effects of the change; provided that in the event of a change in GAAP that would affect the calculation of covenants contained in **Section 10.3**, Agent will in its discretion consider (but Agent shall have no obligation to adopt) written requests from US Borrower to conform calculation of the covenants in **Section 10.3** to the corresponding change in GAAP.

**1.3 Uniform Commercial Code.** As used herein, the following terms are defined in accordance with the UCC in effect in the State of California from time to time: "Chattel Paper," "Commercial Tort Claim," "Deposit Account," "Document," "Equipment," "General Intangibles," "Goods," "Instrument," "Investment Property," "Letter-of-Credit Right" and "Supporting Obligation."

**1.4 Certain Matters of Construction.** The terms "herein," "hereof," "hereunder" and other words of similar import refer to this Agreement as a whole and not to any particular section, paragraph or subdivision. Any pronoun used shall be deemed to cover all genders. In the computation of periods of time from a specified date to a later specified date, "from" means "from and including," and "to" and "until" each mean "to but excluding." The terms "including" and "include" shall mean "including, without limitation" and, for purposes of each Loan Document, the parties agree that the rule of *ejusdem generis* shall not be applicable to limit any provision. Section titles appear as a matter of convenience only and shall not affect the interpretation of any Loan Document. All references to (a) laws or statutes include all related rules, regulations, interpretations, amendments and successor provisions; (b) any document, instrument or agreement include any amendments, waivers and other modifications, extensions or renewals (to the extent permitted by the Loan Documents); (c) any section mean, unless the context otherwise requires, a section of this Agreement; (d) any exhibits or schedules mean, unless the context otherwise requires, exhibits and schedules attached hereto, which are hereby incorporated by reference; (e) any Person include successors and assigns; (f) time of day mean time of day in Pasadena, California; or (g) discretion of Agent, Issuing Bank or any Lender mean the sole and absolute discretion of such Person. All calculations of Value, fundings of Loans, issuances of Letters of Credit and payments of Obligations shall be in Dollars and, unless the context otherwise requires, all determinations (including calculations of Borrowing Base and financial covenants) made from time to time under the Loan Documents shall be made in light of the circumstances existing at such time. Borrowing Base calculations shall be consistent with historical methods of valuation and calculation, and otherwise satisfactory to Agent (and not necessarily calculated in accordance with GAAP). Borrowers shall have the burden of establishing any alleged negligence, misconduct or lack of good faith by Agent, Issuing Bank or any Lender under any Loan Documents. No provision of any Loan Documents shall be construed against any party by reason of such party having, or being deemed to have, drafted the provision. Whenever the phrase "to the best of Borrowers' knowledge" or words of similar import are used in any Loan Documents, it means actual knowledge of a Senior Officer, or knowledge that a Senior Officer would have obtained if he or she had engaged in good faith and diligent performance of his or her duties, including reasonably specific inquiries of employees or agents and a good faith attempt to ascertain the matter to which such phrase relates.



## SECTION 2. CREDIT FACILITIES

### 2.1 Revolver Commitment.

2.1.1 Revolver Loans. Each Lender agrees, severally on a Pro Rata basis up to its Revolver Commitment, on the terms set forth herein, to make Revolver Loans to Borrowers from time to time through the Commitment Termination Date. The Revolver Loans may be repaid and reborrowed as provided herein. In no event shall Lenders have any obligation to honor a request for a Revolver Loan if the unpaid balance of Revolver Loans outstanding at such time (including the requested Loan) would exceed the Borrowing Base.

2.1.2 Revolver Notes. The Revolver Loans made by each Lender and interest accruing thereon shall be evidenced by the records of Agent and such Lender. At the request of any Lender, Borrowers shall deliver a Revolver Note to such Lender.

2.1.3 Use of Proceeds. The proceeds of Revolver Loans shall be used by Borrowers solely (a) to satisfy existing Debt; (b) to pay fees and transaction expenses associated with the closing of this credit facility; (c) to pay Obligations in accordance with this Agreement; and (d) for working capital and other lawful corporate purposes of Borrowers.

#### 2.1.4 Voluntary Termination of Revolver Commitments.

(a) The Revolver Commitments shall terminate on the Revolver Termination Date, unless sooner terminated in accordance with this Agreement. Upon at least 10 Business Days prior written notice to Agent at any time, Borrowers may, at their option, terminate the Revolver Commitments and this credit facility. Any notice of termination given by Borrowers shall be irrevocable. On the termination date, Borrowers shall make Full Payment of all Obligations.

(b) Concurrently with any termination of the Revolver Commitments, for whatever reason (including an Event of Default), Borrowers shall pay to Agent, for the Pro Rata benefit of Lenders and as liquidated damages for loss of bargain (and not as a penalty), an amount equal to (i) if the termination occurs during the first Loan Year, 1.0% of the Revolver Commitments being terminated; (ii) if it occurs during the second Loan Year, 0.5% of the Revolver Commitments being terminated; and (iii) if it occurs thereafter, 0.0% of the Revolver Commitments being terminated. No termination charge shall be payable if termination occurs on the Revolver Termination Date or in connection with a refinancing of this credit facility by Bank of America or any of its Affiliates.

2.1.5 Overadvances. If the aggregate Revolver Loans exceed the Borrowing Base ("Overadvance") or the aggregate Revolver Commitments at any time, the excess amount shall be payable by Borrowers **on demand** by Agent, but all such Revolver Loans shall nevertheless constitute Obligations secured by the Collateral and entitled to all benefits of the Loan Documents. Unless its authority has been revoked in writing by Required Lenders, Agent may require Lenders to honor requests for Overadvance Loans and to forbear from requiring Borrowers to cure an Overadvance, (a) when no other Event of Default is known to Agent, as long as (i) the Overadvance does not continue for more than 30 consecutive days (and no Overadvance may exist for at least five consecutive days thereafter before further Overadvance Loans are required), and (ii) the Overadvance is not known by Agent to exceed 10% of the Borrowing Base; and (b) regardless of whether an Event of Default exists, if Agent discovers an Overadvance not previously known by it to exist, as long as from the date of such discovery the Overadvance (i) is not increased by more than \$5,000,000, and (ii) does not continue for more than 30 consecutive days. In no event shall Overadvance Loans be required that would cause the outstanding Revolver Loans and LC Obligations to exceed the aggregate Revolver Commitments. Any funding of an

Overadvance Loan or sufferance of an Overadvance shall not constitute a waiver by Agent or Lenders of the Event of Default caused thereby. In no event shall any Borrower or other Obligor be deemed a beneficiary of this Section nor authorized to enforce any of its terms.

**2.1.6 Protective Advances.** Agent shall be authorized, in its discretion, at any time that any conditions in **Section 6.2** are not satisfied, and without regard to the aggregate Commitments, to make Base Rate Revolver Loans (“**Protective Advances**”) (a) up to an aggregate amount of \$12,500,000 outstanding at any time, if Agent deems such Loans necessary or desirable to preserve or protect Collateral, or to enhance the collectibility or repayment of Obligations; or (b) to pay any other amounts chargeable to Obligors under any Loan Documents, including costs, fees and expenses. Each Lender shall participate in each Protective Advance on a Pro Rata basis. Required Lenders may at any time revoke Agent’s authority to make further Protective Advances by written notice to Agent. Absent such revocation, Agent’s determination that funding of a Protective Advance is appropriate shall be conclusive.

**2.1.7 Increases in Revolver Commitments.** Notwithstanding anything to the contrary contained in this Agreement:

(a) Provided there exists no Default or Event of Default, upon notice to Agent (which shall promptly notify the Lenders), Borrowers may request an increase in the Revolver Commitments to an amount not more than \$125,000,000 in the aggregate. At the time of sending such notice, Borrowers (in consultation with Agent) shall specify the time period within which each Lender is requested to respond (which shall in no event be less than 10 Business Days from the date of delivery of such notice to the Lenders). Each Lender shall notify Agent within such time period whether or not it agrees to increase its Commitment with respect to Loans and Letters of Credit and, if so, whether by an amount equal to, greater than, or less than its Pro Rata Share of such requested increase. Any Lender not responding within such time period shall be deemed to have declined to increase such Commitment. Agent shall notify Borrowers and each Lender of the Lenders’ responses to each request made hereunder. To achieve the full amount of the requested increase, Agent may or Borrowers may, with the prior consent of Agent, invite additional lending institutions that constitute Eligible Assignees to become Lenders pursuant to a joinder agreement in form and substance reasonably satisfactory to Agent and its counsel.

(b) If the Revolver Commitments are increased in accordance with this **Section 2.1.7**, Agent and Borrowers shall determine the effective date (the “**Increase Effective Date**”) and the final allocation of such increase. Agent shall promptly notify Borrowers and the Lenders of the final allocation of such increase and the Increase Effective Date. As a condition precedent to such increase, Borrowers shall (i) pay to Agent (A) for the account of the Lenders that are increasing their Commitments, a closing fee, which closing fee shall be computed on the increase in aggregate Commitments and shall be at least as many basis points as the closing fee payable to Agent for the account of the Lenders in connection with the closing of this Agreement, and (B) for Agent’s own account the fees and reasonable expenses of Agent incurred in connection with such increase; and (ii) deliver to Agent a certificate of each Obligor dated as of the Increase Effective Date signed by a Senior Officer or otherwise acceptable officer of such Obligor (A) certifying and attaching the resolutions adopted by such Obligor approving or consenting to such increase, and (B) in the case of Borrowers, certifying that, before and after giving effect to such increase, (I) the representations and warranties contained in **Section 9** and the other Loan Documents are true and correct in all material respects on and as of the Increase Effective Date, except to the extent that such representations and warranties specifically refer to an earlier date, in which case they are true and correct in all material respects as of such earlier date, and (II) no Default or Event of Default exists.

## **2.2 Term Loan Commitment.**

2.2.1 Term Loans. Each Lender agrees, severally on a Pro Rata basis up to its Term Loan Commitment, on the terms set forth herein, to make a Term Loan to Borrowers. The Term Loans shall be funded by Lenders on the Closing Date. The Term Loan Commitment of each Lender shall expire upon the funding by Lenders of the Term Loans. Once repaid, whether such repayment is voluntary or required, Term Loans may not be reborrowed.

2.2.2 Term Notes. The Term Loan made by each Lender and interest accruing thereon shall be evidenced by the records of Agent and such Lender. At the request of any Lender, Borrowers shall deliver a Term Note to such Lender.

## **2.3 Letter of Credit Facility.**

2.3.1 Issuance of Letters of Credit. Issuing Bank agrees to issue Letters of Credit from time to time until 30 days prior to the Revolver Termination Date (or until the Commitment Termination Date, if earlier), on the terms set forth herein, including the following:

(a) Each Borrower acknowledges that Issuing Bank's willingness to issue any Letter of Credit is conditioned upon Issuing Bank's receipt of a LC Application with respect to the requested Letter of Credit, as well as such other instruments and agreements as Issuing Bank may customarily require for issuance of a letter of credit of similar type and amount. Issuing Bank shall have no obligation to issue any Letter of Credit unless (i) Issuing Bank receives a LC Request and LC Application at least three Business Days prior to the requested date of issuance; and (ii) each LC Condition is satisfied. If Issuing Bank receives written notice from a Lender at least five Business Days before issuance of a Letter of Credit that any LC Condition has not been satisfied, Issuing Bank shall have no obligation to issue the requested Letter of Credit (or any other) until such notice is withdrawn in writing by that Lender or until Required Lenders have waived such condition in accordance with this Agreement. Prior to receipt of any such notice, Issuing Bank shall not be deemed to have knowledge of any failure of LC Conditions.

(b) Letters of Credit may be requested by a Borrower only (i) to support obligations of such Borrower incurred in the Ordinary Course of Business; or (ii) for other purposes as Agent may approve from time to time in writing. The renewal or extension of any Letter of Credit shall be treated as the issuance of a new Letter of Credit, except that delivery of a new LC Application shall be required at the discretion of Issuing Bank.

(c) Borrowers assume all risks of the acts, omissions or misuses of any Letter of Credit by the beneficiary. In connection with issuance of any Letter of Credit, none of Agent, Issuing Bank or any Lender shall be responsible for the existence, character, quality, quantity, condition, packing, value or delivery of any goods purported to be represented by any Documents; any differences or variation in the character, quality, quantity, condition, packing, value or delivery of any goods from that expressed in any Documents; the form, validity, sufficiency, accuracy, genuineness or legal effect of any Documents or of any endorsements thereon; the time, place, manner or order in which shipment of goods is made; partial or incomplete shipment of, or failure to ship, any goods referred to in a Letter of Credit or Documents; any deviation from instructions, delay, default or fraud by any shipper or other Person in connection with any goods, shipment or delivery; any breach of contract between a shipper or vendor and a Borrower; errors, omissions, interruptions or delays in transmission or delivery of any messages, by mail, cable, telegraph, telex, telecopy, e-mail, telephone or otherwise; errors in interpretation of technical terms; the misapplication by a beneficiary of any Letter of Credit or the proceeds thereof; or any consequences arising from causes beyond the control of Issuing Bank, Agent or any Lender, including any act or omission of a Governmental Authority. The rights and remedies of Issuing Bank under the Loan Documents shall be cumulative. Issuing Bank shall be fully subrogated to the rights and remedies of each beneficiary whose claims against Borrowers are discharged with proceeds of any Letter of Credit.

(d) In connection with its administration of and enforcement of rights or remedies under any Letters of Credit or LC Documents, Issuing Bank shall be entitled to act, and shall be fully protected in acting, upon any certification, documentation or communication in whatever form believed by Issuing Bank, in good faith, to be genuine and correct and to have been signed, sent or made by a proper Person. Issuing Bank may consult with and employ legal counsel, accountants and other experts to advise it concerning its obligations, rights and remedies, and shall be entitled to act upon, and shall be fully protected in any action taken in good faith reliance upon, any advice given by such experts. Issuing Bank may employ agents and attorneys-in-fact in connection with any matter relating to Letters of Credit or LC Documents, and shall not be liable for the negligence or misconduct of agents and attorneys-in-fact selected with reasonable care.

#### 2.3.2 Reimbursement; Participations.

(a) If Issuing Bank honors any request for payment under a Letter of Credit, Borrowers shall pay to Issuing Bank, on the same day ("Reimbursement Date"), the amount paid by Issuing Bank under such Letter of Credit, together with interest at the interest rate for Base Rate Revolver Loans from the Reimbursement Date until payment by Borrowers. The obligation of Borrowers to reimburse Issuing Bank for any payment made under a Letter of Credit shall be absolute, unconditional, irrevocable, and joint and several, and shall be paid without regard to any lack of validity or enforceability of any Letter of Credit or the existence of any claim, setoff, defense or other right that Borrowers may have at any time against the beneficiary. Whether or not Borrower Agent submits a Notice of Borrowing, Borrowers shall be deemed to have requested a Borrowing of Base Rate Revolver Loans in an amount necessary to pay all amounts due Issuing Bank on any Reimbursement Date and each Lender agrees to fund its Pro Rata share of such Borrowing whether or not the Commitments have terminated, an Overadvance exists or is created thereby, or the conditions in **Section 6.2** are satisfied.

(b) Upon issuance of a Letter of Credit, each Lender shall be deemed to have irrevocably and unconditionally purchased from Issuing Bank, without recourse or warranty, an undivided Pro Rata interest and participation in all LC Obligations relating to the Letter of Credit. If Issuing Bank makes any payment under a Letter of Credit and Borrowers do not reimburse such payment on the Reimbursement Date, Agent shall promptly notify Lenders and each Lender shall promptly (within one Business Day) and unconditionally pay to Agent, for the benefit of Issuing Bank, the Lender's Pro Rata share of such payment. Upon request by a Lender, Issuing Bank shall furnish copies of any Letters of Credit and LC Documents in its possession at such time.

(c) The obligation of each Lender to make payments to Agent for the account of Issuing Bank in connection with Issuing Bank's payment under a Letter of Credit shall be absolute, unconditional and irrevocable, not subject to any counterclaim, setoff, qualification or exception whatsoever, and shall be made in accordance with this Agreement under all circumstances, irrespective of any lack of validity or unenforceability of any Loan Documents; any draft, certificate or other document presented under a Letter of Credit having been determined to be forged, fraudulent, invalid or insufficient in any respect or any statement therein being untrue or inaccurate in any respect; or the existence of any setoff or defense that any Obligor may have with respect to any Obligations. Issuing Bank does not assume any responsibility for any failure or delay in performance or any breach by any Borrower or other Person of any obligations under any LC Documents. Issuing Bank does not make to Lenders any express or implied warranty, representation or guaranty with respect to the Collateral, LC Documents or any Obligor. Issuing Bank shall not be responsible to any Lender for any recitals, statements, information, representations or warranties contained in, or for the execution, validity, genuineness, effectiveness or

enforceability of any LC Documents; the validity, genuineness, enforceability, collectibility, value or sufficiency of any Collateral or the perfection of any Lien therein; or the assets, liabilities, financial condition, results of operations, business, creditworthiness or legal status of any Obligor.

(d) No Issuing Bank Indemnitee shall be liable to any Lender or other Person for any action taken or omitted to be taken in connection with any LC Documents except as a result of its actual gross negligence or willful misconduct. Issuing Bank shall not have any liability to any Lender if Issuing Bank refrains from any action under any Letter of Credit or LC Documents until it receives written instructions from Required Lenders.

2.3.3 Cash Collateral. If any LC Obligations, whether or not then due or payable, shall for any reason be outstanding at any time (a) that an Event of Default exists, (b) that Availability is less than zero, (c) after the Commitment Termination Date, or (d) within 10 Business Days prior to the Revolver Termination Date, then Borrowers shall, at Issuing Bank's or Agent's request, Cash Collateralize the stated amount of all outstanding Letters of Credit and pay to Issuing Bank the amount of all other LC Obligations. If Borrowers fail to provide Cash Collateral as required herein, Lenders may (and shall upon direction of Agent) advance, as Revolver Loans, the amount of the Cash Collateral required (whether or not the Commitments have terminated, an Overadvance exists or the conditions in **Section 6.2** are satisfied).

## SECTION 3. INTEREST, FEES AND CHARGES

### 3.1 Interest

#### 3.1.1 Rates and Payment of Interest.

(a) The Obligations shall bear interest (i) if a Base Rate Loan, at the Base Rate in effect from time to time, plus the Applicable Margin; (ii) if a LIBOR Loan, at LIBOR for the applicable Interest Period, plus the Applicable Margin; and (iii) if any other Obligation (including, to the extent permitted by law, interest not paid when due), at the Base Rate in effect from time to time, plus the Applicable Margin for Base Rate Revolver Loans. Interest shall accrue from the date the Loan is advanced or the Obligation is incurred or payable, until paid by Borrowers. If a Loan is repaid on the same day made, one day's interest shall accrue.

(b) During an Insolvency Proceeding with respect to any Borrower, or during any other Event of Default if Agent or Required Lenders in their discretion so elect, Obligations shall bear interest at the Default Rate (whether before or after any judgment). Each Borrower acknowledges that the cost and expense to Agent and Lenders due to an Event of Default are difficult to ascertain and that the Default Rate is a fair and reasonable estimate to compensate Agent and Lenders for this.

(c) Interest accrued on the Loans shall be due and payable in arrears, (i) on the first day of each month and, for any LIBOR Loan, the last day of its Interest Period; (ii) on any date of prepayment, with respect to the principal amount of Loans being prepaid; and (iii) on the Commitment Termination Date. Interest accrued on any other Obligations shall be due and payable as provided in the Loan Documents and, if no payment date is specified, shall be due and payable **on demand**. Notwithstanding the foregoing, interest accrued at the Default Rate shall be due and payable **on demand**.

#### 3.1.2 Application of LIBOR to Outstanding Loans.

(a) Borrowers may on any Business Day, subject to delivery of a Notice of Conversion/Continuation, elect to convert any portion of the Base Rate Loans to, or to continue any LIBOR Loan at the end of its Interest Period as, a LIBOR Loan. During any Default or Event of Default, Agent may (and shall at the direction of Required Lenders) declare that no Loan may be made, converted or continued as a LIBOR Loan.

(b) Whenever Borrowers desire to convert or continue Loans as LIBOR Loans, Borrower Agent shall give Agent a Notice of Conversion/Continuation, no later than 11:00 a.m. at least three Business Days before the requested conversion or continuation date. Promptly after receiving any such notice, Agent shall notify each Lender thereof. Each Notice of Conversion/Continuation shall be irrevocable, and shall specify the amount of Loans to be converted or continued, the conversion or continuation date (which shall be a Business Day), and the duration of the Interest Period (which shall be deemed to be one month if not specified). If, upon the expiration of any Interest Period in respect of any LIBOR Loans, Borrowers shall have failed to deliver a Notice of Conversion/Continuation, they shall be deemed to have elected to convert such Loans into Base Rate Loans.

3.1.3 Interest Periods. In connection with the making, conversion or continuation of any LIBOR Loans, Borrowers shall select an interest period ("Interest Period") to apply, which interest period shall be one, two, three or six months; provided, however, that:

(a) the Interest Period shall commence on the date the Loan is made or continued as, or converted into, a LIBOR Loan, and shall expire on the numerically corresponding day in the calendar month at its end;

(b) if any Interest Period commences on a day for which there is no corresponding day in the calendar month at its end or if such corresponding day falls after the last Business Day of such month, then the Interest Period shall expire on the last Business Day of such month; and if any Interest Period would expire on a day that is not a Business Day, the period shall expire on the next Business Day; and

(c) no Interest Period shall extend beyond the Revolver Termination Date; no six month Interest Period may be established for a LIBOR Term Loan; and no Interest Period for a LIBOR Term Loan may be established that would require repayment before the end of an Interest Period in order to make any scheduled principal payment on Term Loans.

3.1.4 Interest Rate Not Ascertainable. If Agent shall determine that on any date for determining LIBOR, due to any circumstance affecting the London interbank market, adequate and fair means do not exist for ascertaining such rate on the basis provided herein, then Agent shall immediately notify Borrowers of such determination. Until Agent notifies Borrowers that such circumstance no longer exists, the obligation of Lenders to make LIBOR Loans shall be suspended, and no further Loans may be converted into or continued as LIBOR Loans.

### **3.2 Fees**

3.2.1 Unused Line Fee. Borrowers shall pay to Agent, for the Pro Rata benefit of Lenders, a fee equal to 0.25% per annum times the amount by which the Revolver Commitments exceed the average daily balance of Revolver Loans and stated amount of Letters of Credit during any month. Such fee shall be payable in arrears, on the first day of each month and on the Commitment Termination Date.

3.2.2 LC Facility Fees. Borrowers shall pay (a) to Agent, for the Pro Rata benefit of Lenders, a fee equal to the Applicable Margin in effect for LIBOR Revolver Loans times the average daily stated amount of Letters of Credit, which fee shall be payable monthly in arrears, on the first day of

each month; (b) to Agent, for its own account, a fronting fee equal to 0.125% per annum on the stated amount of each Letter of Credit, which fee shall be payable monthly in arrears, on the first day of each month; and (c) to Issuing Bank, for its own account, all customary charges associated with the issuance, amending, negotiating, payment, processing, transfer and administration of Letters of Credit, which charges shall be paid as and when incurred. During an Event of Default, the fee payable under clause (a) shall be increased by 2% per annum.

3.2.3 Agent Fees. In consideration of Agent's syndication of the Commitments and service as Agent hereunder, Borrowers shall pay to Agent, for its own account, the fees described in the Fee Letter.

**3.3 Computation of Interest, Fees, Yield Protection.** All interest, as well as fees and other charges calculated on a per annum basis, shall be computed for the actual days elapsed, based on a year of 360 days. Each determination by Agent of any interest, fees or interest rate hereunder shall be final, conclusive and binding for all purposes, absent manifest error. All fees shall be fully earned when due and shall not be subject to rebate, refund or proration. All fees payable under **Section 3.2** are compensation for services and are not, and shall not be deemed to be, interest or any other charge for the use, forbearance or detention of money. A certificate as to amounts payable by Borrowers under **Section 3.4, 3.6, 3.7, 3.9 or 5.9**, submitted to Borrower Agent by Agent or the affected Lender, as applicable, shall be final, conclusive and binding for all purposes, absent manifest error, and Borrowers shall pay such amounts to the appropriate party within 10 days following receipt of the certificate.

**3.4 Reimbursement Obligations.** Borrowers shall reimburse Agent for all Extraordinary Expenses. Borrowers shall also reimburse Agent for all reasonable legal, accounting, appraisal, consulting, and other reasonable fees, costs and expenses incurred by it in connection with (a) negotiation and preparation of any Loan Documents, including any amendment or other modification thereof; (b) administration of and actions relating to any Collateral, Loan Documents and transactions contemplated thereby, including any actions taken to perfect or maintain priority of Agent's Liens on any Collateral, to maintain any insurance required hereunder or to verify Collateral; and (c) subject to the limits of **Section 10.1.1(b)**, each inspection, audit or appraisal with respect to any Obligor or Collateral, whether prepared by Agent's personnel or a third party. All legal, accounting and consulting fees shall be charged to Borrowers by Agent's professionals at their full hourly rates, regardless of any reduced or alternative fee billing arrangements that Agent, any Lender or any of their Affiliates may have with such professionals with respect to this or any other transaction. All amounts payable by Borrowers under this Section shall be due **on demand**.

**3.5 Illegality.** If any Lender determines that any Applicable Law has made it unlawful, or that any Governmental Authority has asserted that it is unlawful, for any Lender or its applicable Lending Office to make, maintain or fund LIBOR Loans, or to determine or charge interest rates based upon LIBOR, or any Governmental Authority has imposed material restrictions on the authority of such Lender to purchase or sell, or to take deposits of, Dollars in the London interbank market, then, on notice thereof by such Lender to Agent, any obligation of such Lender to make or continue LIBOR Loans or to convert Base Rate Loans to LIBOR Loans shall be suspended until such Lender notifies Agent that the circumstances giving rise to such determination no longer exist. Upon delivery of such notice, Borrowers shall prepay or, if applicable, convert all LIBOR Loans of such Lender to Base Rate Loans, either on the last day of the Interest Period therefor, if such Lender may lawfully continue to maintain such LIBOR Loans to such day, or immediately, if such Lender may not lawfully continue to maintain such LIBOR Loans. Upon any such prepayment or conversion, Borrowers shall also pay accrued interest on the amount so prepaid or converted.

**3.6 Inability to Determine Rates.** If Required Lenders notify Agent for any reason in connection with a request for a Borrowing of, or conversion to or continuation of, a LIBOR Loan that (a) Dollar deposits are not being offered to banks in the London interbank Eurodollar market for the applicable amount and Interest Period of such Loan, (b) adequate and reasonable means do not exist for determining LIBOR for the requested Interest Period, or (c) LIBOR for the requested Interest Period does not adequately and fairly reflect the cost to such Lenders of funding such Loan, then Agent will promptly so notify Borrower Agent and each Lender. Thereafter, the obligation of Lenders to make or maintain LIBOR Loans shall be suspended until Agent (upon instruction by Required Lenders) revokes such notice. Upon receipt of such notice, Borrower Agent may revoke any pending request for a Borrowing of, conversion to or continuation of a LIBOR Loan or, failing that, will be deemed to have submitted a request for a Base Rate Loan.

**3.7 Increased Costs; Capital Adequacy.**

3.7.1 Change in Law. If any Change in Law shall:

(a) impose modify or deem applicable any reserve, special deposit, compulsory loan, insurance charge or similar requirement against assets of, deposits with or for the account of, or credit extended or participated in by, any Lender (except any reserve requirement reflected in LIBOR) or Issuing Bank;

(b) subject any Lender or Issuing Bank to any Tax with respect to any Loan, Loan Document, Letter of Credit or participation in LC Obligations, or change the basis of taxation of payments to such Lender or Issuing Bank in respect thereof (except for Indemnified Taxes or Other Taxes covered by **Section 5.9** and the imposition of, or any change in the rate of, any Excluded Tax payable by such Lender or Issuing Bank); or

(c) impose on any Lender or Issuing Bank or the London interbank market any other condition, cost or expense affecting any Loan, Loan Document, Letter of Credit or participation in LC Obligations;

and the result thereof shall be to increase the cost to such Lender of making or maintaining any LIBOR Loan (or of maintaining its obligation to make any such Loan), or to increase the cost to such Lender or Issuing Bank of participating in, issuing or maintaining any Letter of Credit (or of maintaining its obligation to participate in or to issue any Letter of Credit), or to reduce the amount of any sum received or receivable by such Lender or Issuing Bank hereunder (whether of principal, interest or any other amount) then, upon request of such Lender or Issuing Bank, Borrowers will pay to such Lender or Issuing Bank, as applicable, such additional amount or amounts as will compensate such Lender or Issuing Bank, as applicable, for such additional costs incurred or reduction suffered.

**3.8 Capital Adequacy.** If any Lender or Issuing Bank determines that any Change in Law affecting such Lender or Issuing Bank or any Lending Office of such Lender or such Lender's or Issuing Bank's holding company, if any, regarding capital requirements has or would have the effect of reducing the rate of return on such Lender's, Issuing Bank's or holding company's capital as a consequence of this Agreement, or such Lender's or Issuing Bank's Commitments, Loans, Letters of Credit or participations in LC Obligations, to a level below that which such Lender, Issuing Bank or holding company could have achieved but for such Change in Law (taking into consideration such Lender's, Issuing Bank's and holding company's policies with respect to capital adequacy), then from time to time Borrowers will pay to such Lender or Issuing Bank, as the case may be, such additional amount or amounts as will compensate it or its holding company for any such reduction suffered.



**3.9 Compensation.** Failure or delay on the part of any Lender or Issuing Bank to demand compensation pursuant to this Section shall not constitute a waiver of its right to demand such compensation, but Borrowers shall not be required to compensate a Lender or Issuing Bank for any increased costs incurred or reductions suffered more than nine months prior to the date that the Lender or Issuing Bank notifies Borrower Agent of the Change in Law giving rise to such increased costs or reductions and of such Lender's or Issuing Bank's intention to claim compensation therefor (except that, if the Change in Law giving rise to such increased costs or reductions is retroactive, then the nine-month period referred to above shall be extended to include the period of retroactive effect thereof).

**3.10 Mitigation.** If any Lender gives a notice under **Section 3.5** or requests compensation under **Section 3.7**, or if Borrowers are required to pay additional amounts with respect to a Lender under **Section 5.9**, then such Lender shall use reasonable efforts to designate a different Lending Office or to assign its rights and obligations hereunder to another of its offices, branches or Affiliates, if, in the judgment of such Lender, such designation or assignment (a) would eliminate the need for such notice or reduce amounts payable in the future, as applicable; and (b) in each case, would not subject such Lender to any unreimbursed cost or expense and would not otherwise be disadvantageous to such Lender. Borrowers agree to pay all reasonable costs and expenses incurred by any Lender in connection with any such designation or assignment.

**3.11 Delay in Requests.** Failure or delay on the part of any Lender or the Issuing Bank to demand compensation pursuant to **Sections 3.4** or **3.9** shall not constitute a waiver of such Lender's or the Issuing Bank's right to demand such compensation, provided that Borrowers shall not be required to compensate a Lender or the Issuing Bank pursuant to this Section for any increased costs incurred or reductions occurring more than one hundred eighty (180) days prior to the date that such Lender or the Issuing Bank, as the case may be, obtains actual knowledge or notice of the event giving rise to such Lender's or Issuing Bank's claim for compensation therefor (except that, if the Change in Law giving rise to such increased costs or reductions is retroactive, then the one hundred eighty (180) day period referred to above shall be extended to include the period of retroactive effect thereof).

**3.12 Funding Losses.** If for any reason (other than default by a Lender) (a) any Borrowing of, or conversion to or continuation of, a LIBOR Loan does not occur on the date specified therefor in a Notice of Borrowing or Notice of Conversion/Continuation (whether or not withdrawn), (b) any repayment or conversion of a LIBOR Loan occurs on a day other than the end of its Interest Period, or (c) Borrowers fail to repay a LIBOR Loan when required hereunder, then Borrowers shall pay to Agent its customary administrative charge and to each Lender all losses and expenses that it sustains as a consequence thereof, including loss of anticipated profits and any loss or expense arising from liquidation or redeployment of funds or from fees payable to terminate deposits of matching funds. Lenders shall not be required to purchase Dollar deposits in the London interbank market or any other offshore Dollar market to fund any LIBOR Loan, but the provisions hereof shall be deemed to apply as if each Lender had purchased such deposits to fund its LIBOR Loans.

**3.13 Maximum Interest.** Notwithstanding anything to the contrary contained in any Loan Document, the interest paid or agreed to be paid under the Loan Documents shall not exceed the maximum rate of non-usurious interest permitted by Applicable Law ("maximum rate"). If Agent or any Lender shall receive interest in an amount that exceeds the maximum rate, the excess interest shall be applied to the principal of the Obligations or, if it exceeds such unpaid principal, refunded to Borrowers. In determining whether the interest contracted for, charged or received by Agent or a Lender exceeds the maximum rate, such Person may, to the extent permitted by Applicable Law, (a) characterize any payment that is not principal as an expense, fee or premium rather than interest; (b) exclude voluntary prepayments and the effects thereof; and (c) amortize, prorate, allocate and spread in equal or unequal parts the total amount of interest throughout the contemplated term of the Obligations hereunder.

## SECTION 4. LOAN ADMINISTRATION

### 4.1 Manner of Borrowing and Funding Revolver Loans.

#### 4.1.1 Notice of Borrowing.

(a) Whenever Borrowers desire funding of a Borrowing of Revolver Loans, Borrower Agent shall give Agent a Notice of Borrowing. Such notice must be received by Agent no later than 11:00 a.m. (i) on the Business Day of the requested funding date, in the case of Base Rate Loans, and (ii) at least three Business Days prior to the requested funding date, in the case of LIBOR Loans. Notices received after 11:00 a.m. shall be deemed received on the next Business Day. Each Notice of Borrowing shall be irrevocable and shall specify (A) the amount of the Borrowing, (B) the requested funding date (which must be a Business Day), (C) whether the Borrowing is to be made as Base Rate Loans or LIBOR Loans, and (D) in the case of LIBOR Loans, the duration of the applicable Interest Period (which shall be deemed to be one month if not specified).

(b) Unless payment is otherwise timely made by Borrowers, the becoming due of any Obligations (whether principal, interest, fees or other charges, including Extraordinary Expenses, LC Obligations, Cash Collateral and Bank Product Debt) shall be deemed to be a request for Base Rate Revolver Loans on the due date, in the amount of such Obligations. The proceeds of such Revolver Loans shall be disbursed as direct payment of the relevant Obligation. In addition, Agent may, at its option, charge such Obligations against any operating, investment or other account of a Borrower maintained with Agent or any of its Affiliates.

(c) If Borrowers establish a controlled disbursement account with Agent or any Affiliate of Agent, then the presentation for payment of any check or other item of payment drawn on such account at a time when there are insufficient funds to cover it shall be deemed to be a request for Base Rate Revolver Loans on the date of such presentation, in the amount of the check and items presented for payment. The proceeds of such Revolver Loans may be disbursed directly to the controlled disbursement account or other appropriate account.

4.1.2 Fundings by Lenders. Each Lender shall timely honor its Revolver Commitment by funding its Pro Rata share of each Borrowing of Revolver Loans that is properly requested hereunder. Except for Borrowings to be made as Swingline Loans, Agent shall endeavor to notify Lenders of each Notice of Borrowing (or deemed request for a Borrowing) by 12:00 noon on the proposed funding date for Base Rate Loans or by 3:00 p.m. at least two Business Days before any proposed funding of LIBOR Loans. Each Lender shall fund to Agent such Lender's Pro Rata share of the Borrowing to the account specified by Agent in immediately available funds not later than 2:00 p.m. on the requested funding date, unless Agent's notice is received after the times provided above, in which event Lender shall fund its Pro Rata share by 11:00 a.m. on the next Business Day. Subject to its receipt of such amounts from Lenders, Agent shall disburse the proceeds of the Revolver Loans as directed by Borrower Agent. Unless Agent shall have received (in sufficient time to act) written notice from a Lender that it does not intend to fund its Pro Rata share of a Borrowing, Agent may assume that such Lender has deposited or promptly will deposit its share with Agent, and Agent may disburse a corresponding amount to Borrowers. If a Lender's share of any Borrowing is not in fact received by Agent, then Borrowers agree to repay to Agent **on demand** the amount of such share, together with interest thereon from the date disbursed until repaid, at the rate applicable to such Borrowing.

#### **4.1.3 Swingline Loans; Settlement.**

(a) In determining whether to make Revolver Loans as Swingline Loans or to require funding by each Lender on the date of such Revolver Loans, Agent may, but shall not be obligated to, advance Swingline Loans to Borrowers, up to an aggregate outstanding amount of \$15,000,000, unless the funding is specifically required to be made by all Lenders hereunder. Each Swingline Loan shall constitute a Revolver Loan for all purposes, except that payments thereon shall be made to Agent for its own account. The obligation of Borrowers to repay Swingline Loans shall be evidenced by the records of Agent and need not be evidenced by any promissory note.

(b) To facilitate administration of the Revolver Loans, Lenders and Agent agree (which agreement is solely among them, and not for the benefit of or enforceable by any Borrower) that settlement among them with respect to Swingline Loans and other Revolver Loans may take place periodically on a date determined from time to time by Agent, which shall occur at least once each week. On each settlement date, settlement shall be made with each Lender in accordance with the Settlement Report delivered by Agent to Lenders. Between settlement dates, Agent may in its discretion apply payments on Revolver Loans to Swingline Loans, regardless of any designation by Borrower or any provision herein to the contrary. Each Lender's obligation to make settlements with Agent is absolute and unconditional, without offset, counterclaim or other defense, and whether or not the Commitments have terminated, an Overadvance exists or the conditions in **Section 6** are satisfied. If, due to an Insolvency Proceeding with respect to a Borrower or otherwise, any Swingline Loan may not be settled among Lenders hereunder, then each Lender shall be deemed to have purchased from Agent a Pro Rata participation in each unpaid Swingline Loan and shall transfer the amount of such participation to Agent, in immediately available funds, within one Business Day after Agent's request therefor.

**4.2 Notices.** Each Borrower authorizes Agent and Lenders to extend, convert or continue Loans, effect selections of interest rates, and transfer funds to or on behalf of Borrowers based on telephonic or e-mailed instructions. Borrowers shall confirm each such request by prompt delivery to Agent of a Notice of Borrowing or Notice of Conversion/Continuation, if applicable, but if it differs in any material respect from the action taken by Agent or Lenders, the records of Agent and Lenders shall govern. Neither Agent nor any Lender shall have any liability for any loss suffered by a Borrower as a result of Agent or any Lender acting upon its understanding of telephonic or e-mailed instructions from a person believed in good faith by Agent or any Lender to be a person authorized to give such instructions on a Borrower's behalf, except to the extent that such loss is as a result of gross negligence or willful misconduct of Agent or such Lender.

**4.3 Defaulting Lender.** If a Lender fails to make any payment to Agent that is required hereunder, Agent may (but shall not be required to), in its discretion, retain payments that would otherwise be made to such defaulting Lender hereunder, apply the payments to such Lender's defaulted obligations or readvance the funds to Borrowers in accordance with this Agreement. The failure of any Lender to fund a Loan or to make a payment in respect of a LC Obligation shall not relieve any other Lender of its obligations hereunder, and no Lender shall be responsible for default by another Lender. Lenders and Agent agree (which agreement is solely among them, and not for the benefit of or enforceable by any Borrower) that, solely for purposes of determining a defaulting Lender's right to vote on matters relating to the Loan Documents and to share in payments, fees and Collateral proceeds thereunder, a defaulting Lender shall not be deemed to be a "Lender" until all its defaulted obligations have been cured.

**4.4 Number and Amount of LIBOR Loans; Determination of Rate.** For ease of administration, all LIBOR Revolver Loans and all LIBOR Term Loans having the same length and beginning date of their Interest Periods shall be aggregated together, and such Borrowings shall be

allocated among Lenders on a Pro Rata basis. No more than eight (8) Borrowings of LIBOR Loans may be outstanding at any time, and each Borrowing of LIBOR Loans when made shall be in a minimum amount of \$2,500,000, or an increment of \$1,000,000 in excess thereof. Upon determining LIBOR for any Interest Period requested by Borrowers, Agent shall promptly notify Borrowers thereof by telephone or electronically and, if requested by Borrowers, shall confirm any telephonic notice in writing.

**4.5 Borrower Agent.** Each Borrower hereby designates US Borrower ("Borrower Agent") as its representative and agent for all purposes under the Loan Documents, including requests for Loans and Letters of Credit, designation of interest rates, delivery or receipt of communications, preparation and delivery of Borrowing Base and financial reports, receipt and payment of Obligations, requests for waivers, amendments or other accommodations, actions under the Loan Documents (including in respect of compliance with covenants), and all other dealings with Agent, Issuing Bank or any Lender. Borrower Agent hereby accepts such appointment. Agent and Lenders shall be entitled to rely upon, and shall be fully protected in relying upon, any notice or communication (including any notice of borrowing) delivered by Borrower Agent on behalf of any Borrower. Agent and Lenders may give any notice or communication with a Borrower hereunder to Borrower Agent on behalf of such Borrower. Each of Agent, Issuing Bank and Lenders shall have the right, in its discretion, to deal exclusively with Borrower Agent for any or all purposes under the Loan Documents. Each Borrower agrees that any notice, election, communication, representation, agreement or undertaking made on its behalf by Borrower Agent shall be binding upon and enforceable against it.

**4.6 One Obligation.** The Loans, LC Obligations and other Obligations shall constitute one general obligation of Borrowers and (unless otherwise expressly provided in any Loan Document) shall be secured by Agent's Lien upon all Collateral; provided, however, that Agent and each Lender shall be deemed to be a creditor of, and the holder of a separate claim against, each Borrower to the extent of any Obligations jointly or severally owed by such Borrower.

**4.7 Effect of Termination.** On the effective date of any termination of the Commitments, all Obligations shall be immediately due and payable (other than indemnity claims that are unasserted and not reasonably likely to be asserted), and any Lender may terminate its and its Affiliates' Bank Products (including, only with the consent of Agent, any Cash Management Services). All undertakings of Borrowers contained in the Loan Documents shall survive any termination, and Agent shall retain its Liens in the Collateral and all of its rights and remedies under the Loan Documents, in each case until Full Payment of the Obligations. Notwithstanding Full Payment of the Obligations, Agent shall not be required to terminate its Liens in any Collateral unless, with respect to any damages Agent may incur as a result of the dishonor or return of Payment Items applied to Obligations, Agent receives (a) a written agreement, executed by Borrowers and any Person whose advances are used in whole or in part to satisfy the Obligations, indemnifying Agent and Lenders from any such damages; or (b) such Cash Collateral as Agent, in its discretion, deems necessary to protect against any such damages. The provisions of **Sections 2.3, 3.4, 3.6, 3.7, 3.9, 5.5, 5.9, 12, 14.2** and this Section, and the obligation of each Obligor and Lender with respect to each indemnity given by it in any Loan Document, shall survive Full Payment of the Obligations and any release relating to this credit facility.

## **SECTION 5. PAYMENTS**

**5.1 General Payment Provisions.** All payments of Obligations shall be made in Dollars, without offset, counterclaim or defense of any kind, free of (and without deduction for) any Taxes, and in immediately available funds, not later than 12:00 noon on the due date. Any payment after such time shall be deemed made on the next Business Day. If any payment under the Loan Documents shall be stated to be due on a day other than a Business Day, the due date shall be extended to the next Business Day and such extension of time shall be included in any computation of interest and fees. Any payment

of a LIBOR Loan prior to the end of its Interest Period shall be accompanied by all amounts due under **Section 3.9**. Any prepayment of Loans shall be applied first to Base Rate Loans and then to LIBOR Loans; provided, however, that as long as no Event of Default exists, prepayments of LIBOR Loans may, at the option of Borrowers and Agent, be held by Agent as Cash Collateral and applied to such Loans at the end of their Interest Periods.

**5.2 Repayment of Revolver Loans.** Revolver Loans shall be due and payable in full on the Revolver Termination Date, unless payment is sooner required hereunder. Revolver Loans may be prepaid from time to time, without penalty or premium. If any Asset Disposition includes the disposition of Accounts or Inventory, then Net Proceeds equal to the greater of (a) the net book value of such Accounts and Inventory, or (b) the reduction in the Borrowing Base upon giving effect to such disposition, shall be applied to the Revolver Loans (without commitment reduction). Notwithstanding anything herein to the contrary, if an Overadvance exists, Borrowers shall, on the sooner of Agent's demand or the first Business Day after any Borrower has knowledge thereof, repay the outstanding Revolver Loans in an amount sufficient to reduce the principal balance of Revolver Loans to the Borrowing Base.

**5.3 Repayment of Term Loans.**

5.3.1 Payment of Principal. The principal amount of the Term Loans shall be repaid on the first Business Day of each month in consecutive monthly installments of \$513,889, commencing on February 1, 2008 and continuing until the Term Loan Maturity Date, on which date all principal, interest and other amounts owing with respect to the Term Loans shall be due and payable in full. Each installment shall be paid to Agent for the Pro Rata benefit of Term Loan Lenders. Once repaid, whether such repayment is voluntary or required, Term Loans may not be reborrowed.

5.3.2 Mandatory Prepayments.

(a) Concurrently with any issuance of Equity Interests (other than equity received in connection with the LandAmerica Acquisition) by a Borrower, Borrowers shall prepay Term Loans in an amount equal to the net proceeds of such issuance; and

(b) On the Commitment Termination Date, Borrowers shall prepay all Term Loans (unless sooner repaid hereunder).

5.3.3 Optional Prepayments. Borrowers may, at their option from time to time, prepay the Term Loans, which prepayment must be at least \$2,000,000, plus any increment of \$1,000,000 in excess thereof. Borrowers shall give written notice to Agent of an intended prepayment of Term Loans, which notice shall specify the amount of the prepayment, shall be given at least 10 Business Days prior to such repayment.

5.3.4 Interest; Application of Prepayments. Each prepayment of Term Loans shall be accompanied by all interest accrued thereon and any amounts payable under **Section 3.9**, and shall be applied to principal in inverse order of maturity.

**5.4 Payment of Other Obligations.** Obligations other than Loans, including LC Obligations and Extraordinary Expenses, shall be paid by Borrowers as provided in the Loan Documents or, if no payment date is specified, **on demand**.

**5.5 Marshaling; Payments Set Aside.** None of Agent or Lenders shall be under any obligation to marshal any assets in favor of any Obligor or against any Obligations. If any payment by or on behalf of Borrowers is made to Agent, Issuing Bank or any Lender, or Agent, Issuing Bank or any Lender exercises a right of setoff, and such payment or the proceeds of such setoff or any part thereof is subsequently invalidated, declared to be fraudulent or preferential, set aside or required (including pursuant to any settlement entered into by Agent, Issuing Bank or such Lender in its discretion) to be repaid to a trustee, receiver or any other Person, then to the extent of such recovery, the Obligation originally intended to be satisfied, and all Liens, rights and remedies relating thereto, shall be revived and continued in full force and effect as if such payment had not been made or such setoff had not occurred.

**5.6 Post-Default Allocation of Payments.**

5.6.1 Allocation. Notwithstanding anything herein to the contrary, during an Event of Default, monies to be applied to the Obligations, whether arising from payments by Obligors, realization on Collateral, setoff or otherwise, shall be allocated as follows:

- (a) first, to all Obligations constituting costs and expenses, including Extraordinary Expenses, owing to Agent;
- (b) second, to all amounts owing to Agent on Swingline Loans;
- (c) third, to all amounts owing to Issuing Bank on LC Obligations;
- (d) fourth, to all Obligations constituting fees then due and payable (excluding amounts relating to Bank Products);
- (e) fifth, to all Obligations constituting interest (excluding amounts relating to Bank Products);
- (f) sixth, to provide Cash Collateral for outstanding Letters of Credit;
- (g) seventh, to all other Obligations, other than Bank Product Debt; and
- (h) last, to Bank Product Debt.

Amounts shall be applied to each category of Obligations set forth above until Full Payment thereof and then to the next category. If amounts are insufficient to satisfy a category, they shall be applied on a pro rata basis among the Obligations in the category. Amounts distributed with respect to any Bank Product Debt relating to Cash Management Services provided by a Lender (or its Affiliates) other than Bank of America shall be the lesser of the applicable Bank Product Amount last reported to Agent or the actual Bank Product Debt as calculated by the methodology reported to Agent for determining the amount due. Agent shall have no obligation to calculate the amount to be distributed with respect to any Bank Product Debt, but may rely upon written notice of the amount (setting forth a reasonably detailed calculation) from the Secured Party. In the absence of such notice, Agent may assume the amount to be distributed is the Bank Product Amount last reported to it. The allocations set forth in this Section are solely to determine the rights and priorities of Agent and Lenders as among themselves, and may be changed by agreement among them without the consent of any Obligor. This Section is not for the benefit of or enforceable by any Borrower.

5.6.2 Erroneous Application. Agent shall not be liable for any application of amounts made by it in good faith and, if any such application is subsequently determined to have been made in error, the sole recourse of any Lender or other Person to which such amount should have been made shall be to recover the amount from the Person that actually received it (and, if such amount was received by any Lender, such Lender hereby agrees to return it).

**5.7 Application of Payments.** The ledger balance in the main Dominion Account of US Borrower as of the end of a Business Day shall be applied to the Obligations at the beginning of the next Business Day, during any Trigger Period. If, as a result of such application, a credit balance exists, the balance shall not accrue interest in favor of Borrowers and shall be made available to Borrowers as long as no Default or Event of Default exists. As long as no Default or Event of Default exists, Borrower Agent may direct the application of payments received by Agent to the Obligations; provided, however, that Agent shall retain the right to apply and reapply such payments against Obligations then due and owing or in a manner as Agent deems reasonably advisable, notwithstanding any entry by Agent in its records.

**5.8 Loan Account; Account Stated.**

5.8.1 Loan Account. Agent shall maintain in accordance with its usual and customary practices an account or accounts ("Loan Account") evidencing the Debt of Borrowers resulting from each Loan or issuance of a Letter of Credit from time to time. Any failure of Agent to record anything in the Loan Account, or any error in doing so, shall not limit or otherwise affect the obligation of Borrowers to pay any amount owing hereunder. Agent may maintain a single Loan Account in the name of Borrower Agent, and each Borrower confirms that such arrangement shall have no effect on the joint and several character of its liability for the Obligations.

5.8.2 Entries Binding. Entries made in the Loan Account shall constitute presumptive evidence of the information contained therein absent manifest error. If any information contained in the Loan Account is provided to or inspected by any Person, then such information shall be conclusive and binding on such Person for all purposes absent manifest error, except to the extent such Person notifies Agent in writing within 45 days after receipt or inspection that specific information is subject to dispute.

**5.9 Taxes.**

5.9.1 Payments Free of Taxes.

(a) Any and all payments by any Obligor on account of any Obligations shall be made free and clear of and without reduction or withholding for any Indemnified Taxes or Other Taxes, provided that if an Obligor shall be required by Applicable Law to deduct any Indemnified Taxes (including any Other Taxes) from such payments, then (i) the sum payable shall be increased as necessary so that after making all required deductions (including deductions applicable to additional sums payable under this Section) Agent, Lender or Issuing Bank, as the case may be, receives an amount equal to the sum it would have received had no such deductions been made; (ii) the Obligor shall make such deductions; and (iii) Borrowers shall timely pay the full amount deducted to the relevant Governmental Authority in accordance with Applicable Law. Without limiting the foregoing, Borrowers shall timely pay all Other Taxes to the relevant Governmental Authorities.

(b) If a Tax Deduction is required by law to be made by a Borrower in respect of any interest payable by it under this Agreement and if the clause above is unenforceable for any reason in respect of such Borrower the applicable interest rate in relation to that interest payment shall be (i) the interest rate which would have been applied to that interest payment (as provided for in the absence of this clause), (ii) divided by one (1) minus the minimum permissible rate at which the relevant Tax Deduction is required to be made in view of domestic tax law or applicable Treaties (where the rate at which the relevant Tax Deduction is required to be made is, for this purpose, expressed as a fraction of one (1)).

(c) A Treaty Lender and each Obligor which makes a payment to which that Treaty Lender is entitled shall co-operate in completing any procedural formalities necessary for that Obligor to obtain authorization to make that payment without a Tax Deduction. An Obligor is not required to make an increased payment in respect of tax imposed in Switzerland from a payment of interest on a Loan, if on the date on which the payment falls due:

(i) the payment could have been made to the Agent, the relevant Lender or the Issuing Bank, as the case might be, without a Tax Deduction if it was a Qualifying Beneficiary, but on that date that Lender is not or has ceased to be a Qualifying Beneficiary other than as a result of any change after the date it became a lender under this Agreement in (or in the interpretation, administration, or application of) any law or Treaty, or any published practice or concession of any relevant taxing authority; or

(ii) the relevant Lender is a Treaty Lender and the Obligor making the payment is able to demonstrate that the payment could have been made to the Lender without Tax Deduction had that Lender complied with its obligation to co-operate in completing any procedural formalities necessary to obtain authorization to make that payment without a Tax Deduction.

5.9.2 Payment. Borrowers shall indemnify, hold harmless and reimburse Agent, Lenders and Issuing Bank, within 10 days after demand therefor, for the full amount of any Indemnified Taxes or Other Taxes (including Indemnified Taxes or Other Taxes imposed or asserted on or attributable to amounts payable under this Section) paid by Agent, any Lender or Issuing Bank with respect to any Obligations, Letters of Credit or Loan Documents, and any penalties, interest and reasonable expenses arising therefrom or with respect thereto, whether or not such Indemnified Taxes or Other Taxes were correctly or legally imposed or asserted by the relevant Governmental Authority. A certificate as to the amount of such payment or liability delivered to Borrower Agent by a Lender or Issuing Bank (with a copy to Agent), or by Agent, shall be conclusive absent manifest error. As soon as practicable after any payment of Indemnified Taxes or Other Taxes by a Borrower, Borrower Agent shall deliver to Agent a receipt issued by the Governmental Authority evidencing such payment or other evidence of payment satisfactory to Agent; provided, however that if a Borrower reasonably believes that such Taxes were not correctly or legally asserted, the Applicable Agent Lender, or Issuing Bank, as the case may be, will use reasonable efforts at Borrowers' cost to cooperate with such Borrower to obtain a refund of such Taxes so long as such efforts would not, in the sole determination of the Applicable Agent, Lender, or Issuing Bank, result in any non-reimbursable additional costs, expenses or risks or be otherwise disadvantageous to the Applicable Agent, Lender, or Issuing Bank. If the Applicable Agent, Lender, or Issuing Bank determines that it has received a refund, credit, or other reduction of taxes in respect of any Taxes paid by Borrower pursuant to this Section 5.9.2, such Person shall within 30 days from the date of actual receipt of such refund or the filing of the tax return in which such credit or other reduction results in a lower tax payment, pay over such refund or the amount of such tax reduction to the Borrower (but only to the extent of Taxes paid by Borrower pursuant to this Section 5.9.2), net of all out-of-pocket expenses of such Person, and without interest (other than interest paid by the relevant Governmental Authority with respect to such refund).



## **5.10 Foreign Lenders.**

5.10.1 Exemption. Any Foreign Lender that is entitled to an exemption from or reduction of withholding tax under the law of the jurisdiction in which an Obligor is resident for tax purposes, or any treaty to which such jurisdiction is a party, with respect to payments under any Loan Document shall deliver to Agent and Borrower Agent, at the time or times prescribed by Applicable Law or reasonably requested by Agent or Borrower Agent, such properly completed and executed documentation prescribed by Applicable Law as will permit such payments to be made without withholding or at a reduced rate of withholding. In addition, any Lender, if requested by Agent or Borrower Agent, shall deliver such other documentation prescribed by Applicable Law or reasonably requested by Agent or Borrower Agent as will enable Agent and Borrower Agent to determine whether or not such Lender is subject to backup withholding or information reporting requirements.

5.10.2 Documentation. Without limiting the generality of the foregoing, if a Borrower is resident for tax purposes in the United States, a Foreign Lender shall deliver to Agent and Borrower Agent (in such number of copies as shall be requested by the recipient) on or prior to the date on which such Foreign Lender becomes a Lender hereunder (and from time to time thereafter upon the request of Agent or Borrower Agent, but only if such Foreign Lender is legally entitled to do so), (a) duly completed copies of IRS Form W-8BEN claiming eligibility for benefits of an income tax treaty to which the United States is a party; (b) duly completed copies of IRS Form W-8ECI; (c) in the case of a Foreign Lender claiming the benefits of the exemption for portfolio interest under section 881(c) of the Code, (i) a certificate to the effect that such Foreign Lender is not (A) a “bank” within the meaning of section 881(c)(3)(A) of the Code, (B) a “10 percent shareholder” of any Obligor within the meaning of section 881(c)(3)(B) of the Code, or (C) a “controlled foreign corporation” described in section 881(c)(3)(C) of the Code, and (ii) duly completed copies of IRS Form W-8BEN; or (d) any other form prescribed by Applicable Law as a basis for claiming exemption from or a reduction in United States federal withholding tax, duly completed together with such supplementary documentation as may be prescribed by Applicable Law to permit Borrowers to determine the withholding or deduction required to be made.

## **5.11 Nature and Extent of Each Borrower’s Liability.**

5.11.1 Joint and Several Liability. Each Borrower agrees that it is jointly and severally liable for, and absolutely and unconditionally guarantees to Agent and Lenders the prompt payment and performance of, all Obligations and all agreements under the Loan Documents. Each Borrower agrees that its guaranty obligations hereunder constitute a continuing guaranty of payment and not of collection, that such obligations shall not be discharged until Full Payment of the Obligations, and that such obligations are absolute and unconditional, irrespective of (a) the genuineness, validity, regularity, enforceability, subordination or any future modification of, or change in, any Obligations or Loan Document, or any other document, instrument or agreement to which any Obligor is or may become a party or be bound; (b) the absence of any action to enforce this Agreement (including this Section) or any other Loan Document, or any waiver, consent or indulgence of any kind by Agent or any Lender with respect thereto; (c) the existence, value or condition of, or failure to perfect a Lien or to preserve rights against, any security or guaranty for the Obligations or any action, or the absence of any action, by Agent or any Lender in respect thereof (including the release of any security or guaranty); (d) the insolvency of any Obligor; (e) any election by Agent or any Lender in an Insolvency Proceeding for the application of Section 1111(b)(2) of the Bankruptcy Code; (f) any borrowing or grant of a Lien by any other Borrower, as debtor-in-possession under Section 364 of the Bankruptcy Code or otherwise; (g) the disallowance of any claims of Agent or any Lender against any Obligor for the repayment of any Obligations under Section 502 of the Bankruptcy Code or otherwise; or (h) any other action or circumstances that might otherwise constitute a legal or equitable discharge or defense of a surety or guarantor, except Full Payment of all Obligations.

#### 5.11.2 Waivers.

(a) Each Borrower expressly waives all rights that it may have now or in the future under any statute, at common law, in equity or otherwise, to compel Agent or Lenders to marshal assets or to proceed against any Obligor, other Person or security for the payment or performance of any Obligations before, or as a condition to, proceeding against such Borrower. Each Borrower waives all defenses available to a surety, guarantor or accommodation co-obligor other than Full Payment of all Obligations. It is agreed among each Borrower, Agent and Lenders that the provisions of this **Section 5.11** are of the essence of the transaction contemplated by the Loan Documents and that, but for such provisions, Agent and Lenders would decline to make Loans and issue Letters of Credit. Each Borrower acknowledges that its guaranty pursuant to this Section is necessary to the conduct and promotion of its business, and can be expected to benefit such business.

(b) Agent and Lenders may, in their discretion, pursue such rights and remedies as they deem appropriate, including realization upon Collateral or any Real Estate by judicial foreclosure or non-judicial sale or enforcement, without affecting any rights and remedies under this **Section 5.11**. If, in taking any action in connection with the exercise of any rights or remedies, Agent or any Lender shall forfeit any other rights or remedies, including the right to enter a deficiency judgment against any Borrower or other Person, whether because of any Applicable Laws pertaining to “election of remedies” or otherwise, each Borrower consents to such action and waives any claim based upon it, even if the action may result in loss of any rights of subrogation that any Borrower might otherwise have had. Any election of remedies that results in denial or impairment of the right of Agent or any Lender to seek a deficiency judgment against any Borrower shall not impair any other Borrower’s obligation to pay the full amount of the Obligations. Each Borrower waives all rights and defenses arising out of an election of remedies, such as nonjudicial foreclosure with respect to any security for the Obligations, even though that election of remedies destroys such Borrower’s rights of subrogation against any other Person. Agent may bid all or a portion of the Obligations at any foreclosure or trustee’s sale or at any private sale, and the amount of such bid need not be paid by Agent but shall be credited against the Obligations. The amount of the successful bid at any such sale, whether Agent or any other Person is the successful bidder, shall be conclusively deemed to be the fair market value of the Collateral, and the difference between such bid amount and the remaining balance of the Obligations shall be conclusively deemed to be the amount of the Obligations guaranteed under this **Section 5.11**, notwithstanding that any present or future law or court decision may have the effect of reducing the amount of any deficiency claim to which Agent or any Lender might otherwise be entitled but for such bidding at any such sale.

#### 5.11.3 Extent of Liability; Contribution.

(a) Notwithstanding anything herein to the contrary, each Borrower’s liability under this **Section 5.11** shall be limited to the greater of (i) all amounts for which such Borrower is primarily liable, as described below, and (ii) such Borrower’s Allocable Amount.

(b) If any Borrower makes a payment under this **Section 5.11** of any Obligations (other than amounts for which such Borrower is primarily liable) (a “Guarantor Payment”) that, taking into account all other Guarantor Payments previously or concurrently made by any other Borrower, exceeds the amount that such Borrower would otherwise have paid if each Borrower had paid the aggregate Obligations satisfied by such Guarantor Payments in the same proportion that such Borrower’s Allocable Amount bore to the total Allocable Amounts of all Borrowers, then such Borrower shall be entitled to receive contribution and indemnification payments from, and to be reimbursed by, each other Borrower for the amount of such excess, pro rata based upon their respective Allocable Amounts in effect immediately prior to such Guarantor Payment. The “Allocable Amount” for any Borrower shall be the maximum amount that could then be recovered from such Borrower under this **Section 5.11** without rendering such payment voidable under Section 548 of the Bankruptcy Code or under any applicable state fraudulent transfer or conveyance act, or similar statute or common law.

(c) Nothing contained in this **Section 5.11** shall limit the liability of any Borrower to pay Loans made directly or indirectly to that Borrower (including Loans advanced to any other Borrower and then re-loaned or otherwise transferred to, or for the benefit of, such Borrower), LC Obligations relating to Letters of Credit issued to support such Borrower's business, and all accrued interest, fees, expenses and other related Obligations with respect thereto, for which such Borrower shall be primarily liable for all purposes hereunder. Agent and Lenders shall have the right, at any time in their discretion, to condition Loans and Letters of Credit upon a separate calculation of borrowing availability for each Borrower and to restrict the disbursement and use of such Loans and Letters of Credit to such Borrower.

5.11.4 Joint Enterprise. Each Borrower has requested that Agent and Lenders make this credit facility available to Borrowers on a combined basis, in order to finance Borrowers' business most efficiently and economically. Borrowers' business is a mutual and collective enterprise, and Borrowers believe that consolidation of their credit facility will enhance the borrowing power of each Borrower and ease the administration of their relationship with Lenders, all to the mutual advantage of Borrowers. Borrowers acknowledge and agree that Agent's and Lenders' willingness to extend credit to Borrowers and to administer the Collateral on a combined basis, as set forth herein, is done solely as an accommodation to Borrowers and at Borrowers' request.

5.11.5 Subordination. Each Borrower hereby subordinates any claims, including any rights at law or in equity to payment, subrogation, reimbursement, exoneration, contribution, indemnification or set off, that it may have at any time against any other Obligor, howsoever arising, to the Full Payment of all Obligations.

## **SECTION 6. CONDITIONS PRECEDENT**

**6.1 Conditions Precedent to Initial Loans.** In addition to the conditions set forth in **Section 6.2**, Lenders shall not be required to fund any requested Loan, issue any Letter of Credit, or otherwise extend credit to Borrowers hereunder, until the date ("Closing Date") that each of the following conditions has been satisfied or waived by Agent in its discretion:

(a) Notes shall have been executed by Borrowers and delivered to each Lender that requests issuance of a Note. Each other Loan Document shall have been duly executed and delivered to Agent by each of the signatories thereto, and each Obligor shall be in compliance with all terms thereof.

(b) Agent shall have received acknowledgments of all filings or recordings reasonably necessary to perfect its Liens in the Collateral, as well as UCC and Lien searches and other evidence reasonably satisfactory to Agent that such Liens are the only Liens upon the Collateral, except Permitted Liens.

(c) Agent shall have received the Related Real Estate Documents for all Real Estate subject to a Mortgage; provided that no surveys shall be required with respect to the properties located in Virginia that are subject to Mortgages on the Closing Date.

(d) Agent shall have received duly executed agreements establishing Agent's control over, and springing dominion with respect to, the Dominion Accounts (and related lockboxes, if any) of Borrowers with US Bank and Wells Fargo Bank, N.A., and shall have received an assignment of deposit accounts acknowledged by UBS with respect to the Dominion Account (and related lockbox, if any) of Swiss Borrower at UBS, each in form and substance reasonably satisfactory to Agent.

(e) Agent shall have received certificates, in form and substance reasonably satisfactory to it, from a knowledgeable Senior Officer of each Borrower certifying that, after giving effect to the initial Loans and transactions hereunder, (i) US Borrower is Solvent, Swiss Borrower is Solvent after taking into account its rights of contribution and the Obligors taken as a whole are Solvent; (ii) no Default or Event of Default exists; and (iii) the representations and warranties set forth in **Section 9** are true and correct.

(f) Agent shall have received a certificate of a duly authorized officer of each Obligor, certifying (i) that attached copies of such Obligor's Organic Documents are true and complete, and in full force and effect, without amendment except as shown; (ii) that an attached copy of resolutions authorizing execution and delivery of the Loan Documents is true and complete, and that such resolutions are in full force and effect, were duly adopted, have not been amended, modified or revoked, and constitute all resolutions adopted with respect to this credit facility; and (iii) to the title, name and signature of each Person authorized to sign the Loan Documents. Agent may conclusively rely on this certificate until it is otherwise notified by the applicable Obligor in writing.

(g) Agent shall have received a written opinion of Kirkland & Ellis LLP, as well as any local counsel to Borrowers or Agent, in form and substance reasonably satisfactory to Agent.

(h) Agent shall have received copies of the charter documents of each Obligor, certified by the Secretary of State or other appropriate official of such Obligor's jurisdiction of organization (if applicable). Agent shall have received good standing certificates for each Obligor, issued by the Secretary of State or other appropriate official of such Obligor's jurisdiction of organization (if applicable) and each jurisdiction where such Obligor's conduct of business or ownership of Property necessitates qualification.

(i) Agent shall have received copies of policies or certificates of insurance for the insurance policies carried by Borrowers, all in compliance with the Loan Documents.

(j) Agent shall have completed its business, financial and legal due diligence of Obligors, with results satisfactory to Agent. No Material Adverse Effect shall have occurred since August 31, 2007.

(k) Borrowers shall have paid all fees and expenses to be paid to Agent and Lenders on the Closing Date.

(l) Agent shall have received a Borrowing Base Certificate prepared as of December 31, 2007 and a roll-forward of gross balances comprising the Borrowing Base in form and substance satisfactory to Agent prepared as of the end of the most recently ended-week prior to the Closing Date. Upon giving effect to the initial funding of Loans and issuance of Letters of Credit, and the payment by Borrowers of all fees and expenses incurred in connection herewith, Availability shall be at least \$8,000,000.

**6.2 Conditions Precedent to All Credit Extensions.** Agent, Issuing Bank and Lenders shall not be required to fund any Loans, arrange for issuance of any Letters of Credit or grant any other accommodation to or for the benefit of Borrowers, unless the following conditions are satisfied:

(a) No Default or Event of Default shall exist at the time of, or result from, such funding, issuance or grant;

(b) The representations and warranties of each Obligor in the Loan Documents shall be true and correct on the date of, and upon giving effect to, such funding, issuance or grant (except for representations and warranties that expressly relate to an earlier date);

(c) No event shall have occurred or circumstance exist that has or could reasonably be expected to have a Material Adverse Effect; and

(d) With respect to issuance of a Letter of Credit, the LC Conditions shall be satisfied.

Each request (or deemed request) by Borrowers for funding of a Loan, issuance of a Letter of Credit or grant of an accommodation shall constitute a representation by Borrowers that the foregoing conditions are satisfied on the date of such request and on the date of such funding, issuance or grant. As an additional condition to any funding, issuance or grant, Agent shall have received such other information, documents, instruments and agreements as it reasonably deems appropriate in connection therewith.

**6.3 Limited Waiver of Conditions Precedent.** If Agent, Issuing Bank or Lenders fund any Loans, arrange for issuance of any Letters of Credit or grant any other accommodation when any conditions precedent are not satisfied (regardless of whether the lack of satisfaction was known or unknown at the time), it shall not operate as a waiver of (a) the right of Agent, Issuing Bank and Lenders to insist upon satisfaction of all conditions precedent with respect to any subsequent funding, issuance or grant; nor (b) any Default or Event of Default due to such failure of conditions or otherwise.

## **SECTION 7. COLLATERAL**

**7.1 Grant of Security Interest.** To secure the prompt payment and performance of all Obligations, each Borrower hereby grants to Agent, for the benefit of Secured Parties, a continuing security interest in and Lien upon all assets of such Borrower, including, without limitation, all of the following Property, whether now owned or hereafter acquired, and wherever located:

- (a) all Accounts;
- (b) all Chattel Paper, including electronic chattel paper;
- (c) all Commercial Tort Claims;
- (d) all Deposit Accounts;
- (e) all Documents;
- (f) all General Intangibles, including Payment Intangibles, Software and Intellectual Property;
- (g) all Goods, including Inventory, Equipment and fixtures;
- (h) all Instruments;
- (i) all Investment Property;
- (j) all Letter-of-Credit Rights;
- (k) all Supporting Obligations;

(l) all monies, whether or not in the possession or under the control of Agent, a Lender, or a bailee or Affiliate of Agent or a Lender, including any Cash Collateral;

(m) all accessions to, substitutions for, and all replacements, products, and cash and non-cash proceeds of the foregoing, including proceeds of and unearned premiums with respect to insurance policies, and claims against any Person for loss, damage or destruction of any Collateral; and

(n) all books and records (including customer lists, files, correspondence, tapes, computer programs, print-outs and computer records) pertaining to the foregoing.

Notwithstanding anything herein to the contrary, the term “Collateral” shall not include Excluded Collateral unless the provision in the applicable license, contract or agreement to which such Obligor is a party as of the date hereof expressly prohibiting the grant of a security interest in such Excluded Collateral (other than property described in clause (e) of the definition of “Excluded Collateral”) (A) has been waived or (B) would be rendered ineffective pursuant to Sections 9-406, 9-408, 9-409 of the Code or other applicable provisions of the Uniform Commercial Code of any relevant jurisdiction or any other applicable law (including the Bankruptcy Code) or principles of equity); provided, that (x) immediately upon the ineffectiveness, lapse, termination or waiver of any such provision, the Collateral shall include, and such Grantor shall be deemed to have granted a security interest in, all such right, title and interest as if such provision had never been in effect and (y) the foregoing exclusion shall in no way be construed so as to limit, impair or otherwise affect the Agent’s unconditional continuing security interest in and liens upon any rights or interests of a Obligor in or to the proceeds of, or any monies due or to become due under, any such license, contract or agreement.

## **7.2 Lien on Deposit Accounts; Cash Collateral.**

7.2.1 Deposit Accounts. To further secure the prompt payment and performance of all Obligations, US Borrower hereby grants to Agent, for the benefit of Secured Parties, a continuing security interest in and Lien upon all amounts credited to any Deposit Account (other than Excluded Accounts) of US Borrower, including any sums in any blocked or lockbox accounts or in any accounts into which such sums are swept. During any Trigger Period, US Borrower authorizes and directs each bank or other depository to deliver to Agent, on a daily basis, all balances in each Deposit Account (other than Excluded Accounts) maintained by US Borrower with such depository for application to the Obligations then outstanding pursuant to **Section 5.6.1** or **5.7**, as applicable. US Borrower irrevocably appoints Agent as US Borrower’s attorney-in-fact to collect such balances to the extent any such delivery is not so made.

7.2.2 Cash Collateral. Any Cash Collateral may be invested, at Agent’s discretion, in Cash Equivalents, but Agent shall have no duty to do so, regardless of any agreement or course of dealing with any Borrower, and shall have no responsibility for any investment or loss. Each Borrower hereby grants to Agent, for the benefit of Secured Parties, a security interest in all Cash Collateral held from time to time and all proceeds thereof, as security for the Obligations, whether such Cash Collateral is held in a Cash Collateral Account or elsewhere. Agent may apply Cash Collateral to the payment of any Obligations, in such order as Agent may elect pursuant to **Section 5.6.1** or **5.7**, as applicable, as they become due and payable. Each Cash Collateral Account and all Cash Collateral shall be under the sole dominion and control of Agent. No Borrower or other Person claiming through or on behalf of any Borrower shall have any right to any Cash Collateral, until Full Payment of all Obligations.

### **7.3 Real Estate Collateral.**

7.3.1 **Lien on Real Estate.** The Obligations shall also be secured by Mortgages upon all Real Estate owned by Borrowers, including the Real Estate located at (i) 808 Valley View Road, Elk Creek, Virginia, (ii) 709/710/711 Powerhouse Road, Independence, Virginia, (iii) 311 West Main Street, Independence, Virginia, (iv) 607 West Main Street, Independence, Virginia and (v) 12032 Highway 155N, Tyler, Texas. The Mortgages shall be duly recorded, at Borrowers' expense, in each office where such recording is required to constitute a fully perfected Lien on the Real Estate covered thereby. If any Borrower acquires Real Estate hereafter, Borrowers shall, within 30 days, execute, deliver and record a Mortgage sufficient to create a first priority Lien (subject to Permitted Liens) in favor of Agent on such Real Estate, and shall deliver all Related Real Estate Documents.

7.3.2 **Collateral Assignment of Leases.** To further secure the prompt payment and performance of all Obligations, each Borrower hereby transfers and assigns to Agent, for the benefit of Secured Parties, all of such Borrower's right, title and interest in, to and under all now or hereafter existing leases of real Property to which such Borrower is a party, whether as lessor or lessee, and all extensions, renewals, modifications and proceeds thereof.

### **7.4 Other Collateral.**

7.4.1 **Commercial Tort Claims.** Borrowers shall promptly notify Agent in writing if any Borrower has a Commercial Tort Claim (other than, as long as no Default or Event of Default exists, a Commercial Tort Claim for less than \$250,000) and, upon Agent's request, shall promptly take such actions as Agent deems appropriate to confer upon Agent (for the benefit of Secured Parties) a duly perfected, first priority Lien upon such claim.

7.4.2 **Certain After-Acquired Collateral.** Borrowers shall promptly notify Agent in writing if, after the Closing Date, any Borrower obtains any interest in any Collateral consisting of Deposit Accounts, Chattel Paper, Documents, Instruments, Intellectual Property, Investment Property or Letter-of-Credit Rights, in each case to the extent that the aggregate amount of such Collateral (along with all other Collateral of any type described above) exceeds \$250,000, and, upon Agent's request, shall promptly take such actions as Agent deems reasonably appropriate to effect Agent's duly perfected, first priority Lien upon such Collateral, including obtaining any appropriate possession, control agreement or Lien Waiver. If any Collateral in an aggregate amount exceeding \$250,000 is in the possession of a third party (and not otherwise subject to a Lien Waiver), at Agent's request, Borrowers shall obtain an acknowledgment that such third party holds the Collateral for the benefit of Agent.

7.5 **No Assumption of Liability.** The Lien on Collateral granted hereunder is given as security only and shall not subject Agent or any Lender to, or in any way modify, any obligation or liability of Borrowers relating to any Collateral.

7.6 **Further Assurances.** Promptly upon request, Borrowers shall deliver such instruments, assignments, title certificates, or other documents or agreements, and shall take such actions, as Agent deems reasonably appropriate under Applicable Law to evidence or perfect its Lien on any Collateral (subject to the IP Limitation in the proviso of clause (c) of **Section 7.8**), or otherwise to give effect to the intent of this Agreement. Each Borrower authorizes Agent to file any financing statement that indicates the Collateral as "all assets" or "all personal property" of such Borrower, or words to similar effect, and ratifies any action taken by Agent before the Closing Date to effect or perfect its Lien on any Collateral.

7.7 **Foreign Subsidiary Stock.** Notwithstanding **Section 7.1**, the Collateral shall be limited to 65% of the voting stock of any Foreign Subsidiary.

7.8 **Perfection of Intellectual Property.** Notwithstanding anything in this Agreement or any other Loan Document to the contrary, the Lien on Intellectual Property Collateral granted in **Section 7.1** shall constitute a perfected security interest in and Lien upon such Intellectual Property, subject to no

Liens other than Permitted Liens, only if and to the extent such perfection may be achieved by (a) filing UCC financing statements in the applicable jurisdiction, (b) recording the Copyright Security Agreement, Trademark Security Agreement, and Patent Security Agreement in the U.S. Patent and Trademark Office and the U.S. Copyright Office (as applicable), provided that subsequent filings in the U.S. Patent and Trademark Office and the U.S. Copyright Office may be necessary to perfect any security interest in any Intellectual Property Collateral acquired by any Obligor after the date hereof; and (c) the taking of actions outside the United States that are required in order to perfect the Lien on Intellectual Property Collateral that is protected under non-U.S. law, provided, however, that unless reasonably requested by the Agent, no Obligor shall have any obligation to record or file, or take any other actions, to create a perfected Lien on or security interest in any non-U.S. Intellectual Property Collateral, and even if so requested by the Agent, the Obligors shall only be obligated to do so to the extent that any such Intellectual Property Collateral can be perfected under applicable laws and regulations (the foregoing clause (a), (b) and (c) collectively, the “IP Limitations”).

## SECTION 8. COLLATERAL ADMINISTRATION

**8.1 Borrowing Base Certificates.** By the 15th day of each month, Borrowers and DashAmerica shall deliver to Agent (and Agent shall promptly deliver same to Lenders) a Borrowing Base Certificate prepared as of the close of business of the previous month, and at such other times as Agent may request; provided that (i) during the continuance of any Trigger Period, or (ii) at the option of Borrowers, Borrowers and DashAmerica shall deliver the required Borrowing Base Certificates on a weekly basis no later than the fourth Business Day of each week, prepared as of the close of business of the previous week; provided further that in the event that Borrowers exercise their option to deliver weekly Borrowing Base Certificates set forth in clause (ii) above, Borrowers and DashAmerica shall continue to deliver weekly Borrowing Base Certificates thereafter for a period not shorter than 6 weeks and shall provide Agent with two weeks’ prior written notice thereafter if Borrowers desire to return to monthly delivery of Borrowing Base Certificates (if such reporting is otherwise permitted pursuant to the terms of this **Section**). All calculations of Availability in any Borrowing Base Certificate shall originally be made by Borrowers and DashAmerica and certified by a Senior Officer, provided that Agent may from time to time review and adjust any such calculation (a) to reflect its reasonable estimate of declines in value of any Collateral, due to collections received in the Dominion Account or otherwise; (b) to adjust advance rates to reflect changes in dilution (without duplication of dilution reserves), quality, mix and other factors affecting Collateral; and (c) to the extent the calculation is not made in accordance with this Agreement or does not accurately reflect the Availability Reserve. Notwithstanding the foregoing, Agent will not use a single basis for adjustment to both establish new Availability Reserves and to reduce advance rates.

### **8.2 Administration of Accounts.**

**8.2.1 Records and Schedules of Accounts.** Each Borrower and DashAmerica shall keep accurate and complete records of its Accounts, including all payments and collections thereon, and shall submit to Agent on or before the 15<sup>th</sup> day of each month (i) sales, collection, reconciliation and other reports in form reasonably satisfactory to Agent and (ii) a detailed aged trial balance of all Accounts as of the end of the preceding month, specifying each Account’s Account Debtor name and address, amount, invoice date and due date, showing any discount, allowance, credit, authorized return or dispute, and including such proof of delivery, copies of invoices and invoice registers, copies of related documents, repayment histories, status reports and other information as Agent may reasonably request; provided that during the continuance of any Trigger Period Borrowers and DashAmerica shall deliver the required reporting relating to Accounts on a weekly basis no later than the fourth Business Day of each week. If Accounts in an aggregate face amount of \$5,000,000 or more cease to be Eligible Accounts, Borrowers shall notify Agent of such occurrence promptly (and in any event within one Business Day) after any Borrower or DashAmerica has knowledge thereof.



8.2.2 Taxes. If an Account of any Borrower or DashAmerica includes a charge for any Taxes, to the extent such Borrower or DashAmerica has not already done so, Agent is authorized, in its discretion, to pay the amount thereof to the proper taxing authority for the account of such Borrower or DashAmerica and to charge Borrowers therefor; provided, however, that neither Agent nor Lenders shall be liable for any Taxes that may be due from Borrowers or DashAmerica or with respect to any Collateral.

8.2.3 Account Verification. Whether or not a Default or Event of Default exists, Agent shall have the right at any time, in the name of Agent, any designee of Agent, any Borrower or DashAmerica, to verify the validity, amount or any other matter relating to any Accounts of Borrowers and DashAmerica by mail, telephone or otherwise. Borrowers and DashAmerica shall cooperate fully with Agent in an effort to facilitate and promptly conclude any such verification process.

8.2.4 Maintenance of Dominion Account. Borrowers and DashAmerica shall maintain Dominion Accounts pursuant to lockbox or other arrangements acceptable to Agent. US Borrower shall obtain an agreement (in form and substance satisfactory to Agent) from each lockbox servicer and Dominion Account bank, establishing Agent's control over and Lien in the lockbox or Dominion Account, which may be exercised by Agent during any Trigger Period, requiring immediate deposit of all remittances received in the lockbox to a Dominion Account, and waiving offset rights of such servicer or bank, except for customary administrative charges. If a Dominion Account is not maintained with Bank of America, Agent may, during any Trigger Period, require immediate transfer of all funds in such account to a Dominion Account maintained with Bank of America. Neither Agent nor Lenders assume any responsibility to Borrowers for any lockbox arrangement or Dominion Account, including any claim of accord and satisfaction or release with respect to any Payment Items accepted by any bank. Collections on Swiss Borrower's Accounts will be deposited into a deposit account in Switzerland over which Agent has been granted a Lien pursuant to an assignment agreement in form and substance satisfactory to Agent and acknowledged by Swiss Borrower's depository bank maintaining such Swiss Dominion Account. During any Trigger Period Agent will have the authority to direct collections received in the Swiss Borrower's Dominion Account to US Borrower's main Dominion Account.

8.2.5 Proceeds of Collateral. Borrowers and DashAmerica shall request in writing and otherwise take all necessary steps to ensure that all payments on Accounts or otherwise relating to Collateral are made directly to a Dominion Account (or a lockbox relating to a Dominion Account). If any Borrower or Subsidiary receives cash or Payment Items with respect to any Collateral, it shall hold same in trust for Agent and promptly (not later than the next Business Day, in the case of US Borrower or any Subsidiary (other than a Foreign Subsidiary)) deposit same into, (i) in the case of proceeds of Collateral of Swiss Borrower, the Dominion Account of Swiss Borrower, (ii) in the case of proceeds of Collateral of US Borrower, the US Borrower's main Dominion Account at US Bank, and (iii) in the case of proceeds of Collateral of any Guarantor, such Guarantor's Dominion Account (or, if such Guarantor has no Dominion Account, into the US Borrower's main Dominion Account at US Bank).

### **8.3 Administration of Inventory.**

8.3.1 Records and Reports of Inventory. Each Borrower and DashAmerica shall keep accurate and complete records of its Inventory, including costs and daily withdrawals and additions, and shall submit to Agent inventory and reconciliation reports in form reasonably satisfactory to Agent, on or before the 15<sup>th</sup> day of each month prepared as of the close of business of the previous month. Each Borrower and DashAmerica shall conduct a physical inventory at least once per calendar year (and on a

more frequent basis if requested by Agent when an Event of Default exists) and periodic cycle counts consistent with historical practices, and shall provide to Agent a report based on each such inventory and count promptly upon completion thereof, together with such supporting information as Agent may request. Agent may participate in and observe each physical count.

**8.3.2 Returns of Inventory.** None of Borrowers or DashAmerica shall return any Inventory to a supplier, vendor or other Person, whether for cash, credit or otherwise, unless (a) such return is in the Ordinary Course of Business; (b) no Default, Event of Default or Overadvance exists or would result therefrom; (c) Agent is promptly notified if the aggregate Value of all Inventory returned in any month exceeds \$5,000,000; and (d) any payment received by a Borrower or DashAmerica for a return is promptly remitted to Agent for application to the Obligations.

**8.3.3 Acquisition, Sale and Maintenance.** None of Borrowers or DashAmerica shall acquire or accept any Inventory on consignment or approval, and Borrowers and DashAmerica shall take all steps to assure that all Inventory is produced in accordance in all material respects with Applicable Law, including the FLSA. None of Borrowers or DashAmerica shall sell any Inventory on consignment or approval (other than sales to consumers on approval consistent with Borrowers' historical practices) or any other basis under which the customer may return or require a Borrower or DashAmerica to repurchase such Inventory. Borrowers and DashAmerica shall use, store and maintain all Inventory with reasonable care and caution, in accordance with applicable standards of any insurance and in conformity in all material respects with all Applicable Law, and shall make current rent payments (within applicable grace periods provided for in leases) at all locations where any Collateral is located, other than rent payments subject to a good faith dispute disclosed in writing to Agent.

#### **8.4 Administration of Equipment.**

**8.4.1 Records and Schedules of Equipment.** Each Borrower shall keep accurate and complete records of its Equipment, including kind, quality, quantity, cost, acquisitions and dispositions thereof, and shall submit to Agent, on such periodic basis as Agent may reasonably request, a current schedule thereof, in form reasonably satisfactory to Agent. Promptly upon request, Borrowers shall deliver to Agent evidence of their ownership or interests in any Equipment.

**8.4.2 Dispositions of Equipment.** No Borrower shall sell, lease or otherwise dispose of any Equipment, without the prior written consent of Agent, other than (a) a Permitted Asset Disposition; and (b) replacement of Equipment that is worn, damaged or obsolete with Equipment of like function and value, if the replacement Equipment is acquired substantially contemporaneously with such disposition and is free of Liens.

**8.4.3 Condition of Equipment.** The Equipment is in good operating condition and repair (ordinary wear and tear excepted), and all necessary replacements and repairs have been made so that the value and operating efficiency of the Equipment is preserved at all times, ordinary wear and tear excepted. Each Borrower shall ensure that the Equipment is mechanically and structurally sound, and capable of performing the functions for which it was designed, in accordance with manufacturer specifications (ordinary wear and tear excepted). No Borrower shall permit any Equipment to become affixed to real Property unless any landlord or mortgagee delivers a Lien Waiver.

**8.4.4 Administration of Deposit Accounts.** **Schedule 8.5** sets forth all Deposit Accounts maintained by Borrowers, including all Dominion Accounts. US Borrower shall take all actions necessary to establish Agent's control of each such Deposit Account (other than Excluded Accounts). Each Borrower shall be the sole account holder of each Deposit Account and shall not allow any other Person (other than Agent) to have control over a Deposit Account or any Property deposited therein. Each Borrower shall promptly notify Agent of any opening or closing of a Deposit Account and, with the consent of Agent, will amend **Schedule 8.5** to reflect same.

## **8.5 General Provisions.**

8.5.1 Location of Collateral. All tangible items of Collateral, other than (i) Inventory in transit or (ii) Collateral (A) out for repair or refurbishment or (B) on loan to employees (such as laptop computers and vehicles) in an aggregate amount not to exceed \$200,000 at any time on loan, shall at all times be kept by Borrowers at the business locations set forth in **Schedule 8.6.1**, except that Borrowers may (a) make sales or other dispositions of Collateral in accordance with **Section 10.2.6**; and (b) move Collateral to another location within the United States or within The Netherlands, upon 15 Business Days prior written notice to Agent, provided that if no Default or Event of Default has occurred and is continuing Borrowers may establish temporary locations if Collateral is not located at any such location for a period longer than 30 days and no more than \$500,000 of Collateral is located at any such location (or \$2,500,000 at all such locations) at any time.

### **8.5.2 Insurance of Collateral; Condemnation Proceeds.**

(a) Each Borrower shall maintain insurance with respect to the Collateral, covering casualty, hazard, public liability, theft, malicious mischief, flood and other risks, in amounts, with endorsements and with insurers (with a Best Rating of at least A+, unless otherwise approved by Agent) satisfactory to Agent. All proceeds under each policy shall be payable to Agent. From time to time upon request, Borrowers shall deliver to Agent the originals or certified copies of its insurance policies and updated flood plain searches. Unless Agent shall agree otherwise, each policy shall include satisfactory endorsements (i) showing Agent as sole loss payee or additional insured, as appropriate; (ii) requiring 30 days prior written notice to Agent in the event of cancellation of the policy for any reason whatsoever; and (iii) specifying that the interest of Agent shall not be impaired or invalidated by any act or neglect of any Borrower or the owner of the Property, nor by the occupation of the premises for purposes more hazardous than are permitted by the policy. If any Borrower fails to provide and pay for any insurance, Agent may, at its option, but shall not be required to, procure the insurance and charge Borrowers therefor. Each Borrower agrees to deliver to Agent, promptly as rendered, copies of all reports made to insurance companies; provided that if no Event of Default has occurred and is continuing Borrowers are not required to deliver reports with respect to claims less than \$1,000,000 in aggregate. While no Event of Default exists, Borrowers may settle, adjust or compromise any insurance claim, as long as the proceeds are delivered to Agent (for deposit by Agent into the Dominion Account). If an Event of Default exists, only Agent shall be authorized to settle, adjust and compromise such claims.

(b) Any proceeds of insurance (other than proceeds from workers' compensation or D&O insurance) and any awards arising from condemnation of any Collateral shall be paid to Agent. Any such proceeds or awards shall be applied to payment of the Revolver Loans (without a reduction in commitments), and then to any other Obligations outstanding, other than Term Loans.

8.5.3 Protection of Collateral. All expenses of protecting, storing, warehousing, insuring, handling, maintaining and shipping any Collateral, all Taxes payable with respect to any Collateral (including any sale thereof), and all other payments required to be made by Agent to any Person to realize upon any Collateral, shall be borne and paid by Borrowers. Agent shall not be liable or responsible in any way for the safekeeping of any Collateral, for any loss or damage thereto (except for reasonable care in its custody while Collateral is in Agent's actual possession), for any diminution in the value thereof, or for any act or default of any warehouseman, carrier, forwarding agency or other Person whatsoever, but the same shall be at Borrowers' sole risk.

8.5.4 **Defense of Title to Collateral.** Each Borrower shall at all times defend its title to Collateral and Agent's Liens therein against all Persons, claims and demands whatsoever, except Permitted Liens.

**8.6 Power of Attorney.** Each Borrower hereby irrevocably constitutes and appoints Agent (and all Persons designated by Agent) as such Borrower's true and lawful attorney (and agent-in-fact) for the purposes provided in this Section. Agent, or Agent's designee, may, without notice and in either its or a Borrower's name, but at the cost and expense of Borrowers:

(a) Endorse a Borrower's name on any Payment Item or other proceeds of Collateral (including proceeds of insurance as permitted hereunder) that come into Agent's possession or control; and

(b) During an Event of Default, (i) notify any Account Debtors of the assignment of their Accounts, demand and enforce payment of Accounts, by legal proceedings or otherwise, and generally exercise any rights and remedies with respect to Accounts; (ii) settle, adjust, modify, compromise, discharge or release any Accounts or other Collateral, or any legal proceedings brought to collect Accounts or Collateral; (iii) sell or assign any Accounts and other Collateral upon such terms, for such amounts and at such times as Agent deems advisable; (iv) take control, in any manner, of any proceeds of Collateral; (v) prepare, file and sign a Borrower's name to a proof of claim or other document in a bankruptcy of an Account Debtor, or to any notice, assignment or satisfaction of Lien or similar document; (vi) receive, open and dispose of mail addressed to a Borrower, and notify postal authorities to change the address for delivery thereof to such address as Agent may designate; (vii) endorse any Chattel Paper, Document, Instrument, invoice, freight bill, bill of lading, or similar document or agreement relating to any Accounts, Inventory or other Collateral; (viii) use a Borrower's stationery and sign its name to verifications of Accounts and notices to Account Debtors; (ix) use the information recorded on or contained in any data processing equipment and computer hardware and software relating to any Collateral; (x) make and adjust claims under policies of insurance; (xi) take any action as may be necessary or appropriate to obtain payment under any letter of credit or banker's acceptance for which a Borrower is a beneficiary; and (xii) take all other actions as Agent deems appropriate to fulfill any Borrower's obligations under the Loan Documents.

## **SECTION 9. REPRESENTATIONS AND WARRANTIES**

**9.1 General Representations and Warranties.** To induce Agent and Lenders to enter into this Agreement and to make available the Commitments, Loans and Letters of Credit, each Borrower represents and warrants that:

9.1.1 **Organization and Qualification.** Each Borrower and Subsidiary is duly organized and validly existing. As of the Closing Date, US Borrower is in good standing under the laws of the jurisdiction of its organization. Each Borrower and Subsidiary is duly qualified, authorized to do business and in good standing (to the extent applicable in jurisdictions outside of the United States) in its jurisdiction of organization and as a foreign corporation in each jurisdiction where failure to be so qualified could reasonably be expected to have a Material Adverse Effect.

9.1.2 **Power and Authority.** Each Obligor is duly authorized to execute, deliver and perform its obligations under the Loan Documents to which it is a party. The execution, delivery and performance of the Loan Documents have been duly authorized by all necessary action, and do not (a) require any consent or approval of any holders of Equity Interests of any Obligor, other than those already obtained; (b) contravene the Organic Documents of any Obligor; (c) violate or cause a default under any Applicable Law or Material Contract; or (d) result in or require the imposition of any Lien (other than Permitted Liens) on any Property of any Obligor.

9.1.3 Enforceability. Each Loan Document is a legal, valid and binding obligation of each Obligor party thereto, enforceable in accordance with its terms, except as enforceability may be limited by bankruptcy, insolvency or similar laws affecting the enforcement of creditors' rights generally.

9.1.4 Capital Structure. As of the Closing Date, **Schedule 9.1.4** shows, for each Borrower and Subsidiary, its name, its jurisdiction of organization, its authorized and issued Equity Interests, the holders of its Equity Interests (or, in the case of US Borrower, the holders of 5% or more of its Equity Interests); provided that upon reasonable request by Agent on dates after the Closing Date, Borrowers shall provide updated information with respect to the items required on **Schedule 9.1.4**. Each Borrower has good title to its Equity Interests in its Subsidiaries, subject only to Agent's Lien, and all such Equity Interests are duly issued, fully paid and non-assessable. There are no outstanding options to purchase, warrants, subscription rights, agreements to issue or sell, convertible interests, phantom rights or powers of attorney relating to any Equity Interests of any Borrower or Subsidiary which, if exercised could reasonably be expected to result in a Change of Control.

9.1.5 Corporate Names; Locations. During the five years preceding the Closing Date, except as shown on **Schedule 9.1.5**, no Borrower or Subsidiary has been known as or used any corporate names, has been the surviving corporation of a merger or combination, or has acquired any substantial part of the assets of any Person. The chief executive offices and other places of business of Borrowers and Subsidiaries are shown on **Schedule 8.6.1**.

9.1.6 Title to Properties; Priority of Liens. Each Borrower and Subsidiary has good and marketable title to (or valid leasehold interests in) all of its Real Estate, and good title to all of its personal Property, including all Property reflected in any financial statements delivered to Agent or Lenders, in each case free of Liens except Permitted Liens. Each Borrower and Subsidiary has paid and discharged all lawful claims that, if unpaid, could become a Lien on its Properties, other than Permitted Liens. All Liens of Agent in the Collateral are duly perfected, first priority Liens, subject only to Permitted Liens.

9.1.7 Accounts. Agent may rely, in determining which Accounts are Eligible Accounts, on all statements and representations made by Borrowers with respect thereto. Borrowers warrant, with respect to each Account at the time it is shown as an Eligible Account in a Borrowing Base Certificate, that:

- (a) it is genuine and in all respects what it purports to be, and is not evidenced by a judgment;
- (b) it arises out of a completed, *bona fide* sale and delivery of goods in the Ordinary Course of Business, and substantially in accordance with any purchase order, contract or other document relating thereto;
- (c) it is for a sum certain, maturing as stated in the invoice covering such sale, a copy of which has been furnished or is available to Agent on request;
- (d) it is not subject to any offset, Lien (other than Agent's Lien or other inchoate Permitted Liens having priority under law), deduction, defense, dispute, counterclaim or other adverse condition except as arising in the Ordinary Course of Business and disclosed to Agent; and it is absolutely owing by the Account Debtor, without contingency in any respect;

(e) no purchase order, agreement, document or Applicable Law restricts assignment of such Account to Agent (regardless of whether, under the UCC, the restriction is ineffective), and the applicable Borrower is the sole payee or remittance party shown on the invoice;

(f) no extension, compromise, settlement, modification, credit, deduction or return has been authorized with respect to the Account, except discounts or allowances granted in the Ordinary Course of Business for prompt payment that are reflected on the face of the invoice related thereto and in the reports submitted to Agent hereunder; and

(g) to the best of Borrowers' knowledge, (i) there are no facts or circumstances that are reasonably likely to impair the enforceability or collectibility of such Account; (ii) the Account Debtor had the capacity to contract when the Account arose, continues to meet the applicable Borrower's customary credit standards, is Solvent, is not contemplating or subject to an Insolvency Proceeding, and has not failed, or suspended or ceased doing business; and (iii) there are no proceedings or actions threatened or pending against any Account Debtor that could reasonably be expected to have a material adverse effect on the Account Debtor's financial condition.

9.1.8 Financial Statements. The consolidated and consolidating (by business segment in accordance with Borrowers' internal procedures in effect on the Closing Date or such other internal procedures as may be reasonably acceptable to Agent) balance sheets, and related statements of income, cash flow and shareholder's equity, of Borrowers and Subsidiaries that have been and are hereafter delivered to Agent and Lenders, are prepared in accordance with GAAP (other than, in the case of unaudited financial statements, the absence of footnotes and year-end adjustments), and fairly present the financial positions and results of operations of Borrowers and Subsidiaries at the dates and for the periods indicated. All projections delivered from time to time to Agent and Lenders have been prepared in good faith, based on reasonable assumptions in light of the circumstances known at such time, it being understood that such projections are by their nature prospective and contingent on a wide range of factors and that actual results may vary significantly. Since the later of August 31, 2007 or the date of the most recently delivered annual audited financial statements delivered to Agent, there has been no change in the condition, financial or otherwise, of any Borrower or Subsidiary that could reasonably be expected to have a Material Adverse Effect. No financial statement delivered to Agent or Lenders at any time contains any untrue statement of a material fact, nor fails to disclose any material fact necessary to make such statement not materially misleading. US Borrower is Solvent, Swiss Borrower is Solvent after taking into account its rights of contribution and the Obligors taken as a whole are Solvent.

9.1.9 Surety Obligations. No Borrower or Subsidiary is obligated as surety or indemnitor under any bond or other contract that assures payment or performance of any obligation of any Person, except as permitted hereunder.

9.1.10 Taxes. Each Borrower and Subsidiary has filed all federal, state and material local tax returns and other reports that it is required by law to file, and has paid, or made provision for the payment of, all federal, state and material local Taxes upon it, its income and its Properties that are due and payable, except to the extent being Properly Contested. The provision for Taxes on the books of each Borrower and Subsidiary is adequate for all years not closed by applicable statutes, and for its current Fiscal Year.

9.1.11 Brokers. There are no brokerage commissions, finder's fees or investment banking fees payable (other than those set forth in the Fee Letter) in connection with any transactions contemplated by the Loan Documents.

9.1.12 Intellectual Property. Each Borrower and Subsidiary owns or has the lawful right to use all Intellectual Property necessary for the conduct of its business, without conflict with any rights of others, except for conflicts that could not reasonably be expected to have a Material Adverse Effect. There is no pending or, to any Borrower's knowledge, threatened Intellectual Property Claim with respect to any Borrower, any Subsidiary or any of their Property (including any Intellectual Property). Except as disclosed on **Schedule 9.1.12** (as the same may be updated in writing by Borrowers from time to time after the Closing Date), no Borrower or Subsidiary pays or owes any Royalty or other compensation to any Person with respect to any Intellectual Property; provided that following Full Payment of the Term Loans, Borrowers shall not be required to update the Royalties owed with respect to Intellectual Property except to include any new Royalties or material changes to Royalties owed with respect to trademarks used or useful to the disposition of Borrowers' Inventory. All Intellectual Property owned or used by any Borrower or Subsidiary that is registered or subject to a pending application for registration, and all material Intellectual Property Licenses of any Borrower or Subsidiary, is shown on **Schedule 9.1.12** (as the same may be updated in writing by Borrowers from time to time after the Closing Date).

9.1.13 Governmental Approvals. Each Borrower and Subsidiary has, is in compliance with, and is in good standing with respect to, all Governmental Approvals necessary to conduct its business and to own, lease and operate its Properties and all necessary import, export or other licenses, permits or certificates for the import or handling of any goods or other Collateral have been procured and are in effect, and Borrowers and Subsidiaries have complied with all foreign and domestic laws with respect to the shipment and importation of any goods or Collateral, except in each case where noncompliance could not reasonably be expected to have a Material Adverse Effect.

9.1.14 Compliance with Laws. Each Borrower and Subsidiary has duly complied, and its Properties and business operations are in compliance, in all material respects with all Applicable Law, except where noncompliance could not reasonably be expected to have a Material Adverse Effect. There have been no citations, notices or orders of material noncompliance issued to any Borrower or Subsidiary under any Applicable Law except for conflicts that could not reasonably be expected to have a Material Adverse Effect. No Inventory has been produced in violation of the FLSA in any respect which violations could be reasonably expected to have a Material Adverse Effect or could otherwise affect Agent's ability to realize on any material portion of Inventory.

9.1.15 Compliance with Environmental Laws. Except as disclosed on **Schedule 9.1.15**, (i) no Borrower's or Subsidiary's past or present operations or its Real Estate (now or previously owned, leased or operated by it) are the subject of any federal, state or local investigation to determine whether any remedial action is needed to address any environmental pollution, Hazardous Material or environmental clean-up; (ii) no Borrower or Subsidiary has received any Environmental Notice which could reasonably be expected to have a Material Adverse Effect; (iii) no Borrower or Subsidiary has any remedial obligation with respect to any Environmental Release, environmental pollution or Hazardous Material on any Real Estate now or previously owned, leased or operated by it; and (iv) Borrowers and Subsidiaries are in material compliance with all Environmental Laws.

9.1.16 Burdensome Contracts. No Borrower or Subsidiary is a party or subject to any contract, agreement or charter restriction that could reasonably be expected to have a Material Adverse Effect. As of the Closing Date, no Borrower or Subsidiary is party or subject to any Restrictive Agreement which prohibits the execution or delivery of any Loan Documents by an Obligor or the performance by an Obligor of any obligations thereunder.

9.1.17 Litigation. Except as shown on **Schedule 9.1.17**, there are no proceedings or investigations pending or, to any Borrower's knowledge, threatened against any Borrower or Subsidiary, or any of their businesses, operations, Properties or conditions, that (a) relate to any Loan Documents or

transactions contemplated thereby; or (b) could reasonably be expected to have a Material Adverse Effect. No Borrower or Subsidiary is in default with respect to any order, injunction or judgment of any Governmental Authority except for defaults that could not reasonably be expected to have a Material Adverse Effect.

9.1.18 **No Defaults.** No event or circumstance exists that constitutes a Default or Event of Default. No Borrower or Subsidiary is in default, and no event or circumstance has occurred or exists that with the passage of time or giving of notice would constitute a default, under any Material Contract or in the payment of any Borrowed Money which would result in an Event of Default under Section 11.1(f). There is no basis upon which any party (other than a Borrower or Subsidiary) could terminate a Material Contract prior to its scheduled termination date.

9.1.19 **ERISA.** Except as disclosed on **Schedule 9.1.19**:

(a) Except as could not reasonably be expected to result in a liability of the Obligor in excess of \$2,000,000, (i) each Plan is in compliance in all material respects with the applicable provisions of ERISA, the Code, and other federal and state laws, (ii) each Plan that is intended to qualify under Section 401(a) of the Code has received a favorable determination letter from the IRS or an application for such a letter is currently being processed by the IRS with respect thereto and, to the knowledge of Borrowers, nothing has occurred which would prevent, or cause the loss of, such qualification. Each Obligor and ERISA Affiliate has made all required contributions to each Plan subject to Section 412 of the Code, and no application for a funding waiver or an extension of any amortization period pursuant to Section 412 of the Code has been made with respect to any Plan.

(b) There are no pending or, to the knowledge of Borrowers, threatened claims, actions or lawsuits, or action by any Governmental Authority, with respect to any Plan that could reasonably be expected to have a Material Adverse Effect. There has been no prohibited transaction or violation of the fiduciary responsibility rules with respect to any Plan that has resulted in or could reasonably be expected to have a Material Adverse Effect.

(c) Except as could not reasonably be expected to result in a liability of the Obligor in excess of \$2,000,000, (i) No ERISA Event has occurred or is reasonably expected to occur; (ii) no Pension Plan has any Unfunded Pension Liability; (iii) no Obligor or ERISA Affiliate has incurred, or reasonably expects to incur, any liability under Title IV of ERISA with respect to any Pension Plan (other than premiums due and not delinquent under Section 4007 of ERISA); (iv) no Obligor or ERISA Affiliate has incurred, or reasonably expects to incur, any liability (and no event has occurred which, with the giving of notice under Section 4219 of ERISA, would result in such liability) under Section 4201 or 4243 of ERISA with respect to a Multiemployer Plan; and (v) no Obligor or ERISA Affiliate has engaged in a transaction that could be subject to Section 4069 or 4212(c) of ERISA.

(d) Except as could not reasonably be expected to result in a liability of the Obligor in excess of \$2,000,000, with respect to any Foreign Plan, (i) all employer and employee contributions required by law or by the terms of the Foreign Plan have been made, or, if applicable, accrued, in accordance with normal accounting practices; (ii) the fair market value of the assets of each funded Foreign Plan, the liability of each insurer for any Foreign Plan funded through insurance, or the book reserve established for any Foreign Plan, together with any accrued contributions, is sufficient to procure or provide for the accrued benefit obligations with respect to all current and former participants in such Foreign Plan according to the actuarial assumptions and valuations most recently used to account for such obligations in accordance with applicable generally accepted accounting principles; and (iii) it has been registered as required and has been maintained in good standing with applicable regulatory authorities.



9.1.20 Trade Relations. There exists no actual or threatened termination, limitation or modification of any business relationship between any Borrower or Subsidiary and any customer or supplier, or any group of customers or suppliers, except for terminations, limitations or modifications that could not reasonably be expected to have a Material Adverse Effect. There exists no condition or circumstance that could reasonably be expected to impair the ability of any Borrower or Subsidiary to conduct its business at any time hereafter in substantially the same manner as conducted on the Closing Date.

9.1.21 Labor Relations. Except as described on **Schedule 9.1.21**, no Borrower or Subsidiary is party to or bound by any collective bargaining agreement. As of the Closing Date, there are no material grievances, disputes or controversies with any union or other organization of any Borrower's or Subsidiary's employees, or, to any Borrower's knowledge, any asserted or threatened strikes, work stoppages or demands for collective bargaining and no such grievances, disputes, controversies, strikes, work stoppages or demands have arisen after the Closing Date other than those that could not reasonably be expected to have a Material Adverse Effect.

9.1.22 Payable Practices. No Obligor has made any material change in its accounts payable practices and policies from those in effect on the Closing Date other than those that have been disclosed in writing to Agent and consented to by Agent in writing. No Subsidiary has made any material change in its accounts payable practices and policies from those in effect on the Closing Date other than those that could not reasonably be expected to have a Material Adverse Effect.

9.1.23 Not a Regulated Entity. No Obligor is (a) an "investment company" or a "person directly or indirectly controlled by or acting on behalf of an investment company" within the meaning of the Investment Company Act of 1940; or (b) subject to regulation under the Federal Power Act, the Interstate Commerce Act or any other Applicable Law regarding its authority to incur Debt.

9.1.24 Margin Stock. No Borrower or Subsidiary is engaged, principally or as one of its important activities, in the business of extending credit for the purpose of purchasing or carrying any Margin Stock. No Loan proceeds or Letters of Credit will be used by Borrowers to purchase or carry, or to reduce or refinance any Debt incurred to purchase or carry, any Margin Stock in violation of Regulations T, U or X of the Board of Governors.

**9.2 Complete Disclosure**. No Loan Document contains any untrue statement of a material fact, nor fails to disclose any material fact necessary to make the statements contained therein not materially misleading. There is no fact or circumstance that any Obligor has failed to disclose to Agent in writing that could reasonably be expected to have a Material Adverse Effect.

## **SECTION 10. COVENANTS AND CONTINUING AGREEMENTS**

**10.1 Affirmative Covenants**. As long as any Commitments or Obligations are outstanding (other than indemnity claims that are unasserted and not reasonably likely to be asserted), each Borrower shall, and shall cause each Subsidiary to:

### **10.1.1 Inspections; Appraisals**

(a) Permit Agent from time to time, subject (except when a Default or Event of Default exists) to reasonable advance notice and during normal business hours, to visit and inspect the Properties of any Borrower or Subsidiary, inspect, audit and make extracts from any Borrower's or Subsidiary's books and records, and discuss with its officers, employees, agents, advisors and independent accountants such Borrower's or Subsidiary's business, financial condition, assets, prospects and results of

operations. Lenders may participate in any such visit or inspection, at their own expense. Neither Agent nor any Lender shall have any duty to any Borrower to make any inspection, nor to share any results of any inspection, appraisal or report with any Borrower. Borrowers acknowledge that all inspections, appraisals and reports are prepared by Agent and Lenders for their purposes, and Borrowers shall not be entitled to rely upon them; provided that, if no Default or Event of Default has occurred and is continuing, Agent will use commercially reasonable efforts to obtain agreement from its independent appraisers to disclose the results of appraisals to Borrowers, although Borrowers agree that such appraisals are not prepared for Borrower's benefit and cannot be relied upon by Borrowers.

(b) Reimburse Agent for all charges, costs and expenses of Agent in connection with (i) examinations of any Obligor's books and records or any other financial or Collateral matters as Agent deems appropriate, up to four times per Loan Year; and (ii) appraisals of (A) Inventory up to two times per Loan Year and (B) Equipment and Real Estate up to one time per Loan Year; provided, however, that if an examination or appraisal is initiated during a Default or Event of Default, all charges, costs and expenses therefor shall be reimbursed by Borrowers without regard to such limits. Subject to and without limiting the foregoing, Borrowers specifically agree to pay Agent's then standard charges for each day that an employee of Agent or its Affiliates is engaged in any examination activities, and shall pay the standard charges of Agent's internal appraisal group. This Section shall not be construed to limit Agent's right to conduct examinations or to obtain appraisals at any time in its discretion, nor to use third parties for such purposes.

10.1.2 Financial and Other Information. Keep adequate records and books of account with respect to its business activities, in which proper entries are made in accordance with GAAP reflecting all financial transactions; and furnish to Agent and Lenders:

(a) as soon as available, and in any event within 90 days after the close of each Fiscal Year, balance sheets as of the end of such Fiscal Year and the related statements of income, cash flow and shareholders' equity for such Fiscal Year, on consolidated and consolidating (by business segment in accordance with Borrowers' internal procedures in effect on the Closing Date or such other internal procedures as may be reasonably acceptable to Agent) bases for Borrowers and their Subsidiaries, which consolidated statements shall be audited and certified (without qualification as to scope, "going concern" or similar items) by a firm of independent certified public accountants of recognized standing selected by Borrowers and reasonably acceptable to Agent, and shall set forth in comparative form corresponding figures for the preceding Fiscal Year and other information reasonably acceptable to Agent (it being agreed that, with respect to the consolidated statements required under this clause (a), the furnishing of US Borrower's annual report on Form 10-K for such Fiscal Year as filed with the SEC will satisfy such requirement);

(b) (i) as soon as available, and in any event within 30 days after the end of each month (but within 45 days after the last month in a Fiscal Year), unaudited balance sheets as of the end of such month and the related statements of income and cash flow for such month and for the portion of the Fiscal Year then elapsed, on consolidated and consolidating (by business segment in accordance with Borrowers' internal procedures in effect on the Closing Date or such other internal procedures as may be reasonably acceptable to Agent) bases for Borrowers and their Subsidiaries, setting forth in comparative form corresponding figures for the preceding Fiscal Year and certified by the chief financial officer of Borrower Agent as being prepared in accordance with GAAP and fairly presenting in all material respects the financial position and results of operations for such month and period, subject to normal year-end adjustments and the absence of footnotes, and (ii) as soon as available, and in any event within 45 days after the end of each Fiscal Quarter, unaudited balance sheets as of the end of such Fiscal Quarter and the related statements of income and cash flow for such Fiscal Quarter and for the portion of the Fiscal Year then elapsed, on consolidated and consolidating (by business segment in accordance with Borrowers'

internal procedures in effect on the Closing Date or such other internal procedures as may be reasonably acceptable to Agent) bases for Borrowers and their Subsidiaries, setting forth in comparative form corresponding figures for the preceding Fiscal Year and certified by the chief financial officer of Borrower Agent as being prepared in accordance with GAAP and fairly presenting in all material respects the financial position and results of operations for such Fiscal Quarter and period, subject to normal year-end adjustments and the absence of footnotes (it being agreed that, with respect to the consolidated statements required under this clause (b)(ii), the furnishing of US Borrower's quarterly report on Form 10-Q for such Fiscal Quarter as filed with the SEC will satisfy such requirement);

(c) concurrently with delivery of financial statements under clauses (a) and (b) above, a Compliance Certificate executed by the chief financial officer of Borrower Agent;

(d) concurrently with delivery of financial statements under clause (a) above, copies of all management letters and other material reports submitted to Borrowers by their accountants in connection with such financial statements;

(e) not later than 60 days after to the end of each Fiscal Year, projections of Borrowers' consolidated balance sheets, results of operations, cash flow and Availability for the next Fiscal Year, month by month;

(f) at Agent's reasonable request, a listing of each Borrower's trade payables, specifying the trade creditor and balance due, and a detailed trade payable aging, all in form reasonably satisfactory to Agent;

(g) promptly after the sending or filing thereof, copies of any proxy statements, financial statements or reports that any Borrower has made generally available to its shareholders; copies of any regular, periodic and special reports or registration statements or prospectuses that any Borrower files with the Securities and Exchange Commission or any other Governmental Authority, or any securities exchange; and copies of any press releases or other statements made available by a Borrower to the public concerning material changes to or developments in the business of such Borrower;

(h) promptly after the sending or filing thereof, copies of any annual report to be filed in connection with each Plan or Foreign Plan;

(i) such other reports and information (financial or otherwise) as Agent may reasonably request from time to time in connection with any Collateral or any Borrower's, Subsidiary's or other Obligor's financial condition or business; and

Simultaneously with retaining accountants for their annual audit, Borrowers shall send a letter to the accountants, with a copy to Agent and Lenders, notifying the accountants that one of the purposes for retaining their services and obtaining audited financial statements is for use by Agent and Lenders and authorizing the accountants to communicate with Agent regarding the audited financial statements. Agent is authorized to send such notice if Borrowers fail to do so for any reason.

10.1.3 **Notices.** Notify Agent and Lenders in writing, promptly after a Borrower's obtaining knowledge thereof, of any of the following that affects an Obligor: (a) the threat or commencement of any proceeding or investigation, whether or not covered by insurance, if an adverse determination could reasonably be expected to have a Material Adverse Effect; (b) any pending or threatened labor dispute, strike or walkout, or the expiration of any material labor contract; (c) any default under or termination of a Material Contract or any default under or early termination of the HSBC Agreements; (d) the existence of any Default or Event of Default; (e) any judgment in an amount

exceeding \$1,000,000 which is not covered by insurance or any judgment in an amount exceeding \$5,000,000 whether or not covered by insurance; (f) the assertion of any Intellectual Property Claim which could reasonably be expected to have a Material Adverse Effect; (g) any violation or asserted violation of any Applicable Law (including ERISA, OSHA, FLSA, or any Environmental Laws), if an adverse resolution could have a Material Adverse Effect; (h) any Environmental Release by an Obligor or on any Real Estate owned, leased or occupied by an Obligor or receipt of any Environmental Notice, which could reasonably be expected to have a Material Adverse Effect; (i) the occurrence of any ERISA Event; (j) the discharge of or any withdrawal or resignation by Borrowers' independent accountants; or (k) any opening of a new office or place of business, at least 15 Business Days prior to such opening (other than temporary locations permitted under **Section 8.5.1**).

10.1.4 **Landlord and Storage Agreements.** Upon request, provide Agent with copies of all existing agreements, and promptly after execution thereof, following notice to Agent of such new agreements and Agent's request for copies thereof, provide Agent with copies of all future agreements, between an Obligor and any landlord, warehouseman, third party processor of Inventory, shipper, bailee or other Person that owns any premises at which any Collateral with a value in excess of \$1,000,000 at any one time may be kept or that otherwise may possess or handle any such Collateral.

10.1.5 **Compliance with Laws.** Comply with all Applicable Laws, including ERISA, Environmental Laws, FLSA, OSHA, Anti-Terrorism Laws, and laws regarding collection and payment of Taxes, and maintain all Governmental Approvals necessary to the ownership of its Properties or conduct of its business, unless failure to comply (other than failure to comply with Anti-Terrorism Laws) or maintain could not reasonably be expected to have a Material Adverse Effect. Without limiting the generality of the foregoing, if any Environmental Release occurs at or on any Properties of any Borrower or Subsidiary, it shall act promptly and diligently to investigate and report to Agent and any necessary Governmental Authorities the extent of, and to make appropriate remedial action with respect to, such Environmental Release, in each case to the extent required under Environmental Laws.

10.1.6 **Taxes.** Pay and discharge all federal, State and material local Taxes prior to the date on which they become delinquent or penalties attach, unless such Taxes are being Properly Contested.

10.1.7 **Insurance.** In addition to the insurance required hereunder with respect to Collateral, maintain insurance with insurers (with a Best Rating of at least A+, unless otherwise approved by Agent) satisfactory to Agent, (a) with respect to the Properties and business of Borrowers and Subsidiaries of such type (including product liability, workers' compensation, larceny, embezzlement, or other criminal misappropriation insurance), in such amounts, and with such coverages and deductibles as are customary for companies similarly situated; and (b) business interruption insurance in an amount not less than \$200,000,000, with deductibles satisfactory to Agent.

10.1.8 **Licenses.** (a) Keep each License affecting any Collateral (including the manufacture, distribution or disposition of Inventory) or any other Property of Borrowers and Subsidiaries in full force and effect, unless the failure to do so could not reasonably be expected to have a Material Adverse Effect; (b) promptly notify Agent of any proposed modification to any such License that would materially adversely affect Borrowers' rights therein, or entry into any new License affecting any material portion of the Collateral (including the manufacture, distribution or disposition of Inventory) or any other material Property of Borrowers, in each case at least 30 days prior to its effective date; (c) pay all Royalties unless the failure to do so could not reasonably be expected to have a Material Adverse Effect; and (d) notify Agent of any default or breach asserted by any Person to have occurred under any such License, unless such default or breach could not reasonably be expected to have a Material Adverse Effect,.

10.1.9 Future Subsidiaries. Promptly notify Agent upon any Person becoming a Subsidiary and, if such Person is not a Foreign Subsidiary, cause it to guaranty the Obligations in a manner reasonably satisfactory to Agent, and to execute and deliver such documents, instruments and agreements and to take such other actions as Agent shall reasonably require to evidence and perfect a Lien in favor of Agent (for the benefit of Secured Parties) on all assets of such Person (other than a Foreign Subsidiary), including delivery of such legal opinions, in form and substance reasonably satisfactory to Agent, as it shall deem appropriate (subject to the IP Limitations).

**10.2 Negative Covenants.** As long as any Commitments or Obligations are outstanding (other than indemnity claims that are unasserted and not reasonably likely to be asserted), each Borrower shall not, and shall cause each Subsidiary not to:

10.2.1 Permitted Debt. Create, incur, guarantee or suffer to exist any Debt, except:

- (a) the Obligations;
- (b) Subordinated Debt in amounts and on terms satisfactory to Agent;
- (c) Permitted Purchase Money Debt;
- (d) Borrowed Money (other than the Obligations, Subordinated Debt and Permitted Purchase Money Debt), but only to the extent outstanding on the Closing Date and not satisfied with proceeds of the initial Loans;
- (e) Bank Product Debt;
- (f) Permitted Contingent Obligations;
- (g) Refinancing Debt as long as each Refinancing Condition is satisfied;
- (h) the Proposed IP Financing; provided that (i) the Term Loans have been repaid in full (or are repaid in full with the proceeds of such Debt at the time of its closing), (ii) such Debt is obtained within fourteen months after the Closing Date, (iii) such Debt is subject to an intercreditor agreement in form and substance reasonably satisfactory to Agent, (iv) on a pro forma basis, after giving effect to such Debt (and all associated transaction costs) and payments required to be made on or before October 30, 2008 in connection with the LandAmerica Acquisition, Borrowers' shall have Excess Availability of not less than \$15,000,000, and (v) no Default or Event of Default has occurred and is continuing at the time such Debt is incurred;
- (i) Debt owed by Foreign Subsidiaries of US Borrower (other than Swiss Borrower) in an aggregate amount not to exceed \$35,000,000; provided that such Debt shall not encumber any of the Collateral and no Borrower shall guarantee or otherwise be responsible for repayment of any such Debt;
- (j) Debt owed by Swiss Borrower to US Borrower in an aggregate amount not to exceed the sum of the amount of such Debt outstanding on the Closing Date plus (at any time of calculation) the amounts contributed to the Borrowing Base by the Eligible Accounts and Eligible Inventory owned by Swiss Borrower;
- (k) Debt of Borrowers or Subsidiaries to an insurance company, the proceeds which are used by such Credit Parties or such Subsidiaries to finance their insurance premiums payable on workers' compensation insurance policies maintained by such Borrowers or such Subsidiaries, in each case incurred in the Ordinary Course of Business;

(l) Debt incurred in respect of the deferred purchase price for any Permitted Acquisition, provided such Debt does not require the payment in cash of principal (other than in respect of working capital or purchase price adjustments or offsets) prior to the Commitment Termination Date and is the form of Subordinated Debt;

(m) Debt constituting the obligation to make purchase price or working capital adjustments and indemnities in connection with the Permitted Acquisitions;

(n) Debt permitted under **Section 10.2.7(e)**;

(o) Debt of Nautilus (Xiamen) Fitness Co. Ltd. to US Borrower incurred in order for Nautilus (Xiamen) Fitness Co. Ltd. to make the payments permitted under the definition of LandAmerica Acquisition set forth herein;

(p) Debt of Subsidiaries of US Borrower (other than Obligors) to US Borrower in an aggregate amount not to exceed \$15,000,000 at any time outstanding, provided that (i) the Term Loans have been repaid in full prior to the incurrence of any such Debt, (ii) no Default or Event of Default has occurred and is continuing or would result therefrom and (iii) Borrowers have Excess Availability of not less than \$15,000,000 both before and after giving effect thereto; and

(q) Debt that is not included in any of the preceding clauses of this Section, is not secured by a Lien and does not exceed \$10,000,000 in the aggregate at any time.

10.2.2 Permitted Liens. Create or suffer to exist any Lien upon any of its Property, except the following (collectively, "Permitted Liens"):

(a) Liens on the Collateral in favor of Agent;

(b) Purchase Money Liens securing Permitted Purchase Money Debt;

(c) Liens for Taxes not yet due or being Properly Contested;

(d) statutory Liens (other than Liens for Taxes or imposed under ERISA) arising in the Ordinary Course of Business, but only if (i) payment of the obligations secured thereby is not yet due or is being Properly Contested, and (ii) such Liens do not materially impair the value or use of the Property or materially impair operation of the business of any Borrower or Subsidiary;

(e) carriers,' warehousemen's, mechanics,' materialmen's, repairmen's and other like Liens imposed by Applicable Law, (i) that are being Properly Contested, or (iii) the existence of which would not reasonably be expected to result in a Material Adverse Effect;

(f) pledges and deposits of cash by any Obligor or any Subsidiary of any Obligor after the Closing Date in the ordinary course of business in connection with workers' compensation, unemployment insurance and other types of social security benefits;

(g) deposits made in the Ordinary Course of Business to secure the performance of tenders, bids, leases, contracts (except those relating to Borrowed Money), statutory obligations and other similar obligations, or arising as a result of progress payments under government contracts;

- (h) Liens arising in the Ordinary Course of Business that are subject to Lien Waivers;
- (i) Liens arising from (i) operating leases and the precautionary UCC financing statement filings in respect thereof and (ii) equipment or other materials which are not owned by any Obligor or Subsidiary located on the premises of such Obligor or Subsidiary (but not in connection with, or as part of, the financing thereof) from time to time in the ordinary course of business and consistent with current practices of such Obligor or such Subsidiary and the precautionary UCC financing statement filings in respect thereof;
- (j) deposits of cash with the owner or lessor of premises leased and operated by the Obligors or their Subsidiaries (exclusive of Affiliates of Borrowers) in the Ordinary Course of Business of such Obligors or such Subsidiaries to secure the performance by Borrowers of their respective obligations under the terms of the lease for such premises;
- (k) Liens, pledges and encumbrances with respect to any Real Estate granted to a public utility or any Governmental Authority when required by such utility or Governmental authority in connection with the operation of the business or other ownership or the assets of the Person, which do not (whether by interference in any material respect with the use of such Real Estate or with the ordinary conduct of the business of the Obligors or their Subsidiaries as presently conducted thereon) materially impair the value of the Real Estate which may be subject thereto;
- (l) any interest or title of a licensor, sub-licensor, lessor or sublessor under any license or operating or true lease agreement, provided that no such interests could reasonably be expected to have a Material Adverse Effect;
- (m) Liens arising from precautionary UCC filings regarding “true” operating leases or the consignment of goods to an Obligor or any of its Subsidiaries;
- (n) Liens arising by operation of law under Article 4 of the UCC in connection with collection of items provided for therein;
- (o) Liens arising by operation of law under Article 2 of the UCC in favor of a reclaiming seller or goods or buyer of goods, provided that any such Liens are subordinated under law to the Liens in favor of Agent;
- (p) Liens arising by virtue of a judgment or judicial order against any Borrower or Subsidiary, or any Property of a Borrower or Subsidiary, as long as such Liens are (i) in existence for less than 20 consecutive days or being Properly Contested, and (ii) at all times junior to Agent’s Liens;
- (q) easements, rights-of-way, restrictions, covenants or other agreements of record, and other similar charges or encumbrances on Real Estate, that do not secure any monetary obligation and do not interfere with the Ordinary Course of Business or such title defects or survey matters that are disclosed by current surveys and that could not reasonably be expected to have a Material Adverse Effect;
- (r) normal and customary rights of setoff upon deposits in favor of depository institutions, and Liens of a collecting bank on Payment Items in the course of collection;
- (s) Liens on US Borrower’s Intellectual Property securing Debt permitted by **Section 10.2.1(h)**;

(t) licenses of Intellectual Property owned by a Borrower and granted to any Person in the Ordinary Course of Business, and any restrictions or conditions on transfer, assignment or renewal customarily imposed in a license to use Intellectual Property;

(u) judgments and other similar Liens arising in connection with court proceedings that do not constitute an Event of Default;

(v) pledges and deposits of cash after the Closing Date to secure obligations under appeal bonds or as otherwise required in connection with court proceedings (including, without limitation, surety bonds, security for costs of litigation where required by law and letters of credit) or any other instruments serving a similar purpose;

(w) Liens in favor of an insurance company to secure Debt of the Borrowers or Subsidiaries permitted under **Section 10.2.1(k)** hereof to finance their insurance premiums on the workers' compensation insurance policies maintained by such Borrower or such Subsidiary in the Ordinary Course of Business,

(x) Liens attaching solely to earnest money deposits in connection with any letter of intent or purchase agreement executed in connection with a Permitted Acquisition;

(y) Liens in the nature of rights of set off in favor contractual counterparties in the Ordinary Course of Business to the extent such Liens have been disclosed to Agent in Borrowers' reports delivered to Agent pursuant to **Section 8.2.1**;

(z) Liens on assets of Foreign Subsidiaries of US Borrower (other than Swiss Borrower) securing Debt permitted pursuant to **Section 10.2.1(i)**; provided that such Liens shall not encumber any Collateral; and

(aa) existing Liens shown on **Schedule 10.2.2**.

**10.2.3 Capital Expenditures.** Make Capital Expenditures in excess of \$8,200,000 in the aggregate during the period from January 1, 2008 through September 30, 2008.

**10.2.4 Distributions; Upstream Payments.** (a) Declare or make any Distributions, except Upstream Payments and Distributions in the form of common stock; provided that US Borrower may pay dividends to its shareholders or repurchase stock from its shareholders, in each case if (i) no Event of Default has occurred and is continuing or would result therefrom, (ii) after giving effect to such dividend, Borrowers' Fixed Charge Coverage Ratio for the trailing twelve month period most recently ended would be at least 1.0 to 1.0, and (iii) Borrowers' Excess Availability after giving effect to such dividend is not less than \$20,000,000; or (b) create or suffer to exist any encumbrance or restriction on the ability of a Subsidiary to make any Upstream Payment, except for restrictions under the Loan Documents, under Applicable Law or in effect on the Closing Date as shown on **Schedule 9.1.16**.

**10.2.5 Restricted Investments.** Make any Restricted Investment.

**10.2.6 Disposition of Assets.** Make any Asset Disposition, except a Permitted Asset Disposition, a disposition of Equipment under **Section 8.4.2**, or a transfer of Property by a Subsidiary or Obligor to a Borrower.



10.2.7 Loans. Make any loans or other advances of money to any Person, except (a) advances to an officer or employee for salary, travel expenses, commissions and similar items in the Ordinary Course of Business; (b) prepaid expenses and extensions of trade credit made in the Ordinary Course of Business; (c) deposits with financial institutions permitted hereunder; (d) intercompany loans permitted under **Section 10.2.1(j)**, **10.2.1(o)** and **10.2.1(p)**; (e) loans made by Subsidiaries that are not Borrowers to Borrowers or loans by Swiss Borrower to US Borrower; and (f) payables permitted under **Section 10.2.17(e)**.

10.2.8 Restrictions on Payment of Certain Debt. Make any payments (whether voluntary or mandatory, or a prepayment, redemption, retirement, defeasance or acquisition) with respect to any (a) Subordinated Debt, except regularly scheduled payments of principal, interest and fees, but only to the extent permitted under any subordination agreement relating to such Debt (and a Senior Officer of Borrower Agent shall certify to Agent, not less than five Business Days prior to the date of payment, that all conditions under such agreement have been satisfied); or (b) Borrowed Money (other than the Obligations) prior to its due date under the agreements evidencing such Debt as in effect on the Closing Date (or as amended thereafter with the consent of Agent).

10.2.9 Fundamental Changes. Merge, combine or consolidate with any Person, or liquidate, wind up its affairs or dissolve itself, in each case whether in a single transaction or in a series of related transactions, except for Permitted Acquisitions or the LandAmerica Acquisition or mergers or consolidations of a wholly-owned Subsidiary with another wholly-owned Subsidiary or into a Borrower; change its legal name; change its tax, charter or other organizational identification number; or change its form or state of organization.

10.2.10 Subsidiaries. Form or acquire any Subsidiary after the Closing Date, except in accordance with **Sections 10.1.9** and **10.2.5**; or permit any existing Subsidiary to issue any additional Equity Interests except director's qualifying shares.

10.2.11 Organic Documents. Amend, modify or otherwise change any of its Organic Documents as in effect on the Closing Date in each case in any manner adverse to the interest of Agent or the Lenders.

10.2.12 Tax Consolidation. File or consent to the filing of any consolidated income tax return with any Person other than Borrowers and Subsidiaries.

10.2.13 Accounting Changes. Make any material change in accounting treatment or reporting practices, except as required by GAAP and in accordance with **Section 1.2**; or change its Fiscal Year.

10.2.14 Restrictive Agreements. Become a party to any Restrictive Agreement, except (a) a Restrictive Agreement as in effect on the Closing Date and shown on **Schedule 9.1.16**; (b) a Restrictive Agreement relating to secured Debt permitted hereunder, if such restrictions could not reasonably be expected to have a Material Adverse Effect or otherwise affect Obligor's ability to perform their obligations under the Loan Documents; and (c) customary provisions in leases and other contracts restricting assignment thereof.

10.2.15 Hedging Agreements. Enter into any Hedging Agreement, except to hedge risks arising in the Ordinary Course of Business and not for speculative purposes.

10.2.16 Conduct of Business. Engage in any business, other than its business as conducted on the Closing Date and any activities incidental thereto.

10.2.17 **Affiliate Transactions.** Enter into or be party to any transaction with an Affiliate, except (a) transactions contemplated or permitted by the Loan Documents; (b) payment of reasonable compensation to officers and employees for services actually rendered, and loans and advances permitted by **Section 10.2.7**; (c) payment of customary directors' fees and indemnities; (d) transactions solely among Borrowers and their Subsidiaries permitted hereunder; (e) intercompany payables entered into between Obligor or by non-Obligor Subsidiaries to Obligor in each case in the Ordinary Course of Business, provided that at no time shall intercompany payables outstanding from non-Obligor Subsidiaries to Obligor exceed \$25,000,000 in the aggregate; and (f) transactions with Affiliates in the Ordinary Course of Business, upon fair and reasonable terms fully disclosed to Agent and no less favorable than would be obtained in a comparable arm's-length transaction with a non-Affiliate.

10.2.18 **Plans.** Become party to any Multiemployer Plan or Foreign Plan, other than any in existence on the Closing Date.

10.2.19 **Amendments to Subordinated Debt.** Amend, supplement or otherwise modify any document, instrument or agreement relating to any Subordinated Debt, if such modification (a) increases the principal balance of such Debt, or increases any required payment of principal or interest; (b) accelerates the date on which any installment of principal or any interest is due, or adds any additional redemption, put or prepayment provisions; (c) shortens the final maturity date or otherwise accelerates amortization; (d) increases the interest rate (unless such increase is acceptable to Agent); (e) increases or adds any fees or charges (unless such increase or addition is acceptable to Agent); (f) modifies any covenant in a manner or adds any representation, covenant or default that is more onerous or restrictive in any material respect for any Borrower or Subsidiary, or that is otherwise materially adverse to any Borrower, any Subsidiary or Lenders; or (g) results in the Obligations not being fully benefited by the intercreditor agreement or other subordination provisions thereof.

**10.3 Financial Covenants.** As long as any Commitments or Obligations are outstanding (other than indemnity claims that are unasserted and not reasonably likely to be asserted), Borrowers shall:

10.3.1 **Minimum EBITDA.** Upon the commencement and during the continuation of a Trigger Period, maintain EBITDA at least equal to the required amount set forth below with respect to each measurement date set forth below for the period from October 1, 2007 to such measurement date:

<u>Measurement Date</u>	<u>Required EBITDA</u>
December 31, 2007	\$ 0
January 31, 2008	\$ 1,500,000
February 28, 2008	\$ 3,000,000
March 31, 2008	\$ 4,000,000
April 30, 2008	\$ 4,000,000
May 31, 2008	\$ 4,500,000
June 30, 2008	\$ 4,500,000
July 31, 2008	\$ 7,400,000
August 31, 2008	\$ 10,400,000
September 30, 2008	\$ 12,900,000
October 31, 2008	\$ 18,900,000
November 30, 2008	\$ 24,900,000

; provided that in the event that a Trigger Period commences in between measurement dates, this covenant shall be measured for the immediately preceding measurement date at the time of commencement of such Trigger Period.

10.3.2 Fixed Charge Coverage Ratio. Commencing with the calendar month ending December 31, 2008, upon the commencement and during the continuation of a Trigger Period, maintain a Fixed Charge Coverage Ratio of at least 1.0 to 1.0 as of the last day of such calendar month for the period of twelve calendar months then ending; provided that in the event that a Trigger Period commences in between measurement dates, this covenant shall be measured for the immediately preceding measurement date at the time of commencement of such Trigger Period.

## SECTION 11. EVENTS OF DEFAULT; REMEDIES ON DEFAULT

**11.1 Events of Default.** Each of the following shall be an “Event of Default” hereunder, if the same shall occur for any reason whatsoever, whether voluntary or involuntary, by operation of law or otherwise:

- (a) A Borrower fails to pay any Obligations when due (whether at stated maturity, on demand, upon acceleration or otherwise);
- (b) Any representation, warranty or other written statement of an Obligor made in connection with any Loan Documents or transactions contemplated thereby is incorrect or misleading in any material respect when given;
- (c) A Borrower breaches or fail to perform any covenant contained in **Section 7.2, 7.3, 7.6, 8.1, 8.2.4, 8.2.5, 8.5.2, 10.1.1, 10.1.2, 10.2 or 10.3**;
- (d) An Obligor breaches or fails to perform any other covenant contained in any Loan Documents, and such breach or failure is not cured within 15 days after a Senior Officer of such Obligor has knowledge thereof or receives notice thereof from Agent, whichever is sooner; provided, however, that such notice and opportunity to cure shall not apply if the breach or failure to perform is not capable of being cured within such period or is a willful breach by an Obligor;
- (e) A Guarantor repudiates, revokes or attempts to revoke its Guaranty; an Obligor denies or contests the validity or enforceability of any Loan Documents or Obligations, or the perfection or priority of any Lien granted to Agent; or this Agreement, any Guaranty, any Security Document or any other material Loan Document ceases to be in full force or effect for any reason (other than a waiver or release by Agent and Lenders);
- (f) Any breach or default of an Obligor occurs under any document, instrument or agreement to which it is a party or by which it or any of its Properties is bound, relating to any Debt (other than the Obligations) in excess of \$5,000,000, if the maturity of or any payment with respect to such Debt may be accelerated or demanded due to such breach;
- (g) Any judgment or order for the payment of money is entered against an Obligor in an amount that exceeds, individually or cumulatively with all unsatisfied judgments or orders against all Obligors, \$2,000,000 (net of any insurance coverage therefor acknowledged in writing by the insurer), unless a stay of enforcement of such judgment or order is in effect, by reason of a pending appeal or otherwise;
- (h) A loss, theft, damage or destruction occurs with respect to any Collateral if the amount not covered by insurance exceeds \$5,000,000;

(i) An Obligor is enjoined, restrained or in any way prevented by any Governmental Authority from conducting any material part of its business; an Obligor suffers the loss, revocation or termination of any license, permit, lease or agreement necessary to its business which loss, revocation or termination could reasonably be expected to have a Material Adverse Effect; there is a cessation of any material part of an Obligor's business for a material period of time; an Obligor agrees to or commences any liquidation, dissolution or winding up of its affairs other than pursuant to a merger with and into another Obligor (provided that the surviving entity shall be a Borrower); US Borrower ceases to be Solvent, Swiss Borrower ceases to be Solvent after taking into account its rights of contribution or the Obligors taken as a whole cease to be Solvent; or ; any material Collateral or Property of an Obligor is taken or impaired through condemnation and such taking or condemnation could reasonably be expected to have a Material Adverse Effect;

(j) An Insolvency Proceeding is commenced by an Obligor; an Obligor makes an offer of settlement, extension or composition to its unsecured creditors generally; a trustee is appointed to take possession of any substantial Property of or to operate any of the business of an Obligor; or an Insolvency Proceeding is commenced against an Obligor and: the Obligor consents to institution of the proceeding, the petition commencing the proceeding is not timely controverted by the Obligor, the petition is not dismissed within 60 days after filing, or an order for relief is entered in the proceeding;

(k) Except as could not reasonably be expected to result in a liability of the Obligors in excess of \$2,000,000, (i) an ERISA Event occurs with respect to a Pension Plan or Multiemployer Plan; (ii) an Obligor or ERISA Affiliate fails to pay when due any installment payment with respect to its withdrawal liability under Section 4201 of ERISA under a Multiemployer Plan; or (iii) any event similar to the foregoing occurs or exists with respect to a Foreign Plan;

(l) An Obligor or any of its Senior Officers is criminally indicted or convicted for (i) a felony committed in the conduct of the Obligor's business, or (ii) violating any state or federal law (including the Controlled Substances Act, Money Laundering Control Act of 1986 and Illegal Exportation of War Materials Act) that could reasonably be expected to lead to forfeiture of any material Property or any Collateral; or

(m) A Change of Control occurs; or any event occurs or condition exists that has a Material Adverse Effect.

**11.2 Remedies upon Default.** If an Event of Default described in **Section 11.1(j)** occurs with respect to any Borrower, then to the extent permitted by Applicable Law, all Obligations shall become automatically due and payable and all Commitments shall terminate, without any action by Agent or notice of any kind. In addition, or if any other Event of Default exists, Agent may in its discretion (and shall upon written direction of Required Lenders) do any one or more of the following from time to time:

(a) declare any Obligations immediately due and payable, whereupon they shall be due and payable without diligence, presentment, demand, protest or notice of any kind, all of which are hereby waived by Borrowers to the fullest extent permitted by law;

(b) terminate, reduce or condition any Commitment, or make any adjustment to the Borrowing Base;

(c) require Obligors to Cash Collateralize LC Obligations, Bank Product Debt and other Obligations that are contingent (other than indemnity claims that are unasserted and not reasonably likely to be asserted) or not yet due and payable, and, if Obligors fail promptly to deposit such Cash Collateral, Agent may (and shall upon the direction of Required Lenders) advance the required Cash Collateral as Revolver Loans (whether or not an Overadvance exists or is created thereby, or the conditions in **Section 6** are satisfied); and

(d) exercise any other rights or remedies afforded under any agreement, by law, at equity or otherwise, including the rights and remedies of a secured party under the UCC. Such rights and remedies include the rights to (i) take possession of any Collateral; (ii) require Borrowers to assemble Collateral, at Borrowers' expense, and make it available to Agent at a place designated by Agent; (iii) enter any premises where Collateral is located and store Collateral on such premises until sold (and if the premises are owned or leased by a Borrower, Borrowers agree not to charge for such storage); and (iv) sell or otherwise dispose of any Collateral in its then condition, or after any further manufacturing or processing thereof, at public or private sale, with such notice as may be required by Applicable Law, in lots or in bulk, at such locations, all as Agent, in its discretion, deems advisable. Each Borrower agrees that 10 days notice of any proposed sale or other disposition of Collateral by Agent shall be reasonable. Agent shall have the right to conduct such sales on any Obligor's premises, without charge, and such sales may be adjourned from time to time in accordance with Applicable Law. Agent shall have the right to sell, lease or otherwise dispose of any Collateral for cash, credit or any combination thereof, and Agent may purchase any Collateral at public or, if permitted by law, private sale and, in lieu of actual payment of the purchase price, may set off the amount of such price against the Obligations.

**11.3 License.** Agent is hereby granted an irrevocable, non-exclusive license or other right to use, license or sub-license (without payment of royalty or other compensation to any Person), to the extent that Borrower is permitted to grant such a license, to use any or all Intellectual Property of Borrowers, including Intellectual Property rights in any computer hardware and software, trade secrets, brochures, customer lists, promotional and advertising materials, labels, packaging materials and other Property, in connection with the advertising for sale, marketing, selling, collecting, completing manufacture of, or otherwise exercising any rights or remedies with respect to, any Collateral; provided that such license shall be effective and exercisable only upon the occurrence of, and during the continuation of, an Event of Default, and provided further that such Borrower shall have the right to exercise reasonable standards of quality control over any goods or products bearing its trademarks, to the extent necessary to maintain and protect the same, including the goodwill associated therewith, and to avoid any risk of invalidation or unenforceability thereof. Each Borrower's rights and interests under Intellectual Property shall inure to Agent's benefit.

**11.4 Setoff.** At any time during an Event of Default, Agent, Issuing Bank, Lenders, and any of their Affiliates are authorized, to the fullest extent permitted by Applicable Law, to set off and apply any and all deposits (general or special, time or demand, provisional or final, in whatever currency) at any time held and other obligations (in whatever currency) at any time owing by Agent, Issuing Bank, such Lender or such Affiliate to or for the credit or the account of an Obligor against any Obligations, irrespective of whether or not Agent, Issuing Bank, such Lender or such Affiliate shall have made any demand under this Agreement or any other Loan Document and although such Obligations may be contingent or unmatured or are owed to a branch or office of Agent, Issuing Bank, such Lender or such Affiliate different from the branch or office holding such deposit or obligated on such indebtedness. The rights of Agent, Issuing Bank, each Lender and each such Affiliate under this Section are in addition to other rights and remedies (including other rights of setoff) that such Person may have.

**11.5 Remedies Cumulative; No Waiver.**

**11.5.1 Cumulative Rights.** All covenants, conditions, provisions, warranties, guaranties, indemnities and other undertakings of Borrowers contained in the Loan Documents are cumulative and not in derogation or substitution of each other. In particular, the rights and remedies of Agent and Lenders are cumulative, may be exercised at any time and from time to time, concurrently or in any order, and shall not be exclusive of any other rights or remedies that Agent and Lenders may have, whether under any agreement, by law, at equity or otherwise.

11.5.2 Waivers. The failure or delay of Agent or any Lender to require strict performance by Borrowers with any terms of the Loan Documents, or to exercise any rights or remedies with respect to Collateral or otherwise, shall not operate as a waiver thereof nor as establishment of a course of dealing. All rights and remedies shall continue in full force and effect until Full Payment of all Obligations. No waiver of any Default or Event of Default shall constitute a waiver of any other Default or Event of Default that may exist at such time, unless expressly stated. If Agent or any Lender accepts performance by any Obligor under any Loan Documents in a manner other than that specified therein, or during any Default or Event of Default, or if Agent or any Lender shall delay or exercise any right or remedy under any Loan Documents, such acceptance, delay or exercise shall not operate to waive any Default or Event of Default nor to preclude exercise of any other right or remedy. It is expressly acknowledged by Borrowers that any failure to satisfy a financial covenant on a measurement date shall not be cured or remedied by satisfaction of such covenant on a subsequent date.

## **SECTION 12. AGENT**

### **12.1 Appointment, Authority and Duties of Agent**

12.1.1 Appointment and Authority. Each Lender appoints and designates Bank of America as Agent hereunder. Agent may, and each Lender authorizes Agent to, enter into all Loan Documents to which Agent is intended to be a party and accept all Security Documents, for Agent's benefit and the Pro Rata benefit of Lenders. Each Lender agrees that any action taken by Agent or Required Lenders in accordance with the provisions of the Loan Documents, and the exercise by Agent or Required Lenders of any rights or remedies set forth therein, together with all other powers reasonably incidental thereto, shall be authorized by and binding upon all Lenders. Without limiting the generality of the foregoing, Agent shall have the sole and exclusive authority to (a) act as the disbursing and collecting agent for Lenders with respect to all payments and collections arising in connection with the Loan Documents; (b) execute and deliver as Agent each Loan Document, including any intercreditor or subordination agreement, and accept delivery of each Loan Document from any Obligor or other Person; (c) act as collateral agent for Secured Parties for purposes of perfecting and administering Liens under the Loan Documents, and for all other purposes stated therein; (d) manage, supervise or otherwise deal with Collateral; and (e) take any Enforcement Action or otherwise exercise any rights or remedies with respect to any Collateral under the Loan Documents, Applicable Law or otherwise. The duties of Agent shall be ministerial and administrative in nature, and Agent shall not have a fiduciary relationship with any Lender, Secured Party, Participant or other Person, by reason of any Loan Document or any transaction relating thereto. Agent alone shall be authorized to determine whether any Accounts or Inventory constitute Eligible Accounts, Eligible In-Transit Inventory or Eligible Inventory, or whether to impose or release any reserve, which determinations and judgments, if exercised in good faith, shall exonerate Agent from liability to any Lender or other Person for any error in judgment.

12.1.2 Duties. Agent shall not have any duties except those expressly set forth in the Loan Documents. The conferral upon Agent of any right shall not imply a duty on Agent's part to exercise such right, unless instructed to do so by Required Lenders in accordance with this Agreement.

12.1.3 Agent Professionals. Agent may perform its duties through agents and employees. Agent may consult with and employ Agent Professionals, and shall be entitled to act upon, and shall be fully protected against any liability to the Lenders with respect to any action taken in good faith reliance upon, any advice given by an Agent Professional. Agent shall not be responsible to the Lenders for the negligence or misconduct of any agents, employees or Agent Professionals selected by it with reasonable care.

12.1.4 Instructions of Required Lenders. The rights and remedies conferred upon Agent under the Loan Documents may be exercised without the necessity of joinder of any other party, unless required by Applicable Law. Agent may request instructions from Required Lenders with respect to any act (including the failure to act) in connection with any Loan Documents, and may seek assurances to its satisfaction from Lenders of their indemnification obligations under **Section 12.6** against all Claims that could be incurred by Agent in connection with any act. Agent shall be entitled to refrain from any act until it has received such instructions or assurances, and Agent shall not incur liability to any Lender by reason of so refraining. Instructions of Required Lenders shall be binding upon all Lenders, and no Lender shall have any right of action whatsoever against Agent as a result of Agent acting or refraining from acting in accordance with the instructions of Required Lenders. Notwithstanding the foregoing, instructions by and consent of all Lenders shall be required in the circumstances described in **Section 14.1.1**, and in no event shall Required Lenders, without the prior written consent of each Lender, direct Agent to accelerate and demand payment of Loans held by one Lender without accelerating and demanding payment of all other Loans, nor to terminate the Commitments of one Lender without terminating the Commitments of all Lenders. In no event shall Agent be required to take any action that, in its opinion, is contrary to Applicable Law or any Loan Documents or could subject any Agent Indemnatee to personal liability.

## **12.2 Agreements Regarding Collateral and Field Examination Reports.**

12.2.1 Lien Releases; Care of Collateral. Lenders authorize Agent to release any Lien with respect to any Collateral (a) upon Full Payment of the Obligations; (b) that is the subject of an Asset Disposition which Borrowers certify in writing to Agent is a Permitted Asset Disposition or a Lien which Borrowers certify is a Permitted Lien entitled to priority over Agent's Liens (and Agent may rely conclusively on any such certificate without further inquiry); (c) that does not constitute a material part of the Collateral; or (d) with the written consent of all Lenders. Agent shall have no obligation whatsoever to any Lenders to assure that any Collateral exists or is owned by a Borrower, or is cared for, protected, insured or encumbered, nor to assure that Agent's Liens have been properly created, perfected or enforced, or are entitled to any particular priority, nor to exercise any duty of care with respect to any Collateral.

12.2.2 Possession of Collateral. Agent and Lenders appoint each other Lender as agent (for the benefit of Secured Parties) for the purpose of perfecting Liens in any Collateral held by such Lender, to the extent such Liens are perfected by possession. If any Lender obtains possession of any Collateral, it shall notify Agent thereof and, promptly upon Agent's request, deliver such Collateral to Agent or otherwise deal with it in accordance with Agent's instructions.

12.2.3 Reports. Agent shall promptly, upon receipt thereof, forward to each Lender copies of the results of any field audit, examination or appraisal prepared by or on behalf of Agent with respect to any Obligor or Collateral ("Report"). Each Lender agrees (a) that neither Bank of America nor Agent makes any representation or warranty as to the accuracy or completeness of any Report, and shall not be liable for any information contained in or omitted from any Report; (b) that the Reports are not intended to be comprehensive audits or examinations, and that Agent or any other Person performing any audit or examination will inspect only specific information regarding Obligations or the Collateral and will rely significantly upon Borrowers' books and records as well as upon representations of Borrowers' officers and employees; and (c) to keep all Reports confidential and strictly for such Lender's internal use, and not to distribute any Report (or the contents thereof) to any Person (except to such Lender's Participants, attorneys and accountants) or use any Report in any manner other than administration of the Loans and other Obligations. Each Lender agrees to indemnify and hold harmless Agent and any other Person preparing a Report from any action such Lender may take as a result of or any conclusion it may draw from any Report, as well as any Claims arising in connection with any third parties that obtain any part or contents of a Report through such Lender.

**12.3 Reliance By Agent.** Agent shall be entitled to rely, and shall be fully protected in relying, upon any certification, notice or other communication (including those by telephone, telex, telegram, telecopy or e-mail) believed by it to be genuine and correct and to have been signed, sent or made by the proper Person, and upon the advice and statements of Agent Professionals.

**12.4 Action Upon Default.** Agent shall not be deemed to have knowledge of any Default or Event of Default unless it has received written notice from a Lender or Borrower specifying the occurrence and nature thereof. If any Lender acquires knowledge of a Default or Event of Default, it shall promptly notify Agent and the other Lenders thereof in writing. Each Lender agrees that, except as otherwise provided in any Loan Documents or with the written consent of Agent and Required Lenders, it will not take any Enforcement Action, accelerate Obligations under any Loan Documents, or exercise any right that it might otherwise have under Applicable Law to credit bid at foreclosure sales, UCC sales or other similar dispositions of Collateral. Notwithstanding the foregoing, however, a Lender may take action to preserve or enforce its rights against an Obligor where a deadline or limitation period is applicable that would, absent such action, bar enforcement of Obligations held by such Lender, including the filing of proofs of claim in an Insolvency Proceeding.

**12.5 Ratable Sharing.** If any Lender shall obtain any payment or reduction of any Obligation, whether through set-off or otherwise, in excess of its share of such Obligation, determined on a Pro Rata basis or in accordance with **Section 5.6.1**, as applicable, such Lender shall forthwith purchase from Agent, Issuing Bank and the other Lenders such participations in the affected Obligation as are necessary to cause the purchasing Lender to share the excess payment or reduction on a Pro Rata basis or in accordance with **Section 5.6.1**, as applicable. If any of such payment or reduction is thereafter recovered from the purchasing Lender, the purchase shall be rescinded and the purchase price restored to the extent of such recovery, but without interest. No Lender shall set off against any Dominion Account without the prior consent of Agent.

**12.6 Indemnification of Agent Indemnitees.** EACH LENDER SHALL INDEMNIFY AND HOLD HARMLESS AGENT INDEMNITEES, TO THE EXTENT NOT REIMBURSED BY OBLIGORS (BUT WITHOUT LIMITING THE INDEMNIFICATION OBLIGATIONS OF OBLIGORS UNDER ANY LOAN DOCUMENTS), ON A PRO RATA BASIS, AGAINST ALL CLAIMS THAT MAY BE INCURRED BY OR ASSERTED AGAINST ANY AGENT INDEMNITEE, PROVIDED THE CLAIM RELATES TO OR ARISES FROM AN AGENT INDEMNITEE ACTING AS OR FOR AGENT (IN ITS CAPACITY AS AGENT). In Agent's discretion, it may reserve for any such Claims made against an Agent Indemnitee, and may satisfy any judgment, order or settlement relating thereto, from proceeds of Collateral prior to making any distribution of Collateral proceeds to Lenders. If Agent is sued by any receiver, bankruptcy trustee, debtor-in-possession or other Person for any alleged preference or fraudulent transfer, then any monies paid by Agent in settlement or satisfaction of such proceeding, together with all interest, costs and expenses (including attorneys' fees) incurred in the defense of same, shall be promptly reimbursed to Agent by each Lender to the extent of its Pro Rata share.

**12.7 Limitation on Responsibilities of Agent.** Agent shall not be liable to Lenders for any action taken or omitted to be taken under the Loan Documents, except for losses directly and solely caused by Agent's gross negligence or willful misconduct. Agent does not assume any responsibility for any failure or delay in performance or any breach by any Obligor or Lender of any obligations under the Loan Documents. Agent does not make to Lenders any express or implied warranty, representation or guarantee with respect to any Obligations, Collateral, Loan Documents or Obligor. No Agent Indemnitee



shall be responsible to Lenders for any recitals, statements, information, representations or warranties contained in any Loan Documents; the execution, validity, genuineness, effectiveness or enforceability of any Loan Documents; the genuineness, enforceability, collectibility, value, sufficiency, location or existence of any Collateral, or the validity, extent, perfection or priority of any Lien therein; the validity, enforceability or collectibility of any Obligations; or the assets, liabilities, financial condition, results of operations, business, creditworthiness or legal status of any Obligor or Account Debtor. No Agent Indemnitee shall have any obligation to any Lender to ascertain or inquire into the existence of any Default or Event of Default, the observance or performance by any Obligor of any terms of the Loan Documents, or the satisfaction of any conditions precedent contained in any Loan Documents.

## **12.8 Successor Agent and Co-Agents.**

12.8.1 **Resignation; Successor Agent.** Subject to the appointment and acceptance of a successor Agent as provided below, Agent may resign at any time by giving at least 30 days written notice thereof to Lenders and Borrowers. Upon receipt of such notice, Required Lenders shall have the right to appoint a successor Agent which shall be (a) a Lender or an Affiliate of a Lender; or (b) a commercial bank that is organized under the laws of the United States or any state or district thereof, has a combined capital surplus of at least \$200,000,000 and (provided no Default or Event of Default exists) is reasonably acceptable to Borrowers. If no successor agent is appointed prior to the effective date of the resignation of Agent, then Agent may appoint a successor agent from among Lenders. Upon acceptance by a successor Agent of an appointment to serve as Agent hereunder, such successor Agent shall thereupon succeed to and become vested with all the powers and duties of the retiring Agent without further act, and the retiring Agent shall be discharged from its duties and obligations hereunder but shall continue to have the benefits of the indemnification set forth in **Sections 12.6** and **14.2**. Notwithstanding any Agent's resignation, the provisions of this **Section 12** shall continue in effect for its benefit with respect to any actions taken or omitted to be taken by it while Agent. Any successor to Bank of America by merger or acquisition of stock or this loan shall continue to be Agent hereunder without further act on the part of the parties hereto, unless such successor resigns as provided above.

12.8.2 **Separate Collateral Agent.** It is the intent of the parties that there shall be no violation of any Applicable Law denying or restricting the right of financial institutions to transact business in any jurisdiction. If Agent believes that it may be limited in the exercise of any rights or remedies under the Loan Documents due to any Applicable Law, Agent may appoint an additional Person who is not so limited, as a separate collateral agent or co-collateral agent. If Agent so appoints a collateral agent or co-collateral agent, each right and remedy intended to be available to Agent under the Loan Documents shall also be vested in such separate agent. Every covenant and obligation necessary to the exercise thereof by such agent shall run to and be enforceable by it as well as Agent. Lenders shall execute and deliver such documents as Agent deems appropriate to vest any rights or remedies in such agent. If any collateral agent or co-collateral agent shall die or dissolve, become incapable of acting, resign or be removed, then all the rights and remedies of such agent, to the extent permitted by Applicable Law, shall vest in and be exercised by Agent until appointment of a new agent.

**12.9 Due Diligence and Non-Reliance.** Each Lender acknowledges and agrees that it has, independently and without reliance upon Agent or any other Lenders, and based upon such documents, information and analyses as it has deemed appropriate, made its own credit analysis of each Obligor and its own decision to enter into this Agreement and to fund Loans and participate in LC Obligations hereunder. Each Lender has made such inquiries concerning the Loan Documents, the Collateral and each Obligor as such Lender feels necessary. Each Lender further acknowledges and agrees that the other Lenders and Agent have made no representations or warranties concerning any Obligor, any Collateral or the legality, validity, sufficiency or enforceability of any Loan Documents or Obligations. Each Lender will, independently and without reliance upon the other Lenders or Agent, and based upon such financial

statements, documents and information as it deems appropriate at the time, continue to make and rely upon its own credit decisions in making Loans and participating in LC Obligations, and in taking or refraining from any action under any Loan Documents. Except for notices, reports and other information expressly requested by a Lender, Agent shall have no duty or responsibility to provide any Lender with any notices, reports or certificates furnished to Agent by any Obligor or any credit or other information concerning the affairs, financial condition, business or Properties of any Obligor (or any of its Affiliates) which may come into possession of Agent or any of Agent's Affiliates.

**12.10 Replacement of Certain Lenders.** If a Lender (a) fails to fund its Pro Rata share of any Loan or LC Obligation hereunder, and such failure is not cured within two Business Days, (b) defaults in performing any of its obligations under the Loan Documents, or (c) fails to give its consent to any amendment, waiver or action for which consent of all Lenders was required and Required Lenders consented, then, in addition to any other rights and remedies that any Person may have, Agent may (and shall use commercially reasonable efforts to, upon reasonable request of the Borrowers), by notice to such Lender within 120 days after such event, require such Lender to assign all of its rights and obligations under the Loan Documents to Eligible Assignee(s) specified by Agent, pursuant to appropriate Assignment and Acceptance(s) and within 20 days after Agent's notice. Agent is irrevocably appointed as attorney-in-fact to execute any such Assignment and Acceptance if the Lender fails to execute same. Such Lender shall be entitled to receive, in cash, concurrently with such assignment, all amounts owed to it under the Loan Documents, including all principal, interest and fees through the date of assignment (but excluding any prepayment charge).

**12.11 Remittance of Payments and Collections.**

12.11.1 **Remittances Generally.** All payments by any Lender to Agent shall be made by the time and on the day set forth in this Agreement, in immediately available funds. If no time for payment is specified or if payment is due on demand by Agent and request for payment is made by Agent by 11:00 a.m. on a Business Day, payment shall be made by Lender not later than 2:00 p.m. on such day, and if request is made after 11:00 a.m., then payment shall be made by 11:00 a.m. on the next Business Day. Payment by Agent to any Lender shall be made by wire transfer, in the type of funds received by Agent. Any such payment shall be subject to Agent's right of offset for any amounts due from such Lender under the Loan Documents.

12.11.2 **Failure to Pay.** If any Lender fails to pay any amount when due by it to Agent pursuant to the terms hereof, such amount shall bear interest from the due date until paid at the rate determined by Agent as customary in the banking industry for interbank compensation. In no event shall Borrowers be entitled to receive credit for any interest paid by a Lender to Agent.

12.11.3 **Recovery of Payments.** If Agent pays any amount to a Lender in the expectation that a related payment will be received by Agent from an Obligor and such related payment is not received, then Agent may recover such amount from each Lender that received it. If Agent determines at any time that an amount received under any Loan Document must be returned to an Obligor or paid to any other Person pursuant to Applicable Law or otherwise, then, notwithstanding any other term of any Loan Document, Agent shall not be required to distribute such amount to any Lender. If any amounts received and applied by Agent to any Obligations are later required to be returned by Agent pursuant to Applicable Law, each Lender shall pay to Agent, **on demand**, such Lender's Pro Rata share of the amounts required to be returned.

**12.12 Agent in its Individual Capacity.** As a Lender, Bank of America shall have the same rights and remedies under the other Loan Documents as any other Lender, and the terms "Lenders," "Required Lenders" or any similar term shall include Bank of America in its capacity as a Lender. Each

of Bank of America and its Affiliates may accept deposits from, maintain deposits or credit balances for, invest in, lend money to, provide Bank Products to, act as trustee under indentures of, serve as financial or other advisor to, and generally engage in any kind of business with, Obligors and their Affiliates, as if Bank of America were any other bank, without any duty to account therefor (including any fees or other consideration received in connection therewith) to the other Lenders. In their individual capacity, Bank of America and its Affiliates may receive information regarding Obligors, their Affiliates and their Account Debtors (including information subject to confidentiality obligations), and each Lender agrees that Bank of America and its Affiliates shall be under no obligation to provide such information to Lenders, if acquired in such individual capacity and not as Agent hereunder.

**12.13 Agent Titles.** Each Lender, other than Bank of America, that is designated (on the cover page of this Agreement or otherwise) by Bank of America as an “Agent” or “Arranger” of any type shall not have any right, power, responsibility or duty under any Loan Documents other than those applicable to all Lenders, and shall in no event be deemed to have any fiduciary relationship with any other Lender.

**12.14 No Third Party Beneficiaries.** This Section 12 is an agreement solely among Lenders and Agent, and shall survive Full Payment of the Obligations. This Section 12 does not confer any rights or benefits upon Borrowers or any other Person other than as specifically set forth herein. As between Borrowers and Agent, any action that Agent may take under any Loan Documents or with respect to any Obligations shall be conclusively presumed to have been authorized and directed by Lenders.

### **SECTION 13. BENEFIT OF AGREEMENT; ASSIGNMENTS AND PARTICIPATIONS**

**13.1 Successors and Assigns.** This Agreement shall be binding upon and inure to the benefit of Borrowers, Agent, Lenders, and their respective successors and assigns, except that (a) no Borrower shall have the right to assign its rights or delegate its obligations under any Loan Documents; and (b) any assignment by a Lender must be made in compliance with Section 13.3. Agent may treat the Person which made any Loan as the owner thereof for all purposes until such Person makes an assignment in accordance with Section 13.3. Any authorization or consent of a Lender shall be conclusive and binding on any subsequent transferee or assignee of such Lender.

#### **13.2 Participations.**

**13.2.1 Permitted Participants; Effect.** Any Lender may, in the ordinary course of its business and in accordance with Applicable Law, at any time sell to a financial institution (“Participant”) a participating interest in the rights and obligations of such Lender under any Loan Documents. Despite any sale by a Lender of participating interests to a Participant, such Lender’s obligations under the Loan Documents shall remain unchanged, such Lender shall remain solely responsible to the other parties hereto for performance of such obligations, such Lender shall remain the holder of its Loans and Commitments for all purposes, all amounts payable by Borrowers shall be determined as if such Lender had not sold such participating interests, and Borrowers and Agent shall continue to deal solely and directly with such Lender in connection with the Loan Documents. Each Lender shall be solely responsible for notifying its Participants of any matters under the Loan Documents, and Agent and the other Lenders shall not have any obligation or liability to any such Participant. **A Participant that would be a Foreign Lender if it were a Lender shall not be entitled to the benefits of Section 5.9 unless Borrowers agree otherwise in writing.**

**13.2.2 Voting Rights.** Each Lender shall retain the sole right to approve, without the consent of any Participant, any amendment, waiver or other modification of any Loan Documents other than that which forgives principal, interest or fees, reduces the stated interest rate or fees payable with respect to any Loan or Commitment in which such Participant has an interest, postpones the Commitment Termination Date or any date fixed for any regularly scheduled payment of principal, interest or fees on such Loan or Commitment, or releases any Borrower, Guarantor or substantial portion of the Collateral.

13.2.3 **Benefit of Set-Off.** Borrowers agree that each Participant shall have a right of set-off in respect of its participating interest to the same extent as if such interest were owing directly to a Lender, and each Lender shall also retain the right of set-off with respect to any participating interests sold by it. By exercising any right of set-off, a Participant agrees to share with Lenders all amounts received through its set-off, in accordance with **Section 12.5** as if such Participant were a Lender.

### **13.3 Assignments.**

13.3.1 **Permitted Assignments.** A Lender may assign to an Eligible Assignee any of its rights and obligations under the Loan Documents, as long as (a) each assignment is of a constant, and not a varying, percentage of the transferor Lender's rights and obligations under the Loan Documents and, in the case of a partial assignment, is in a minimum principal amount of \$10,000,000 (unless otherwise agreed by Agent in its discretion) and integral multiples of \$5,000,000 in excess of that amount; (b) except in the case of an assignment in whole of a Lender's rights and obligations, the aggregate amount of the Commitments retained by the transferor Lender is at least \$10,000,000 (unless otherwise agreed by Agent in its discretion); and (c) the parties to each such assignment shall execute and deliver to Agent, for its acceptance and recording, an Assignment and Acceptance; provided, however, that (i) the total number of creditors (other than Qualifying Banks) of the Swiss Borrower under the Loan Documents shall not at any time exceed the number of ten (10), in each case in accordance with the meaning of the Guidelines and (ii) the total number of creditors (other than Qualifying Banks) to whom the Swiss Borrower has Debt outstanding shall not at any time exceed the number of twenty (20), in each case in accordance with the meaning of the Guidelines, as a result of such assignment or transfer, and provided further that the new Lender is a Treaty Lender. Nothing herein shall limit the right of a Lender to pledge or assign any rights under the Loan Documents to (i) any Federal Reserve Bank or the United States Treasury as collateral security pursuant to Regulation A of the Board of Governors and any Operating Circular issued by such Federal Reserve Bank, or (ii) counterparties to swap agreements relating to any Loans; provided, however, that any payment by Borrowers to the assigning Lender in respect of any Obligations assigned as described in this sentence shall satisfy Borrowers' obligations hereunder to the extent of such payment, and no such assignment shall release the assigning Lender from its obligations hereunder.

13.3.2 **Effect; Effective Date.** Upon delivery to Agent of an assignment notice in the form of Exhibit D and a processing fee of \$3,500 (unless otherwise agreed by Agent in its discretion), the assignment shall become effective as specified in the notice, if it complies with this **Section 13.3**. From such effective date, the Eligible Assignee shall for all purposes be a Lender under the Loan Documents, and shall have all rights and obligations of a Lender thereunder. Upon consummation of an assignment, the transferor Lender, Agent and Borrowers shall make appropriate arrangements for issuance of replacement and/or new Notes, as applicable. The transferee Lender shall comply with **Section 5.10** and deliver, upon request, an administrative questionnaire reasonably satisfactory to Agent.

## **SECTION 14. MISCELLANEOUS**

### **14.1 Consents, Amendments and Waivers.**

14.1.1 **Amendment.** No modification of any Loan Document, including any extension or amendment of a Loan Document or any waiver of a Default or Event of Default, shall be effective without the prior written agreement of Agent (with the consent of Required Lenders) and each Obligor party to such Loan Document; provided, however, that

(a) without the prior written consent of Agent, no modification shall be effective with respect to any provision in a Loan Document that relates to any rights, duties or discretion of Agent;

(b) without the prior written consent of Issuing Bank, no modification shall be effective with respect to any LC Obligations or **Section 2.3**;

(c) without the prior written consent of each affected Lender, no modification shall be effective that would (i) increase the Commitment of such Lender; or (ii) reduce the amount of, or waive or delay payment of, any principal, interest or fees payable to such Lender; and

(d) without the prior written consent of all Lenders (except a defaulting Lender as provided in **Section 4.2**), no modification shall be effective that would (i) extend the Revolver Termination Date or Term Loan Maturity Date; (ii) alter **Section 5.6, 7.1** (except to add Collateral) or **14.1.1**; (iii) amend the definitions of Borrowing Base (and the defined terms used in such definition), Pro Rata or Required Lenders; (iv) increase any advance rate, decrease the Availability Block or the Books and Records Block or increase total Commitments; (v) release Collateral with a book value greater than \$5,000,000 during any calendar year, except as currently contemplated by the Loan Documents; or (vi) release any Obligor from liability for any Obligations, if such Obligor is Solvent at the time of the release.

**14.1.2 Limitations.** The agreement of Borrowers shall not be necessary to the effectiveness of any modification of a Loan Document that deals solely with the rights and duties of Lenders, Agent and/or Issuing Bank as among themselves. Only the consent of the parties to the Fee Letter or any agreement relating to a Bank Product shall be required for any modification of such agreement, and no Affiliate of a Lender that is party to a Bank Product agreement shall have any other right to consent to or participate in any manner in modification of any other Loan Document. The making of any Loans during the existence of a Default or Event of Default shall not be deemed to constitute a waiver of such Default or Event of Default, nor to establish a course of dealing. Any waiver or consent granted by Lenders hereunder shall be effective only if in writing, and then only in the specific instance and for the specific purpose for which it is given.

**14.1.3 Payment for Consents.** No Borrower will, directly or indirectly, pay any remuneration or other thing of value, whether by way of additional interest, fee or otherwise, to any Lender (in its capacity as a Lender hereunder) as consideration for agreement by such Lender with any modification of any Loan Documents, unless such remuneration or value is concurrently paid, on the same terms, on a Pro Rata basis to all Lenders providing their consent.

**14.2 Indemnity.** EACH BORROWER SHALL INDEMNIFY AND HOLD HARMLESS THE INDEMNITEES AGAINST ANY CLAIMS THAT MAY BE INCURRED BY OR ASSERTED AGAINST ANY INDEMNITEE, INCLUDING CLAIMS ARISING FROM THE NEGLIGENCE OF AN INDEMNITEE EXCEPT TO THE EXTENT SUCH CLAIM IS AS A RESULT OF BAD FAITH, GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF SUCH INDEMNITEE OR ITS AGENTS, OFFICERS, DIRECTORS, ATTORNEYS, ADVISORS OR AFFILIATES. Without limiting in any way the foregoing, each Borrower shall fully indemnify and hold harmless the Indemnitees for any breach of any representation, warranty or covenant in this Agreement, including but not limited to those made in **Section 9.1.15**. In no event shall any party to a Loan Document have any obligation thereunder to indemnify or hold harmless an Indemnitee with respect to a Claim that is determined in a final judgment by a court of competent jurisdiction for which the appeal period has expired to result from the bad faith, gross negligence or willful misconduct of such Indemnitee or its agents, officers, directors, attorneys, advisors or Affiliates.

#### **14.3 Notices and Communications.**

14.3.1 **Notice Address.** Subject to **Section 4.1.4**, all notices and other communications by or to a party hereto shall be in writing and shall be given to any Borrower, at Borrower Agent's address shown on the signature pages hereof, and to any other Person at its address shown on the signature pages hereof (or, in the case of a Person who becomes a Lender after the Closing Date, at the address shown on its Assignment and Acceptance), or at such other address as a party may hereafter specify by notice in accordance with this **Section 14.3**. Each such notice or other communication shall be effective only (a) if given by facsimile transmission, when transmitted to the applicable facsimile number, if confirmation of receipt is received; (b) if given by mail, three Business Days after deposit in the U.S. mail, with first-class postage pre-paid, addressed to the applicable address; or (c) if given by personal delivery, when duly delivered to the notice address with receipt acknowledged. Notwithstanding the foregoing, no notice to Agent pursuant to **Section 2.1.4, 2.3, 3.1.2, 4.1.1 or 5.3.3** shall be effective until actually received by the individual to whose attention at Agent such notice is required to be sent. Any written notice or other communication that is not sent in conformity with the foregoing provisions shall nevertheless be effective on the date actually received by the noticed party. Any notice received by Borrower Agent shall be deemed received by all Borrowers.

14.3.2 **Electronic Communications; Voice Mail.** Electronic mail and internet websites may be used only for routine communications, such as financial statements, Borrowing Base Certificates and other information required by **Section 10.1.2**, administrative matters, distribution of Loan Documents for execution, and matters permitted under **Section 4.1.4**. Agent and Lenders make no assurances as to the privacy and security of electronic communications. Electronic and voice mail may not be used as effective notice under the Loan Documents.

14.3.3 **Non-Conforming Communications.** Agent and Lenders may rely upon any notices purportedly given by or on behalf of any Borrower even if such notices were not made in a manner specified herein, were incomplete or were not confirmed, or if the terms thereof, as understood by the recipient, varied from a later confirmation. Each Borrower shall indemnify and hold harmless each Indemnitee from any liabilities, losses, costs and expenses arising from any telephonic communication purportedly given by or on behalf of a Borrower.

**14.4 Performance of Borrowers' Obligations.** Agent may, in its discretion at any time and from time to time, at Borrowers' expense, pay any amount or do any act required of a Borrower under any Loan Documents or otherwise lawfully requested by Agent to (a) enforce any Loan Documents or collect any Obligations; (b) protect, insure, maintain or realize upon any Collateral; or (c) defend or maintain the validity or priority of Agent's Liens in any Collateral, including any payment of a judgment, insurance premium, warehouse charge, finishing or processing charge, or landlord claim, or any discharge of a Lien. All payments, costs and expenses (including Extraordinary Expenses) of Agent under this Section shall be reimbursed to Agent by Borrowers, **on demand**, with interest from the date incurred to the date of payment thereof at the Default Rate applicable to Base Rate Revolver Loans. Any payment made or action taken by Agent under this Section shall be without prejudice to any right to assert an Event of Default or to exercise any other rights or remedies under the Loan Documents.

**14.5 Credit Inquiries.** Each Borrower hereby authorizes Agent and Lenders (but they shall have no obligation) to respond to usual and customary credit inquiries from third parties concerning any Borrower or Subsidiary.

**14.6 Severability.** Wherever possible, each provision of the Loan Documents shall be interpreted in such manner as to be valid under Applicable Law. If any provision is found to be invalid under Applicable Law, it shall be ineffective only to the extent of such invalidity and the remaining provisions of the Loan Documents shall remain in full force and effect.

**14.7 Cumulative Effect; Conflict of Terms.** The provisions of the Loan Documents are cumulative. The parties acknowledge that the Loan Documents may use several limitations, tests or measurements to regulate similar matters, and they agree that these are cumulative and that each must be performed as provided. Except as otherwise provided in another Loan Document (by specific reference to the applicable provision of this Agreement), if any provision contained herein is in direct conflict with any provision in another Loan Document, the provision herein shall govern and control.

**14.8 Counterparts.** Any Loan Document may be executed in counterparts, each of which shall constitute an original, but all of which when taken together shall constitute a single contract. This Agreement shall become effective when Agent has received counterparts bearing the signatures of all parties hereto. Delivery of a signature page of any Loan Document by telecopy shall be effective as delivery of a manually executed counterpart of such agreement.

**14.9 Entire Agreement.** Time is of the essence of the Loan Documents. The Loan Documents constitute the entire contract among the parties relating to the subject matter hereof, and supersede any and all previous agreements and understandings, oral or written, relating to the subject matter hereof.

**14.10 Relationship with Lenders.** The obligations of each Lender hereunder are several, and no Lender shall be responsible for the obligations or Commitments of any other Lender. Amounts payable hereunder to each Lender shall be a separate and independent debt, and each Lender shall be entitled, to the extent not otherwise restricted hereunder, to protect and enforce its rights arising out of the Loan Documents. It shall not be necessary for Agent or any other Lender to be joined as an additional party in any proceeding for such purposes. Nothing in this Agreement and no action of Agent or Lenders pursuant to the Loan Documents shall be deemed to constitute Agent and Lenders to be a partnership, association, joint venture or any other kind of entity, nor to constitute control of any Borrower.

**14.11 No Advisory or Fiduciary Responsibility.** In connection with all aspects of each transaction contemplated by any Loan Document, Borrowers acknowledge and agree that (a)(i) this credit facility and any related arranging or other services by Agent, any Lender, any of their Affiliates or any arranger are arm's-length commercial transactions between Borrowers and such Person; (ii) Borrowers have consulted their own legal, accounting, regulatory and tax advisors to the extent they have deemed appropriate; and (iii) Borrowers are capable of evaluating and understanding, and do understand and accept, the terms, risks and conditions of the transactions contemplated by the Loan Documents; (b) each of Agent, Lenders, their Affiliates and any arranger is and has been acting solely as a principal in connection with this credit facility, is not the financial advisor, agent or fiduciary for Borrowers, any of their Affiliates or any other Person, and has no obligation with respect to the transactions contemplated by the Loan Documents except as expressly set forth therein; and (c) Agent, Lenders, their Affiliates and any arranger may be engaged in a broad range of transactions that involve interests that differ from Borrowers and their Affiliates, and have no obligation to disclose any of such interests to Borrowers or their Affiliates. To the fullest extent permitted by Applicable Law, each Borrower hereby waives and releases any claims that it may have against Agent, Lenders, their Affiliates and any arranger with respect to any breach or alleged breach of agency or fiduciary duty in connection with any aspect of any transaction contemplated by a Loan Document.

**14.12 Confidentiality.** Each of Agent, Lenders and Issuing Bank agrees to maintain the confidentiality of all Information (as defined below), except that Information may be disclosed (a) to its Affiliates and to its and its Affiliates' respective partners, directors, officers, employees, agents, advisors

and representatives (it being understood that the Persons to whom such disclosure is made will be informed of the confidential nature of such Information and instructed to keep such Information confidential); (b) to the extent requested by any regulatory authority purporting to have jurisdiction over it (including any self-regulatory authority, such as the National Association of Insurance Commissioners); (c) to the extent required by Applicable Law or by any subpoena or similar legal process, provided that such disclosing party will use commercially reasonable efforts to give Borrowers notice prior to such disclosure to the extent such notice is permitted by Applicable Law; (d) to any other party hereto; (e) in connection with the exercise of any remedies, the enforcement of any rights, or any action or proceeding relating to any Loan Documents; (f) subject to an agreement containing provisions substantially the same as those of this Section, to any Transferee or any actual or prospective party (or its advisors) to any Bank Product; (g) with the consent of the Borrower; or (h) to the extent such Information (i) becomes publicly available other than as a result of a breach of this Section or (ii) becomes available to Agent, any Lender, Issuing Bank or any of their Affiliates on a nonconfidential basis from a source other than Borrowers. Notwithstanding the foregoing, Agent and Lenders may issue and disseminate to the public general information describing this credit facility, including the names and addresses of Borrowers and a general description of Borrowers' businesses, and may use Borrowers' names in advertising and other promotional materials. For purposes of this Section, "Information" means all information received from an Obligor or Subsidiary relating to it or its business, other than any information that is available to Agent, any Lender or Issuing Bank on a nonconfidential basis prior to disclosure by the Obligor or Subsidiary. Any Person required to maintain the confidentiality of Information pursuant to this Section shall be considered to have complied with its obligation to do so if such Person has exercised the same degree of care to maintain the confidentiality of such Information as such Person would accord to its own confidential information. Each of Agent, Lenders and Issuing Bank acknowledges that (i) Information may include material non-public information concerning an Obligor or Subsidiary; (ii) it has developed compliance procedures regarding the use of material non-public information; and (iii) it will handle such material non-public information in accordance with Applicable Law, including federal and state securities laws.

**14.13 GOVERNING LAW.** THIS AGREEMENT AND THE OTHER LOAN DOCUMENTS, UNLESS OTHERWISE SPECIFIED, SHALL BE GOVERNED BY THE LAWS OF THE STATE OF CALIFORNIA, WITHOUT GIVING EFFECT TO ANY CONFLICT OF LAW PRINCIPLES (BUT GIVING EFFECT TO FEDERAL LAWS RELATING TO NATIONAL BANKS).

**14.14 Consent to Forum; Arbitration.**

14.14.1 Forum. EACH BORROWER HEREBY CONSENTS TO THE NON-EXCLUSIVE JURISDICTION OF ANY FEDERAL OR STATE COURT SITTING IN OR WITH JURISDICTION OVER LOS ANGELES COUNTY, CALIFORNIA, IN ANY PROCEEDING OR DISPUTE RELATING IN ANY WAY TO ANY LOAN DOCUMENTS, AND AGREES THAT ANY SUCH PROCEEDING SHALL BE BROUGHT BY IT SOLELY IN ANY SUCH COURT. EACH BORROWER IRREVOCABLY WAIVES ALL CLAIMS, OBJECTIONS AND DEFENSES THAT IT MAY HAVE REGARDING SUCH COURT'S PERSONAL OR SUBJECT MATTER JURISDICTION, VENUE OR INCONVENIENT FORUM. EACH PARTY HERETO IRREVOCABLY CONSENTS TO SERVICE OF PROCESS IN THE MANNER PROVIDED FOR NOTICES IN SECTION 14.3.1. Nothing herein shall limit the right of Agent or any Lender to bring proceedings against any Obligor in any other court reasonably deemed necessary or appropriate by Agent or such Lender in its discretion, nor limit the right of any party to serve process in any other manner permitted by Applicable Law. Nothing in this Agreement shall be deemed to preclude enforcement by Agent of any judgment or order obtained in any forum or jurisdiction.



14.14.2 **Arbitration.** Notwithstanding any other provision of this Agreement to the contrary, any controversy or claim among the parties relating in any way to any Obligations or Loan Documents, including any alleged tort, shall at the request of any party hereto be determined by binding arbitration conducted in accordance with the United States Arbitration Act (Title 9 U.S. Code). Arbitration proceedings will be determined in accordance with the Act, the then-current rules and procedures for the arbitration of financial services disputes of the American Arbitration Association (“AAA”), and the terms of this Section. In the event of any inconsistency, the terms of this Section shall control. If AAA is unwilling or unable to serve as the provider of arbitration or to enforce any provision of this Section, Agent may designate another arbitration organization with similar procedures to serve as the provider of arbitration. The arbitration proceedings shall be conducted in Los Angeles or Pasadena, California. The arbitration hearing shall commence within 90 days of the arbitration demand and close within 90 days thereafter. The arbitration award must be issued within 30 days after close of the hearing (subject to extension by the arbitrator for up to 60 days upon a showing of good cause), and shall include a concise written statement of reasons for the award. The arbitrator shall give effect to applicable statutes of limitation in determining any controversy or claim, and for these purposes, service on AAA under applicable AAA rules of a notice of claim is the equivalent of the filing of a lawsuit. Any dispute concerning this Section or whether a controversy or claim is arbitrable shall be determined by the arbitrator. The arbitrator shall have the power to award legal fees to the extent provided by this Agreement. Judgment upon an arbitration award may be entered in any court having jurisdiction. The institution and maintenance of an action for judicial relief or pursuant to a provisional or ancillary remedy shall not constitute a waiver of the right of any party, including the plaintiff, to submit the controversy or claim to arbitration if any other party contests such action for judicial relief. No controversy or claim shall be submitted to arbitration without the consent of all parties if, at the time of the proposed submission, such controversy or claim relates to an obligation secured by Real Estate, but if all parties do not consent to submission of such a controversy or claim to arbitration, it shall be determined as provided in the next sentence. At the request of any party, a controversy or claim that is not submitted to arbitration as provided above shall be determined by judicial reference; and if such an election is made, the parties shall designate to the court a referee or referees selected under the auspices of the AAA in the same manner as arbitrators are selected in AAA sponsored proceedings and the presiding referee of the panel (or the referee if there is a single referee) shall be an active attorney or retired judge; and judgment upon the award rendered by such referee or referees shall be entered in the court in which proceeding was commenced. None of the foregoing provisions of this Section shall limit the right of Agent or Lenders to exercise self-help remedies, such as setoff, foreclosure or sale of any Collateral or to obtain provisional or ancillary remedies from a court of competent jurisdiction before, after or during any arbitration proceeding. The exercise of a remedy does not waive the right of any party to resort to arbitration or reference. At Agent’s option, foreclosure under a Mortgage may be accomplished either by exercise of power of sale thereunder or by judicial foreclosure.

14.15 **Waivers by Borrowers.** To the fullest extent permitted by Applicable Law, each Borrower waives (a) the right to trial by jury (which Agent and each Lender hereby also waives) in any proceeding or dispute of any kind relating in any way to any Loan Documents, Obligations or Collateral; (b) presentment, demand, protest, notice of presentment, default, non-payment, maturity, release, compromise, settlement, extension or renewal of any commercial paper, accounts, documents, instruments, chattel paper and guaranties at any time held by Agent on which a Borrower may in any way be liable, and hereby ratifies anything Agent may do in this regard; (c) notice prior to taking possession or control of any Collateral; (d) any bond or security that might be required by a court prior to allowing Agent to exercise any rights or remedies; (e) the benefit of all valuation, appraisal and exemption laws; (f) any claim against Agent or any Lender, on any theory of liability, for special, indirect, consequential, exemplary or punitive damages (as opposed to direct or actual damages) in any way relating to any Enforcement Action, Obligations, Loan Documents or transactions relating thereto; and (g) notice of acceptance hereof. Each Borrower acknowledges that the foregoing waivers are a material inducement to Agent and Lenders entering into this Agreement and that Agent and Lenders are relying upon the foregoing in their dealings with Borrowers. Each Borrower has reviewed the foregoing waivers with its legal counsel and has knowingly and voluntarily waived its jury trial and other rights following consultation with legal counsel. In the event of litigation, this Agreement may be filed as a written consent to a trial by the court.

#### **14.16 Parallel Debt.**

14.16.1 Each Obligor irrevocably and unconditionally undertakes (and to the extent necessary undertakes in advance (*bij voorbaat*)) to pay to Agent amounts equal to any amounts owing from time to time by that Obligor to any Lender under this Agreement as and when those amounts are due.

14.16.2 Each party hereto acknowledges that the obligations of each Obligor under **Section 14.16.1** are several and are separate and independent (*eigen zelfstandige verplichting*) from, and shall not in any way limit or affect, the corresponding obligations of that Obligor to any Lender under any Loan Document (its “Corresponding Debt”) nor shall the amounts for which each Obligor is liable under **Section 14.16.1** (its “Parallel Debt”) be limited or affected in any way by the Corresponding Debt provided that:

(a) the Parallel Debt of an Obligor shall be decreased to the extent that its Corresponding Debt has been irrevocably paid or (in the case of guarantee obligations) discharged; and

(b) the Corresponding Debt of an Obligor shall be decreased to the extent its Parallel Debt has been irrevocably paid or (in the case of guarantee obligations) discharged; and

(c) the amount of the Parallel Debt of an Obligor shall at all times be equal to the amount of its Corresponding Debt.

14.16.3 For the purpose of this **Section 14.16**, Agent acts in its own name and on behalf of itself and not as agent, representative or trustee of any other Lender, and its claims in respect of a Parallel Debt shall not be held on trust. The security granted to Agent to secure a Parallel Debt is granted to Agent in its capacity as sole creditor of a Parallel Debt and shall not be held on trust.

14.16.4 All monies received or recovered by Agent pursuant to this **Section 14.16**, and all amounts received or recovered by Agent from or by the enforcement of any security granted to secure a Parallel Debt, shall be applied in accordance with **Section 5.7**.

14.16.5 Without limiting or affecting the Agent’s rights against an Obligor (whether under this **Section 14.16** or under any other provision of this Agreement), each Obligor acknowledges that:

(a) nothing in this **Section 14.16** shall impose any obligation on Agent to advance any sum to an Obligor or otherwise under this Agreement, except in its capacity as Lender; and

(b) for the purpose of any vote taken under this Agreement, Agent shall not be regarded as having any participation or commitment other than those which it has in its capacity as a Lender.

14.16.6 For the avoidance of doubt, a Parallel Debt will become due and payable (*opeisbaar*) at the same time a Corresponding Debt becomes due and payable.

14.16.7 Each party hereto confirms that, in accordance with this **Section 14.16** a claim of Agent against an Obligor in respect of its Parallel Debt does not constitute common property (*een gemeenschap*) within the meaning of Section 3:166 of the Dutch Civil Code and that the provisions relating to such common property shall not apply. If, however, it shall be held that such claim of Agent does constitute such common property and such provisions do apply, the parties hereto agree that this Agreement shall constitute the administration agreement (*beheersregeling*) within the meaning of Section 3:168 of the Dutch Civil Code.

**14.17 Limitations - Swiss Borrower.** If and to the extent that obligations of any Swiss Obligor under the Loan Documents are for the benefit of its Affiliates (other than its Subsidiaries) and that complying with such obligations would constitute a repayment of capital (*Einlagerückgewähr*) or the payment of a (constructive) dividend (*Gewinnausschüttung*), the following shall apply:

(a) The aggregate obligations of the Swiss Obligor under the Loan Documents shall be limited to the maximum amount (the “Available Amount”) of the Swiss Obligor’s profits and reserves available for distribution, in each case in accordance with, without limitation, articles 671(1) to (3) and 675(2) of the Swiss Code of Obligations at the time these obligations become due; the Available Amount shall include the equity capital surplus (including any unrestricted portion of legal general reserves, restricted reserves which may be converted into free reserves, other free reserves, retained earnings and current net profits) which is freely available (as the case may be after conversion) for distribution to shareholders under Swiss law. The Swiss Obligor shall at the request of the Agent take all measures legally permissible required to ensure that the Available Amount is as high as possible under Swiss law, including by converting restricted reserves into distributable reserves.

(b) In the event that the Swiss Obligor is required to make a payment or otherwise dispose of its assets under the Loan Documents and such payment or disposal is subject to the limitations set out in **Section 14.17(a)** above, the Swiss Obligor shall immediately:

(i) procure that, within five Business Days, its auditors (A) prepare an interim audited balance sheet, (B) determine the Available Amount based on such interim audited balance sheet and (C) confirm that the Available Amount complies with the provisions of Swiss corporate law which are aimed at protecting the share capital and legal reserves; and, immediately thereafter,

(ii) pay to the Agent, or dispose of (or allow a disposal of) assets equal to, the Available Amount (less, if required, the Swiss Withholding Tax as described in **Section 14.17(c)** below) in accordance with the Loan Documents.

(c) If so required under applicable law (including double tax treaties) at the time it is required to make a payment or dispose of its assets under the Loan Documents, the Swiss Obligor:

(i) may deduct the Swiss Withholding Tax at the rate of 35 per cent (or such other rate as is in force at that time) from any payment or disposal under the Loan Documents; and

(ii) may pay the Swiss Withholding Tax to the Swiss Federal Tax Administration; and

(iii) shall notify and provide evidence to the Agent that the Swiss Withholding Tax has been paid to the Swiss Federal Tax Administration.

(d) The Swiss Obligor shall not be required to make a gross-up, indemnify or otherwise hold harmless the Secured Parties for the deduction of the Swiss Withholding Tax, notwithstanding anything to the contrary contained herein, provided that this should not in any way limit any obligations of any other Obligor to indemnify the Secured Parties in respect of the deduction of the Swiss Withholding Tax.

(e) The Swiss Obligor shall use its best efforts to ensure that any person which is, as a result of a payment or disposal under the Loan Documents, entitled to a full or partial refund of the Swiss Withholding Tax, will, as soon as possible after the deduction of the Swiss Withholding Tax, (i) request a refund of the Swiss Withholding Tax under any applicable law (including double tax treaties) and (ii) pay to the Agent upon receipt any amount so refunded.

(f) The Swiss Obligor shall take and cause to be taken all and any other action, including the passing of any shareholders' resolutions to approve any payment or disposal under the Loan Documents, which may be required as a matter of Swiss mandatory law in force at the time it is required to make a payment or disposal under the Loan Documents in order to allow a prompt payment or disposal.

**14.18 Patriot Act Notice.** Agent and Lenders hereby notify Borrowers that pursuant to the requirements of the Patriot Act, Agent and Lenders are required to obtain, verify and record information that identifies each Borrower, including its legal name, address, tax ID number and other information that will allow Agent and Lenders to identify it in accordance with the Patriot Act. Agent and Lenders will also require information regarding each personal guarantor, if any, and may require information regarding Borrowers' management and owners, such as legal name, address, social security number and date of birth.

[Remainder of page intentionally left blank; signatures begin on following page]

IN WITNESS WHEREOF, this Agreement has been executed and delivered as of the date set forth above.

**BORROWERS:**  
NAUTILUS, INC., a Washington corporation

By: \_\_\_\_\_  
Title: \_\_\_\_\_  
Address: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Attn: \_\_\_\_\_  
Telecopy: \_\_\_\_\_

NAUTILUS INTERNATIONAL S.A., a Swiss  
\_\_\_\_\_

By: \_\_\_\_\_  
Title: \_\_\_\_\_  
Address: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Attn: \_\_\_\_\_  
Telecopy: \_\_\_\_\_

AGENT AND LENDERS:

BANK OF AMERICA, N.A.,  
as Agent and Lender

By: \_\_\_\_\_  
Title: \_\_\_\_\_  
Address: \_\_\_\_\_  
\_\_\_\_\_  
Attn: \_\_\_\_\_  
Telecopy: \_\_\_\_\_

EXHIBIT A  
to  
Loan and Security Agreement

**REVOLVER NOTE**

January \_\_, 2008

\$ \_\_\_\_\_

Los Angeles, California

NAUTILUS, INC., a Washington corporation, and NAUTILUS INTERNATIONAL S.A., a Swiss private share company (collectively, "Borrowers"), for value received, hereby unconditionally promise to pay, on a joint and several basis, to the order of \_\_\_\_\_ ("Lender"), the principal sum of \_\_\_\_\_ DOLLARS (\$\_\_\_\_\_), or such lesser amount as may be advanced by Lender as Revolver Loans and owing as LC Obligations from time to time under the Loan Agreement described below, together with all accrued and unpaid interest thereon. Terms are used herein as defined in the Loan and Security Agreement dated as of January 16, 2008, among Borrowers, Bank of America, N.A., as Agent, Lender, and certain other financial institutions, as such agreement may be amended, modified, renewed or extended from time to time ("Loan Agreement").

Principal of and interest on this Note from time to time outstanding shall be due and payable as provided in the Loan Agreement. This Note is issued pursuant to and evidences Revolver Loans and LC Obligations under the Loan Agreement, to which reference is made for a statement of the rights and obligations of Lender and the duties and obligations of Borrowers. The Loan Agreement contains provisions for acceleration of the maturity of this Note upon the happening of certain stated events, and for the borrowing, prepayment and reborrowing of amounts upon specified terms and conditions.

The holder of this Note is hereby authorized by Borrowers to record on a schedule annexed to this Note (or on a supplemental schedule) the amounts owing with respect to Revolver Loans and LC Obligations, and the payment thereof. Failure to make any notation, however, shall not affect the rights of the holder of this Note or any obligations of Borrowers hereunder or under any other Loan Documents.

Time is of the essence of this Note. Each Borrower and all endorsers, sureties and guarantors of this Note hereby severally waive demand, presentment for payment, protest, notice of protest, notice of intention to accelerate the maturity of this Note, diligence in collecting, the bringing of any suit against any party, and any notice of or defense on account of any extensions, renewals, partial payments, or changes in any manner of or in this Note or in any of its terms, provisions and covenants, or any releases or substitutions of any security, or any delay, indulgence or other act of any trustee or any holder hereof, whether before or after maturity (but specifically excluding the defense of payment or performance). Borrowers jointly and severally agree to pay, and to save the holder of this Note harmless against, any liability for the payment of all costs and expenses (including without limitation reasonable attorneys' fees) if this Note is collected by or through an attorney-at-law.

In no contingency or event whatsoever shall the amount paid or agreed to be paid to the holder of this Note for the use, forbearance or detention of money advanced hereunder exceed the highest lawful rate permitted under Applicable Law. If any such excess amount is inadvertently paid by Borrowers or inadvertently received by the holder of this Note, such excess shall be returned to Borrowers or credited as a payment of principal, in accordance with the Loan Agreement. It is the intent hereof that Borrowers not pay or contract to pay, and that holder of this Note not receive or contract to receive, directly or indirectly in any manner whatsoever, interest in excess of that which may be paid by Borrowers under Applicable Law.

This Note shall be governed by the laws of the State of California, without giving effect to any conflict of law principles (but giving effect to federal laws relating to national banks).

**IN WITNESS WHEREOF**, this Revolver Note is executed as of the date set forth above.

**NAUTILUS, INC.**

By \_\_\_\_\_  
Title:

**NAUTILUS INTERNATIONAL S.A.**

By \_\_\_\_\_  
Title:



EXHIBIT B  
to  
Loan and Security Agreement

**TERM NOTE**

January \_\_, 2008

\$ \_\_\_\_\_

Los Angeles, California

NAUTILUS, INC., a Washington corporation, and NAUTILUS INTERNATIONAL S.A., a Swiss private share company (collectively, "Borrowers"), for value received, hereby unconditionally promise to pay, on a joint and several basis, to the order of \_\_\_\_\_ ("Lender"), the principal sum of \_\_\_\_\_ DOLLARS (\$\_\_\_\_\_), or such lesser amount as may be advanced by Lender as a Term Loan under the Loan Agreement described below, together with all accrued and unpaid interest thereon. Terms are used herein as defined in the Loan and Security Agreement dated as of January 16, 2008, among Borrowers, Bank of America, N.A., as Agent, Lender, and certain other financial institutions, as such agreement may be amended, modified, renewed or extended from time to time ("Loan Agreement").

Principal of and interest on this Note from time to time outstanding shall be due and payable as provided in the Loan Agreement. This Note is issued pursuant to and evidences Lender's Term Loan under the Loan Agreement, to which reference is made for a statement of the rights and obligations of Lender and the duties and obligations of Borrowers. The Loan Agreement contains provisions for acceleration of the maturity of this Note upon the happening of certain stated events, and for the prepayment of amounts upon specified terms and conditions.

The holder of this Note is hereby authorized by Borrowers to record on a schedule annexed to this Note (or on a supplemental schedule) the amounts owing with respect to the Term Loan, including payments thereon. Failure to make any notation, however, shall not affect the rights of the holder of this Note or any obligations of Borrowers hereunder or under any other Loan Documents.

Time is of the essence of this Note. Each Borrower and all endorsers, sureties and guarantors of this Note hereby severally waive demand, presentment for payment, protest, notice of protest, notice of intention to accelerate the maturity of this Note, diligence in collecting, the bringing of any suit against any party, and any notice of or defense on account of any extensions, renewals, partial payments, or changes in any manner of or in this Note or in any of its terms, provisions and covenants, or any releases or substitutions of any security, or any delay, indulgence or other act of any trustee or any holder hereof, whether before or after maturity (but specifically excluding the defense of payment or performance). Borrowers jointly and severally agree to pay, and to save the holder of this Note harmless against, any liability for the payment of all costs and expenses (including without limitation reasonable attorneys' fees) if this Note is collected by or through an attorney-at-law.

In no contingency or event whatsoever shall the amount paid or agreed to be paid to the holder of this Note for the use, forbearance or detention of money advanced hereunder exceed the highest lawful rate permitted under Applicable Law. If any such excess amount is inadvertently paid by Borrowers or inadvertently received by the holder of this Note, such excess shall be returned to Borrowers or credited as a payment of principal, in accordance with the Loan Agreement. It is the intent hereof that Borrowers not pay or contract to pay, and that holder of this Note not receive or contract to receive, directly or indirectly in any manner whatsoever, interest in excess of that which may be paid by Borrowers under Applicable Law.

This Note shall be governed by the laws of the State of California, without giving effect to any conflict of law principles (but giving effect to federal laws relating to national banks).

**IN WITNESS WHEREOF**, this Term Note is executed as of the date set forth above.

**NAUTILUS, INC.**

By \_\_\_\_\_  
Title:

**NAUTILUS INTERNATIONAL S.A.**

By \_\_\_\_\_  
Title:

EXHIBIT C  
to  
Loan and Security Agreement

**ASSIGNMENT AND ACCEPTANCE**

Reference is made to the Loan and Security Agreement dated as of \_\_\_\_\_, 20\_\_, as amended ("Loan Agreement"), among **NAUTILUS, INC.** and **NAUTILUS INTERNATIONAL S.A.** (collectively, "Borrowers"), **BANK OF AMERICA, N.A.**, as agent ("Agent") for the financial institutions from time to time party to the Loan Agreement ("Lenders"), and such Lenders. Terms are used herein as defined in the Loan Agreement.

\_\_\_\_\_ ("Assignor") and \_\_\_\_\_ ("Assignee") agree as follows:

1. Assignor hereby assigns to Assignee and Assignee hereby purchases and assumes from Assignor (a) a principal amount of \$\_\_\_\_\_ of Assignor's outstanding Revolver Loans and \$\_\_\_\_\_ of Assignor's participations in LC Obligations, (b) the amount of \$\_\_\_\_\_ of Assignor's Revolver Commitment (which represents \_\_\_\_\_% of the total Revolver Commitments), and (c) a principal amount of \$\_\_\_\_\_ of Assignor's outstanding Term Loan, (the foregoing items being, collectively, the "Assigned Interest"), together with an interest in the Loan Documents corresponding to the Assigned Interest. This Agreement shall be effective as of the date ("Effective Date") indicated in the corresponding Assignment Notice delivered to Agent, provided such Assignment Notice is executed by Assignor, Assignee, Agent and Borrower Agent, if applicable. From and after the Effective Date, Assignee hereby expressly assumes, and undertakes to perform, all of Assignor's obligations in respect of the Assigned Interest, and all principal, interest, fees and other amounts which would otherwise be payable to or for Assignor's account in respect of the Assigned Interest shall be payable to or for Assignee's account, to the extent such amounts accrue on or after the Effective Date.

2. Assignor (a) represents that as of the date hereof, prior to giving effect to this assignment, (i) its Revolver Commitment is \$\_\_\_\_\_, the outstanding balance of its Revolver Loans and participations in LC Obligations is \$\_\_\_\_\_, and (ii) the outstanding balance of its Term Loan is \$\_\_\_\_\_; (b) makes no representation or warranty and assumes no responsibility with respect to any statements, warranties or representations made in or in connection with the Loan Agreement or the execution, legality, validity, enforceability, genuineness, sufficiency or value of the Loan Agreement or any other instrument or document furnished pursuant thereto, other than that Assignor is the legal and beneficial owner of the interest being assigned by it hereunder and that such interest is free and clear of any adverse claim; and (c) makes no representation or warranty and assumes no responsibility with respect to the financial condition of Borrowers or the performance by Borrowers of their obligations under the Loan Documents. *[Assignor is attaching the Note[s] held by it and requests that Agent exchange such Note[s] for new Notes payable to Assignee [and Assignor].]*

3. Assignee (a) represents and warrants that it is legally authorized to enter into this Assignment and Acceptance; (b) confirms that it has received copies of the Loan Agreement and such other Loan Documents and information as it has deemed appropriate to make its own credit analysis and decision to enter into this Assignment and Acceptance; (c) agrees that it shall, independently and without reliance upon Assignor and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under the Loan Documents; (d) confirms that it is an Eligible Assignee; (e) appoints and authorizes Agent to take such action as agent on its behalf and to exercise such powers under the Loan Agreement as are delegated to Agent by the

terms thereof, together with such powers as are incidental thereto; (f) agrees that it will observe and perform all obligations that are required to be performed by it as a “Lender” under the Loan Documents; and (g) represents and warrants that the assignment evidenced hereby will not result in a non-exempt “prohibited transaction” under Section 406 of ERISA.

4. This Agreement shall be governed by the laws of the State of California. If any provision is found to be invalid under Applicable Law, it shall be ineffective only to the extent of such invalidity and the remaining provisions of this Agreement shall remain in full force and effect.

5. Each notice or other communication hereunder shall be in writing, shall be sent by messenger, by telecopy or facsimile transmission, or by first-class mail, shall be deemed given when sent and shall be sent as follows:

(a) If to Assignee, to the following address (or to such other address as Assignee may designate from time to time):

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

(b) If to Assignor, to the following address (or to such other address as Assignor may designate from time to time):

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Payments hereunder shall be made by wire transfer of immediately available Dollars as follows:

If to Assignee, to the following account (or to such other account as Assignee may designate from time to time):

\_\_\_\_\_  
\_\_\_\_\_  
ABA No. \_\_\_\_\_  
\_\_\_\_\_  
Account No. \_\_\_\_\_  
Reference: \_\_\_\_\_

If to Assignor, to the following account (or to such other account as Assignor may designate from time to time):

\_\_\_\_\_  
\_\_\_\_\_  
ABA No. \_\_\_\_\_  
\_\_\_\_\_  
Account No. \_\_\_\_\_  
Reference: \_\_\_\_\_

**IN WITNESS WHEREOF**, this Assignment and Acceptance is executed as of \_\_\_\_\_, \_\_\_\_\_.

\_\_\_\_\_  
("Assignee")

By \_\_\_\_\_  
Title:

\_\_\_\_\_  
("Assignor")

By \_\_\_\_\_  
Title:

EXHIBIT D  
to  
Loan and Security Agreement

**ASSIGNMENT NOTICE**

Reference is made to (1) the Loan and Security Agreement dated as of \_\_\_\_\_, 20\_\_\_\_, as amended ("Loan Agreement"), among **NAUTILUS, INC.** and **NAUTILUS INTERNATIONAL S.A.** (collectively, "Borrowers"), **BANK OF AMERICA, N.A.**, as agent ("Agent") for the financial institutions from time to time party to the Loan Agreement ("Lenders"), and such Lenders; and (2) the Assignment and Acceptance dated as of \_\_\_\_\_, 20\_\_\_\_ ("Assignment Agreement"), between \_\_\_\_\_ ("Assignor") and \_\_\_\_\_ ("Assignee"). Terms are used herein as defined in the Loan Agreement.

Assignor hereby notifies Borrowers and Agent of Assignor's intent to assign to Assignee pursuant to the Assignment Agreement (a) a principal amount of \$\_\_\_\_\_ of Assignor's outstanding Revolver Loans and \$\_\_\_\_\_ of Assignor's participations in LC Obligations, (b) the amount of \$\_\_\_\_\_ of Assignor's Revolver Commitment (which represents \_\_\_\_\_% of the total Revolver Commitments), and (c) a principal amount of \$\_\_\_\_\_ of Assignor's outstanding Term Loan (the foregoing items being, collectively, the "Assigned Interest"), together with an interest in the Loan Documents corresponding to the Assigned Interest. This Agreement shall be effective as of the date ("Effective Date") indicated below, provided this Assignment Notice is executed by Assignor, Assignee, Agent and Borrower Agent, if applicable. Pursuant to the Assignment Agreement, Assignee has expressly assumed all of Assignor's obligations under the Loan Agreement to the extent of the Assigned Interest, as of the Effective Date.

For purposes of the Loan Agreement, Agent shall deem Assignor's Revolver Commitment to be reduced by \$\_\_\_\_\_, and Assignee's Revolver Commitment to be increased by \$\_\_\_\_\_.

The address of Assignee to which notices and information are to be sent under the terms of the Loan Agreement is:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

The address of Assignee to which payments are to be sent under the terms of the Loan Agreement is shown in the Assignment and Acceptance.

This Notice is being delivered to Borrowers and Agent pursuant to **Section 13.3** of the Loan Agreement. Please acknowledge your acceptance of this Notice by executing and returning to Assignee and Assignor a copy of this Notice.

**IN WITNESS WHEREOF**, this Assignment Notice is executed as of \_\_\_\_\_, \_\_\_\_\_ .

\_\_\_\_\_  
("Assignee")

By \_\_\_\_\_  
Title:

\_\_\_\_\_  
("Assignor")

By \_\_\_\_\_  
Title:

ACKNOWLEDGED AND AGREED,  
AS OF THE DATE SET FORTH ABOVE:

**BORROWER AGENT**:\*  
\_\_\_\_\_  
By \_\_\_\_\_  
Title:

\* No signature required if Assignee is a Lender, U.S.-based Affiliate of a Lender or Approved Fund, or if an Event of Default exists.

**BANK OF AMERICA, N.A.,**  
as Agent

By \_\_\_\_\_  
Title:

SCHEDULE 1.1  
to  
Loan and Security Agreement

**COMMITMENTS OF LENDERS**

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**Lender**

---

**Revolver Commitment**

---

**Term Loan Commitment**

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**Total Commitments**

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SCHEDULE 8.5  
to  
Loan and Security Agreement

**DEPOSIT ACCOUNTS**

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Depository Bank

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Type of Account

---

Account Number

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SCHEDULE 8.6.1  
to  
Loan and Security Agreement

**BUSINESS LOCATIONS**

1. Borrowers currently have the following business locations, and no others:  
Chief Executive Office:  
Other Locations:
2. In the five years preceding the Closing Date, Borrowers have had no office or place of business located in any county other than as set forth above, except:
3. Each Subsidiary currently has the following business locations, and no others:  
Chief Executive Office:  
Other Locations:
4. In the five years preceding the Closing Date, no Subsidiary has had an office or place of business located in any county other than as set forth above, except:
5. The following bailees, warehouseman, similar parties and consignees hold inventory of a Borrower or Subsidiary:

Name and Address of Party	Nature of Relationship	Amount of Inventory	Owner of Inventory
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SCHEDULE 9.1.4  
to  
Loan and Security Agreement

**NAMES AND CAPITAL STRUCTURE**

1. The corporate names, jurisdictions of incorporation, and authorized and issued Equity Interests of each Borrower and Subsidiary are as follows:

Name	Jurisdiction	Number and Class of Authorized Shares	Number and Class of Issued Shares
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2. The record holders of Equity Interests of each Borrower and Subsidiary are as follows:

Name	Class of Stock	Number of Shares	Record Owner
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3. All agreements binding on holders of Equity Interests of Borrowers and Subsidiaries with respect to such interests are as follows:

SCHEDULE 9.1.5  
to  
Loan and Security Agreement

**FORMER NAMES AND COMPANIES**

1. Each Borrower's and Subsidiary's correct corporate name, as registered with the Secretary of State of its state of incorporation, is shown on Schedule 9.1.4.
2. In the conduct of their businesses during five years preceding the Closing Date, Borrowers and Subsidiaries have used the following names:

Entity	Fictitious, Trade or Other Name
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3. In the five years preceding the Closing Date, no Borrower or Subsidiary has been the surviving corporation of a merger or combination, except:
4. In the five years preceding the Closing Date, no Borrower or Subsidiary has acquired any substantial part of the assets of any Person, except:

SCHEDULE 9.1.12  
to  
Loan and Security Agreement

**PATENTS, TRADEMARKS, COPYRIGHTS AND LICENSES**

1. Borrowers' and Subsidiaries' patents:

Patent	Owner	Status in Patent Office	Federal Registration No.	Registration Date
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2. Borrowers' and Subsidiaries' trademarks:

Trademark	Owner	Status in Trademark Office	Federal Registration No.	Registration Date
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3. Borrowers' and Subsidiaries' copyrights:

Copyright	Owner	Status in Copyright Office	Federal Registration No.	Registration Date
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4. Borrowers' and Subsidiaries' licenses (other than routine business licenses, authorizing them to transact business in local jurisdictions):

Licensor	Description of License	Term of License	Royalties Payable
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SCHEDULE 9.1.15  
to  
Loan and Security Agreement  
**ENVIRONMENTAL MATTERS**

SCHEDULE 9.1.16  
to  
Loan and Security Agreement

**RESTRICTIVE AGREEMENTS**

Entity	Agreement	Restrictive Provisions
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SCHEDULE 9.1.17  
to  
Loan and Security Agreement

**LITIGATION**

1. Proceedings and investigations pending against Borrowers or Subsidiaries:
2. Threatened proceedings or investigations of which any Borrower or Subsidiary is aware:



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SCHEDULE 9.1.19  
to  
Loan and Security Agreement  
**PENSION PLAN DISCLOSURES**

SCHEDULE 9.1.21  
to  
Loan and Security Agreement

**LABOR CONTRACTS**

Borrowers and Subsidiaries are party to the following collective bargaining agreements, management agreements and consulting agreements:

**Parties**

**Type of Agreement**

**Term of Agreement**

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SCHEDULE 10.2.2  
to  
Loan and Security Agreement

**EXISTING LIENS**

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SCHEDULE 10.2.17  
to  
Loan and Security Agreement

**EXISTING AFFILIATE TRANSACTIONS**

## FORBEARANCE AGREEMENT

THIS FORBEARANCE AGREEMENT (this “Agreement”), dated as of February 15, 2008, is entered into among Bank of America, N.A., as agent for the Lenders (“Agent”), the Lenders party hereto, Nautilus, Inc., a Washington corporation (“US Borrower”), and Nautilus International S.A., a , a Swiss private share company (“Swiss Borrower”; with US Borrower, collectively, “Borrowers”).

### RECITALS

A. Borrowers, Agent and the financial institutions from time to time party thereto as lenders (“Lenders”) have previously entered into that certain Loan and Security Agreement dated as of January 16, 2008 (the “Loan Agreement”), pursuant to which Agent and the Lenders have made certain loans and financial accommodations available to Borrowers. Terms used herein without definition shall have the meanings ascribed to them in the Loan Agreement.

B. An Event of Default has occurred and is continuing under the Loan Agreement due to Borrower’s failure to achieve EBITDA, when measured for the period commencing October 1, 2007 and ending December 31, 2007, of at least \$0, as required under Section 10.3.1 of the Loan Agreement (the “Known Existing Default”).

C. Borrowers have asked Agent and the Lenders to forbear from exercising its rights and remedies under the Loan Agreement.

D. Agent and Lenders are willing, for a limited period of time and on the terms and conditions set forth herein, to forbear from exercising its rights and remedies under the Loan Agreement with respect to the Known Existing Default.

F. Each Borrower is entering into this Agreement with the understanding and agreement that, except as specifically provided herein, none of Agent’s or any Lender’s rights or remedies as set forth in the Loan Agreement is being waived or modified by the terms of this Agreement.

### AGREEMENT

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants herein contained, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. Incorporation of Recitals. Each of the above recitals is expressly incorporated herein and is represented by Borrowers to be true and correct.

2. Reaffirmation of Obligations. Each Borrower hereby acknowledges that the Loan Documents and the Obligations constitute the valid and binding obligations of such Borrower enforceable against such Borrower in accordance with their respective terms, and each Borrower hereby reaffirms its obligations under the Loan Documents. Agent’s and Lenders’ entry into this Agreement or any of the documents referenced herein, Agent’s or any Lender’s negotiations with any party with respect to any Loan Document, Agent’s or any Lender’s conduct of any analysis or investigation of any collateral for the Obligations or any Loan Document, Agent’s or any Lender’s acceptance from Borrower or any other party of any payments made to Agent or such Lender prior to the date hereof, or any other action or failure to act on the part of Agent or any Lender shall not constitute (a) a modification of any Loan Document, or (b) a waiver of any Default or Event of Default under the Loan Documents, including, without limitation, the Known Existing Default, or a waiver of any term or provision of any Loan Document.

3. Agreement to Forbear. For the Forbearance Term (as defined below), Agent and the Lenders shall forbear and shall not take any action or commence any proceedings with respect to the enforcement of any of its rights or remedies under the Loan Documents as a result of the Known Existing Default. The parties agree that neither the foregoing agreement by Agent and the Lenders nor the acceptance by Agent or any Lender of any of the payments provided for in the Loan Documents, nor any payment prior to the date hereof shall, however, (a) excuse any party from any of its obligations under the Loan Documents, or (b) toll the running of any time periods applicable to any such rights and remedies, including, without limitation, any time periods within which Borrowers may cure defaults under the Loan Documents or otherwise. Each Borrower agrees that it will not assert laches, waiver or any other defense to the enforcement of any of the Loan Documents based upon the foregoing agreement by Agent and the Lenders to forbear or the acceptance by Agent or any Lender of any of the payments provided for in the Loan Documents or any payment prior to the date hereof. As used herein, "Forbearance Term" shall mean the period commencing upon the effectiveness of this Agreement and continuing until the earliest to occur of: (x) any Default or Event of Default under any of the Loan Documents (other than the Known Existing Default) or (y) February 29, 2008.

4. Termination of Agreement to Forbear. Each Borrower acknowledges and agrees that upon the termination of Agent's and Lenders' agreement to forbear as provided in Section 3 hereof, Agent and the Lenders shall be entitled to exercise any or all of their respective remedies under the Loan Documents, including, without limitation, the appointment of a receiver, the acceleration of the Obligations and the enforcement under the UCC of any liens in favor of Agent or any Lender, as a result of the Known Existing Default, and at any time Agent and the Lenders shall be entitled to exercise any or all of their respective remedies under the Loan Documents as a result of any other Default or Event of Default under the Loan Documents.

5. Release; Covenant Not to Sue.

(a) Each Borrower hereby absolutely and unconditionally releases and forever discharges Agent and the Lenders, and any and all participants, parent corporations, subsidiary corporations, affiliated corporations, insurers, indemnitors, successors and assigns thereof, together with all of the present and former directors, officers, agents and employees of any of the foregoing (each a "Released Party"), from any and all claims, demands or causes of action of any kind, nature or description, whether arising in law or equity or upon contract or tort or under any state or federal law or otherwise, which such Borrower has had, now has or has made claim to have against any such person for or by reason of any act, omission, matter, cause or thing whatsoever arising from the beginning of time to and including the date of this Agreement, whether such claims, demands and causes of action are matured or unmatured or known or unknown. It is the intention of each Borrower in providing this release that the same shall be effective as a bar to each and every claim, demand and cause of action specified above, and in furtherance of this intention it waives and relinquishes all rights and benefits under Section 1542 of the Civil Code of the State of California, which provides:

"A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MIGHT HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR."

Each Borrower acknowledges that it may hereafter discover facts different from or in addition to those now known or believed to be true with respect to such claims, demands, or causes of action and agree that this instrument shall be and remain effective in all respects notwithstanding any such differences or additional facts. Each Borrower understands, acknowledges and agrees that the release set forth above may be pleaded as a full and complete defense and may be used as a basis for an injunction against any action, suit or other proceeding which may be instituted, prosecuted or attempted in breach of the provisions of such release.

(b) Each Borrower, on behalf of itself and its successors, assigns, and other legal representatives, hereby absolutely, unconditionally and irrevocably, covenants and agrees with and in favor of each Released Party above that it will not sue (at law, in equity, in any regulatory proceeding or otherwise) any Released Party on the basis of any claim released, remised and discharged by such Borrower pursuant to the release set forth in Section 5(a) above. If any Borrower or any of its successors, assigns or other legal representations violates the foregoing covenant, each Borrower, for itself and its successors, assigns and legal representatives, agrees to pay, in addition to such other damages as any Released Party may sustain as a result of such violation, all reasonable, documented attorneys' fees and costs incurred by such Released Party as a result of such violation.

6. Effectiveness of this Agreement. Agent must have received the following items, in form and content acceptable to Agent, before this Agreement is effective:

(a) Agreement; Acknowledgement and Release. This Agreement and the attached Acknowledgement and Release by Guarantor, each fully executed in a sufficient number of counterparts for distribution to all parties.

(b) Representations and Warranties. Except for the existence of the Known Existing Default, the representations and warranties (i) set forth herein must be true and correct and (ii) set forth in the Loan Agreement must be true and correct in all material respects.

(c) Other Required Documentation. All other documents and legal matters in connection with the transactions contemplated by this Agreement shall have been delivered or executed or recorded and shall be in form and substance reasonably satisfactory to Agent.

7. Representations and Warranties. Each Borrower represents and warrants as follows:

(a) Authority. Such Borrower has the requisite corporate power and authority to execute and deliver this Agreement, and to perform its obligations hereunder and under the Loan Documents to which it is a party. The execution, delivery and performance by such Borrower of this Agreement have been duly approved by all necessary corporate action and no other corporate proceedings are necessary to consummate such transactions.

(b) Enforceability. This Agreement has been duly executed and delivered by such Borrower. This Agreement and each Loan Document is the legal, valid and binding obligation of such Borrower, enforceable against such Borrower in accordance with its terms, except to the extent that then enforcement is limited by bankruptcy, insolvency, reorganization or other laws relating to or affecting the enforcement of creditors' rights generally and by general principles of equity, and is in full force and effect.

(c) Representations and Warranties. The representations and warranties contained in each Loan Document (other than any such representations or warranties that, by their terms, are specifically made as of a date other than the date hereof) are correct in all material respects on and as of the date hereof as though made on and as of the date hereof.

(d) Due Execution. The execution, delivery and performance of this Agreement are within the power of such Borrower, have been duly authorized by all necessary corporate action, have received all necessary governmental approval, if any, and do not contravene any law or any contractual restrictions binding on such Borrower.

(e) No Default. Other than the Known Existing Default, no event has occurred and is continuing that constitutes an Event of Default.

(f) No Duress. This Agreement has been entered into without force or duress, of the free will of such Borrower. Such Borrower's decision to enter into this Agreement is a fully informed decision and such Borrower is aware of all legal and other ramifications of such decision.

(g) Counsel. Such Borrower has read and understands this Agreement, has consulted with and been represented by legal counsel in connection herewith, and has been advised by its counsel of its rights and obligations hereunder and thereunder.

8. Choice of Law. The validity of this Agreement, its construction, interpretation and enforcement, the rights of the parties hereunder, shall be determined under, governed by, and construed in accordance with the internal laws of the State of California governing contracts only to be performed in that State.

9. Counterparts. This Agreement may be executed in any number of counterparts and by different parties and separate counterparts, each of which when so executed and delivered, shall be deemed an original, and all of which, when taken together, shall constitute one and the same instrument. Delivery of an executed counterpart of a signature page to this Agreement by telefacsimile shall be effective as delivery of a manually executed counterpart of this Agreement.

10. Estoppel. To induce Agent and the Lenders to enter into this Agreement and to continue to make advances to Borrowers under the Loan Agreement, each Borrower hereby acknowledges and agrees that, after giving effect to this Agreement, as of the date hereof, there exists no Event of Default (other than the Known Existing Default) and no right of offset, defense, counterclaim or objection in favor of any Borrower as against Agent or any Lender with respect to the Obligations.

11. Integration. This Agreement, together with the other Loan Documents, incorporates all negotiations of the parties hereto with respect to the subject matter hereof and is the final expression and agreement of the parties hereto with respect to the subject matter hereof.

12. Severability. In case any provision in this Agreement shall be invalid, illegal or unenforceable, such provision shall be severable from the remainder of this Agreement and the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

13. Modification. This Agreement may not be amended, waived or modified in any manner without the written consent of the party against whom the amendment, waiver or modification is sought to be enforced.

14. Submission of Agreement. The submission of this Agreement to the parties or their agents or attorneys for review or signature does not constitute a commitment by Agent or any Lender to forbear from the exercise of its rights and remedies under the Loan Documents, and this Agreement shall have no binding force or effect until all of the conditions to the effectiveness of this Agreement have been satisfied as set forth herein.

[Remainder of Page Left Intentionally Blank]



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

BORROWERS:  
NAUTILUS, INC.,  
a Washington corporation

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

NAUTILUS INTERNATIONAL S.A.,  
a Swiss private share company

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

AGENT AND LENDERS:  
BANK OF AMERICA, N.A.,  
a national banking association, as Agent and the sole Lender

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**ACKNOWLEDGEMENT AND RELEASE BY GUARANTOR**

Dated as of February 15, 2008

The undersigned, being a Guarantor (“Guarantor”) under a Guaranty and Security Agreement, dated as of January 16, 2008, made in favor of Agent (as amended, modified or supplemented, the “Guaranty”), hereby acknowledges and agrees to the foregoing Forbearance Agreement (the “Agreement”) and confirms and agrees that its Guaranty is and shall continue to be, in full force and effect and is hereby ratified and confirmed in all respects. Although Agent has informed Guarantor of the matters set forth above, and Guarantor has acknowledged the same, Guarantor understands and agrees that Agent has no duty under the Loan Agreement, the Guaranty or any other agreement with Guarantor to so notify Guarantor or to seek such an acknowledgement, and nothing contained herein is intended to or shall create such a duty as to any advances or transaction hereafter.

Guarantor hereby absolutely and unconditionally releases and forever discharges each Released Party (as defined in the Agreement), from any and all claims, demands or causes of action of any kind, nature or description, whether arising in law or equity or upon contract or tort or under any state or federal law or otherwise, which Guarantor has had, now has or has made claim to have against any such person for or by reason of any act, omission, matter, cause or thing whatsoever arising from the beginning of time to and including the date hereof, whether such claims, demands and causes of action are matured or unmatured or known or unknown. It is the intention of Guarantor in providing this release that the same shall be effective as a bar to each and every claim, demand and cause of action specified, and in furtherance of this intention it waives and relinquishes all rights and benefits under Section 1542 of the Civil Code of the State of California, which provides:

“A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MIGHT HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR.”

Guarantor acknowledges that it may hereafter discover facts different from or in addition to those now known or believed to be true with respect to such claims, demands, or causes of action and agree that this instrument shall be and remain effective in all respects notwithstanding any such differences or additional facts. Guarantor understands, acknowledges and agrees that the release set forth above may be pleaded as a full and complete defense and may be used as a basis for an injunction against any action, suit or other proceeding which may be instituted, prosecuted or attempted in breach of the provisions of such release. Guarantor, on behalf of itself and its successors, assigns, and other legal representatives, hereby absolutely, unconditionally and irrevocably, covenants and agrees with and in favor of each Released Party above that it will not sue (at law, in equity, in any regulatory proceeding or otherwise) any Released Party on the basis of any claim released, remised and discharged by Guarantor pursuant to the above release. If Guarantor or any of its successors, assigns or other legal representations violates the foregoing covenant, Guarantor, for itself and its successors, assigns and legal representatives, agrees to pay, in addition to such other damages as any Released Party may sustain as a result of such violation, all reasonable and documented attorneys’ fees and costs incurred by such Released Party as a result of such violation.

DASH AMERICA, INC.,  
a Colorado corporation

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

# FIRST AMENDMENT TO LOAN AND SECURITY AGREEMENT AND WAIVER

THIS **FIRST AMENDMENT TO LOAN AND SECURITY AGREEMENT WAIVER** (this “Amendment”), dated as of February 29, 2008, is entered into by and among the financial institutions signatory hereto (each a “Lender” and collectively the “Lenders”), **BANK OF AMERICA, N.A.**, as administrative agent for the Lenders (in such capacity, “Agent”), **NAUTILUS, INC.**, a Washington corporation (“US Borrower”), **NAUTILUS INTERNATIONAL S.A.**, a Swiss private share company (“Swiss Borrower”), and together with US Borrower, collectively, “Borrowers”).

## RECITALS

A. Borrowers, Agent and the Lenders have previously entered into that certain Loan and Security Agreement dated as of January 16, 2008 (as amended, supplemented, restated and modified from time to time, the “Loan Agreement”), pursuant to which the Lenders have made certain loans and financial accommodations available to Borrowers. Terms used herein without definition shall have the meanings ascribed to them in the Loan Agreement.

B. An Event of Default has occurred and is continuing under the Loan Agreement due to Borrower’s failure to achieve EBITDA, when measured for the period commencing October 1, 2007 and ending December 31, 2007, of at least \$0, as required under Section 10.3.1 of the Loan Agreement (together with any breach of a representation or warranty resulting from such Event of Default, the “Known Existing Default”).

D. Borrowers have requested that Agent and the Lenders amend the Loan Agreement and waive the Known Existing Default, all of which Agent and the Lenders are willing to do pursuant to the terms and conditions set forth herein.

E. Borrowers are entering into this Amendment with the understanding and agreement that, except as specifically provided herein, none of Agent’s or any Lender’s rights or remedies as set forth in the Loan Agreement is being waived or modified by the terms of this Amendment.

## AGREEMENT

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants herein contained, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

### 1. Amendments to Loan Agreement.

(a) The definition of “Books and records Block” in Section 1.1 of the Loan Agreement is hereby amended and restated to read as follows:

“Books and Records Block: a block in the amount of (a) \$5,000,000, during the period from the Closing Date through the later to occur of (i) the date of receipt by Agent of a field examination in form and substance satisfactory to Agent or (ii) the date of the Disclosed Sale, and (b) \$0 thereafter.”

(b) The definition of “EBITDA” in Section 1.1 of the Loan Agreement is hereby amended and restated in its entirety to read as follows:

“**EBITDA**: determined on a consolidated basis for Borrowers and Subsidiaries, net income, calculated before (in each case, to the extent included in determining net income and to the extent incurred or attributable during the applicable measurement period) (i) interest expense, (ii) provision for income taxes, (iii) depreciation and amortization expense, (iv) gains or losses arising from the sale of capital assets, (v) gains arising from the write-up of assets, and (vi) any extraordinary gains, (vii) fees incurred by Borrowers in connection with entering into this Agreement and the Loan Documents in an aggregate amount not to exceed \$700,000, (viii) legal fees and expenses incurred by US Borrower during the fourth Fiscal Quarter of 2007 or the first Fiscal Quarter of 2008 in connection with the proxy dispute between US Borrower, its directors and Sherborne Investors, L.P. in an aggregate amount not to exceed \$2,700,000, (ix) a write-down of Intellectual Property and associated goodwill taken on or before the last day of the first Fiscal Quarter of 2008 in connection with the Disclosed Sale in an amount not to exceed \$17,500,000, (x) a non-cash inventory write-down taken on or before the last day of the fourth Fiscal Quarter of 2007 in an amount not to exceed \$400,000, (xi) up to \$600,000 in expenses (no more than \$150,000 of which expenses shall be cash expenses) incurred during the first Fiscal Quarter of 2008 in connection with closure of Borrowers’ Australia direct operations, (xii) up to \$1,000,000 in expenses incurred during the first Fiscal Quarter of 2008 in connection with closure of Borrowers’ Italy operations, (xiii) up to \$1,000,000 in expenses (no more than \$400,000 of which expenses shall be cash expenses) incurred during the first and second Fiscal Quarters of 2008 in connection with closure of Borrowers’ Bolingbrook, Illinois distribution center, (xiv) a non-cash write-off of up to \$1,200,000 taken during the fourth Fiscal Quarter of 2007 in connection with the abandonment of the License with Lance Armstrong, (xv) a non-cash charge of up to \$1,890,000 taken during the fourth Fiscal Quarter of 2007 in connection with the elimination of Borrowers’ EV9.16 product line, (xvi) a non-cash charge of up to \$300,000 taken during the fourth Fiscal Quarter of 2007 in connection with the elimination of Borrowers’ fitness advisor product, (xvii) up to \$1,000,000 in expenses actually incurred during the first and second Fiscal Quarters of 2008 in connection with Borrowers’ future employee reductions, (xviii) a non-cash charge of up to \$1,100,000 taken during the fourth Fiscal Quarter of 2007 in connection with the elimination of Borrowers’ TC9.16 product line, (xix) a non-cash warranty accrual taken during the fourth Fiscal Quarter of 2007 relating to discontinued items in an amount up to \$1,000,000, (xx) a non-cash write-off of up to \$3,000,000 taken during the fourth Fiscal Quarter of 2007 in connection with the abandonment or non-use of certain ICON patents; (xxi) an accrual taken in the first Fiscal Quarter of 2008 in connection with future warranty costs resulting from outsourcing of warranty processing in an amount up to \$3,000,000; (xxii) a non-cash write-off in an amount not to exceed \$19,400,000 taken during the fourth Fiscal Quarter of 2007 relating to costs and payments incurred in connection with the LandAmerica Acquisition; and (xxiii) a warranty accrual taken during the fourth Fiscal Quarter of 2007 relating to the discontinued Treadclimber 9.16 line in an amount up to \$12,000,000.”

(c) The definition of “Revolver Commitment” in Section 1.1 of the Loan Agreement is hereby amended and restated in its entirety to read as follows:

“**Revolver Commitment**: for any Lender, its obligation to make Revolver Loans and to participate in LC Obligations up to the maximum principal amount shown on **Schedule 1.1(a)**, or as hereafter determined pursuant to each Assignment and Acceptance to which it is a party. “**Revolver Commitments**” means the aggregate amount of such commitments of all Lenders. Following the Closing Date, the Revolver Commitments

shall be automatically increased on the date of any repayment of any portion of the Term Loans to include the amount of such repayment; provided that (i) unless the aggregate Revolver Commitments have been increased pursuant to **Section 2.1.7**, the Revolver Commitments shall not exceed (A) during the period from the Closing Date through the earlier to occur of the second Business Day following Borrowers' receipt of proceeds from the Disclosed Sale or March 31, 2008, \$100,000,000, or (B) thereafter, \$70,000,000, and (ii) in the event the Revolver Commitments have been increased pursuant to **Section 2.1.7**, the Revolver Commitments shall not exceed (A) during the period from the Closing Date through the earlier to occur of the second Business Day following Borrowers' receipt of proceeds from the Disclosed Sale or March 31, 2008, \$125,000,000, or (B) thereafter, \$95,000,000."

(d) The definition of "Trigger Period" in Section 1.1 of the Loan Agreement is hereby amended and restated in its entirety to read as follows:

"Trigger Period: the period (a) commencing on the day that (i) an Event of Default occurs, (ii) Excess Availability is less than the greater of (A) \$12,000,000 or (B) 15% of the aggregate Revolver Commitments, for three consecutive Business Days or (iii) Excess Availability is less than the greater of (A) \$10,000,000 or (B) 12.5% of the aggregate Revolver Commitments, at any time; and (b) continuing until the day on which the Borrowers have maintained Excess Availability in excess of the greater of (A) \$15,000,000 or (B) 20% of the aggregate Revolver Commitments, for a period of 90 consecutive days."

(e) Section 2.1.7(a) of the Loan Agreement is hereby amended and restated in its entirety to read as follows:

"(a) Provided there exists no Default or Event of Default, upon notice to Agent (which shall promptly notify the Lenders), Borrowers may request an increase in the Revolver Commitments to an amount not more than (i) during the period from the Closing date through the earlier to occur of the second Business Day following Borrowers' receipt of proceeds from the Disclosed Sale or March 31, 2008, \$125,000,000, or (ii) thereafter, \$95,000,000, in the aggregate. At the time of sending such notice, Borrowers (in consultation with Agent) shall specify the time period within which each Lender is requested to respond (which shall in no event be less than 10 Business Days from the date of delivery of such notice to the Lenders). Each Lender shall notify Agent within such time period whether or not it agrees to increase its Commitment with respect to Loans and Letters of Credit and, if so, whether by an amount equal to, greater than, or less than its Pro Rata Share of such requested increase. Any Lender not responding within such time period shall be deemed to have declined to increase such Commitment. Agent shall notify Borrowers and each Lender of the Lenders' responses to each request made hereunder. To achieve the full amount of the requested increase, Agent may or Borrowers may, with the prior consent of Agent, invite additional lending institutions that constitute Eligible Assignees to become Lenders pursuant to a joinder agreement in form and substance reasonably satisfactory to Agent and its counsel."

(f) Section 10.3.1 of the Loan Agreement is hereby amended and restated in its entirety to read as follows:

“10.3.1. Minimum EBITDA. Upon the commencement and during the continuation of a Trigger Period, maintain EBITDA (for purposes of this covenant only, calculated before (to the extent included in determining net income) a non-cash accrual expense of up to \$3,700,000 relating to employee incentive payments to the extent taken during the period between October 1, 2007 and the respective measurement date set forth below) at least equal to the required amount set forth below with respect to each measurement date set forth below for the period from October 1, 2007 to such measurement date:

<u>Measurement Date</u>	<u>Required EBITDA</u>
December 31, 2007	\$ 0
January 31, 2008	(\$2,800,000)
February 28, 2008	(\$500,000)
March 31, 2008	\$ 4,000,000
April 30, 2008	\$ 4,000,000
May 31, 2008	\$ 4,000,000
June 30, 2008	\$ 7,000,000
July 31, 2008	\$ 4,000,000
August 31, 2008	\$ 4,500,000
September 30, 2008	\$ 11,000,000
October 31, 2008	\$ 9,500,000
November 30, 2008	\$ 12,500,000

; provided that in the event that a Trigger Period commences in between measurement dates, this covenant shall be measured for the immediately preceding measurement date at the time of commencement of such Trigger Period.

2. Waiver of Known Existing Default. Agent and the Lenders hereby waive the Known Existing Default; provided, however, nothing herein shall be deemed a waiver with respect to any other or future failure of Borrowers to comply fully with Section 10.3.1 of the Loan Agreement. This waiver shall be effective only for the specific default comprising the Known Existing Default, and in no event shall this waiver be deemed to be a waiver of enforcement of Agent's or any Lender's rights with respect to any other Defaults or Events of Default now existing or hereafter arising. Nothing contained in this Amendment nor any communications between any Borrower or any Guarantor and Agent or any Borrower or any Guarantor and any Lender shall be a waiver of any rights or remedies Agent or any Lender has or may have against any Borrower or any Guarantor, except as specifically provided herein. Except as specifically provided herein, Agent hereby reserves and preserves all of its and the Lenders' rights and remedies against Borrowers and Guarantors under the Loan Agreement and the other Loan Documents.

3. Adjustment of Availability Reserve. Agent hereby acknowledges that the Availability Reserve relating to environmental matters with respect to the US Borrower's owned Real Estate located in Tyler, Texas set forth in clause (i) of the definition of "Availability Reserve" has been adjusted to \$60,000. Nothing contained in this Amendment shall be construed to limit Agent's discretion in adjusting the amounts of Availability Reserves in accordance with the terms of the Loan Agreement.

4. Effectiveness of this Amendment. The following shall have occurred before this Amendment is effective:

(a) Amendment. Agent shall have received this Amendment and the Acknowledgment of Guarantor attached hereto fully executed in a sufficient number of counterparts for distribution to all parties.

- (b) Representations and Warranties. The representations and warranties set forth herein must be true and correct.
- (c) No Default. Other than the Known Existing Default, no event has occurred and is continuing that constitutes an Event of Default.
- (d) Other Required Documentation. All other documents and legal matters in connection with the transactions contemplated by this Amendment shall have been delivered or executed or recorded and shall be in form and substance satisfactory to Agent.

5. Representations and Warranties. Each Borrower represents and warrants as follows:

- (a) Authority. Such Borrower has the requisite corporate power and authority to execute and deliver this Amendment, and to perform its obligations hereunder and under the Loan Documents (as amended or modified hereby) to which it is a party. The execution, delivery and performance by such Borrower of this Amendment have been duly approved by all necessary corporate action and no other corporate proceedings are necessary to consummate such transactions.
- (b) Enforceability. This Amendment has been duly executed and delivered by such Borrower. This Amendment and each Loan Document to which such Borrower is a party (as amended or modified hereby) is the legal, valid and binding obligation of such Borrower, enforceable against such Borrower in accordance with its terms, and is in full force and effect.
- (c) Representations and Warranties. The representations and warranties contained in each Loan Document to which such Borrower is a party (other than any such representations or warranties that, by their terms, are specifically made as of a date other than the date hereof) are correct on and as of the date hereof as though made on and as of the date hereof.
- (d) Due Execution. The execution, delivery and performance of this Amendment are within the power of such Borrower, have been duly authorized by all necessary corporate action, have received all necessary governmental approval, if any, and do not contravene any law or any contractual restrictions binding on Borrower.
- (e) No Default. Other than the Known Existing Default, no event has occurred and is continuing that constitutes an Event of Default.

6. Choice of Law. The validity of this Amendment, its construction, interpretation and enforcement, the rights of the parties hereunder, shall be determined under, governed by, and construed in accordance with the internal laws of the State of California, without giving effect to any conflict of law principles (but giving effect to Federal laws relating to national banks). The consent to forum and arbitration provisions set forth in Section 14.14 of the Loan Agreement are hereby incorporated in this Amendment by reference.

7. Counterparts. This Amendment may be executed in any number of counterparts and by different parties and separate counterparts, each of which when so executed and delivered, shall be deemed an original, and all of which, when taken together, shall constitute one and the same instrument. Delivery of an executed counterpart of a signature page to this Amendment by telefacsimile or a substantially similar electronic transmission shall have the same force and effect as the delivery of an original executed counterpart of this Amendment. Any party delivering an executed counterpart of this Amendment by telefacsimile or a substantially similar electronic transmission shall also deliver an original executed counterpart, but the failure to do so shall not affect the validity, enforceability or binding effect of such agreement.

8. Reference to and Effect on the Loan Documents.

(a) Upon and after the effectiveness of this Amendment, each reference in the Loan Agreement to “this Agreement”, “hereunder”, “hereof” or words of like import referring to the Loan Agreement, and each reference in the other Loan Documents to “the Loan Agreement”, “thereof” or words of like import referring to the Loan Agreement, shall mean and be a reference to the Loan Agreement as modified and amended hereby.

(b) Except as specifically amended above, the Loan Agreement and all other Loan Documents, are and shall continue to be in full force and effect and are hereby in all respects ratified and confirmed and shall constitute the legal, valid, binding and enforceable obligations of Borrowers to Agent and the Lenders.

(c) The execution, delivery and effectiveness of this Amendment shall not, except as expressly provided herein, operate as a waiver of any right, power or remedy of Agent or any Lender under any of the Loan Documents, nor constitute a waiver of any provision of any of the Loan Documents.

(d) To the extent that any terms and conditions in any of the Loan Documents shall contradict or be in conflict with any terms or conditions of the Loan Agreement, after giving effect to this Amendment, such terms and conditions are hereby deemed modified or amended accordingly to reflect the terms and conditions of the Loan Agreement as modified or amended hereby.

9. Ratification. Each Borrower hereby restates, ratifies and reaffirms each and every term and condition set forth in the Loan Agreement, as amended hereby, and the Loan Documents effective as of the date hereof.

10. Estoppel. To induce Lenders to enter into this Amendment and to continue to make advances to Borrowers under the Loan Agreement, each Borrower hereby acknowledges and agrees that, as of the date hereof, there exists no right of offset, defense, counterclaim or objection in favor of such Borrower as against Agent or any Lender with respect to the Obligations.

11. Integration. This Amendment, together with the other Loan Documents, incorporates all negotiations of the parties hereto with respect to the subject matter hereof and is the final expression and agreement of the parties hereto with respect to the subject matter hereof.

12. Severability. In case any provision in this Amendment shall be invalid, illegal or unenforceable, such provision shall be severable from the remainder of this Amendment and the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

[Remainder of Page Left Intentionally Blank]



IN WITNESS WHEREOF, the parties have entered into this Amendment as of the date first above written.

**BORROWERS**

**NAUTILUS, INC.**, a Washington corporation

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**NAUTILUS INTERNATIONAL S.A.**, a Swiss private share  
company

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**AGENT AND LENDERS**

**BANK OF AMERICA, N.A.,**  
as Agent and as sole Lender

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**ACKNOWLEDGEMENT BY GUARANTOR**

Dated as of February 29, 2008

The undersigned, being a Guarantor (“Guarantor”) under that certain Guaranty and Security Agreement dated as of January 16, 2008 made in favor of Agent (“Guaranty”), hereby acknowledges and agrees to the foregoing First Amendment to Loan and Security Agreement and Waiver (the “Amendment”) and confirms and agrees that the Guaranty is and shall continue to be, in full force and effect and is hereby ratified and confirmed in all respects except that, upon the effectiveness of, and on and after the date of the Amendment, each reference in such Guaranty to the Loan Agreement (as defined in the Amendment), “thereunder”, “thereof” or words of like import referring to the “Loan Agreement”, shall mean and be a reference to the Loan Agreement as amended or modified by the Amendment. Although Agent has informed Guarantor of the matters set forth above, and Guarantor has acknowledged the same, Guarantor understands and agrees that Agent has no duty under the Loan Agreement, the Guaranty or any other agreement with Guarantor to so notify Guarantor or to seek such an acknowledgement, and nothing contained herein is intended to or shall create such a duty as to any advances or transaction hereafter.

**DASHAMERICA, INC.,**  
a Colorado corporation

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**SUBSIDIARIES OF NAUTILUS, INC.**

Nautilus, Inc., a Washington corporation  
Nautilus International Holdings, S.A., a Swiss corporation  
Nautilus International, S.A., a Swiss corporation  
Nautilus Switzerland, S.A., a Swiss corporation  
Nautilus Fitness Deutschland GmbH, a German corporation  
Nautilus Fitness UK Ltd., a United Kingdom corporation  
Nautilus Fitness Italy S.r.l., an Italian corporation  
Nautilus Fitness Canada, Inc., a Canadian corporation  
DashAmerica, Inc., a Colorado corporation, d/b/a Pearl Izumi USA, Inc.  
Pearl Izumi GmbH, a German corporation  
Pearl Izumi Spain, SL, a Spanish corporation  
Nautilus (Shanghai) Fitness Co., Ltd., a Chinese corporation  
Nautilus Fitness Australia Pty Ltd., an Australian corporation  
Nautilus Global Investments S.A., a Swiss corporation

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statement Nos. 333-126054, 333-46936, and 333-79643 on Form S-8 of our report dated March 17, 2008, relating to the consolidated financial statements of Nautilus, Inc. (which report expresses an unqualified opinion and includes an explanatory paragraph relating to the adoption of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109*) and our report dated March 17, 2008 relating to internal control over financial reporting (which report expresses an adverse opinion on the effectiveness of the Company's internal control over financial reporting because of a material weakness) appearing in the Annual Report on Form 10-K of Nautilus, Inc. for the year ended December 31, 2007.

***DELOITTE & TOUCHE LLP***

Portland, Oregon  
March 17, 2008

**POWER OF ATTORNEY**

**MICHAEL A. STEIN**

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Michael A. Stein, hereby constitutes and appoints Wayne M. Bolio or William D. Meadowcroft, severally and not jointly, his true and lawful attorney-in-fact and agent, for him and his name, place and stead, in any and all capacities, to sign the Form 10-K of Nautilus, Inc., a Washington corporation, for the fiscal year ended December 31, 2007, and any amendments or supplements thereto, and to file this Power of Attorney and the Form 10-K, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission and the New York Stock Exchange, granting unto said attorney-in-fact and agent full power and authority to do and perform each requisite and necessary act to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, may do or cause to be done by virtue hereof.

Dated this 17th day of March, 2008.

Signature:

/s/ Michael A. Stein

Michael A. Stein

**POWER OF ATTORNEY**

**RICHARD A. HORN**

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Richard A. Horn, hereby constitutes and appoints Wayne M. Bolio or William D. Meadowcroft, severally and not jointly, his true and lawful attorney-in-fact and agent, for him and his name, place and stead, in any and all capacities, to sign the Form 10-K of Nautilus, Inc., a Washington corporation, for the fiscal year ended December 31, 2007, and any amendments or supplements thereto, and to file this Power of Attorney and the Form 10-K, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission and the New York Stock Exchange, granting unto said attorney-in-fact and agent full power and authority to do and perform each requisite and necessary act to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, may do or cause to be done by virtue hereof.

Dated this 17th day of March, 2008.

Signature:

/s/ Richard A. Horn

Richard A. Horn

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**POWER OF ATTORNEY**

**ROBERT S. FALCONE**

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Robert S. Falcone, hereby constitutes and appoints Wayne M. Bolio or William D. Meadowcroft, severally and not jointly, his true and lawful attorney-in-fact and agent, for him and his name, place and stead, in any and all capacities, to sign the Form 10-K of Nautilus, Inc., a Washington corporation, for the fiscal year ended December 31, 2007, and any amendments or supplements thereto, and to file this Power of Attorney and the Form 10-K, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission and the New York Stock Exchange, granting unto said attorney-in-fact and agent full power and authority to do and perform each requisite and necessary act to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, may do or cause to be done by virtue hereof.

Dated this 17th day of March, 2008.

Signature:

/s/ Robert S. Falcone

Robert S. Falcone

**POWER OF ATTORNEY**

**RONALD P. BADIE**

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Ronald P. Badie, hereby constitutes and appoints Wayne M. Bolio or William D. Meadowcroft, severally and not jointly, his true and lawful attorney-in-fact and agent, for him and his name, place and stead, in any and all capacities, to sign the Form 10-K of Nautilus, Inc., a Washington corporation, for the fiscal year ended December 31, 2007, and any amendments or supplements thereto, and to file this Power of Attorney and the Form 10-K, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission and the New York Stock Exchange, granting unto said attorney-in-fact and agent full power and authority to do and perform each requisite and necessary act to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, may do or cause to be done by virtue hereof.

Dated this 17th day of March, 2008.

Signature:

/s/ Ronald P. Badie

Ronald P. Badie

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**POWER OF ATTORNEY**

**GERARD L. EASTMAN**

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Gerard L. Eastman, hereby constitutes and appoints Wayne M. Bolio or William D. Meadowcroft, severally and not jointly, his true and lawful attorney-in-fact and agent, for him and his name, place and stead, in any and all capacities, to sign the Form 10-K of Nautilus, Inc., a Washington corporation, for the fiscal year ended December 31, 2007, and any amendments or supplements thereto, and to file this Power of Attorney and the Form 10-K, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission and the New York Stock Exchange, granting unto said attorney-in-fact and agent full power and authority to do and perform each requisite and necessary act to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, may do or cause to be done by virtue hereof.

Dated this 17th day of March, 2008.

Signature:

/s/ Gerard L. Eastman

Gerard L. Eastman

**POWER OF ATTORNEY**

**EDWARD J. BRAMSON**

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Edward J. Bramson, hereby constitutes and appoints Wayne M. Bolio or William D. Meadowcroft, severally and not jointly, his true and lawful attorney-in-fact and agent, for him and his name, place and stead, in any and all capacities, to sign the Form 10-K of Nautilus, Inc., a Washington corporation, for the fiscal year ended December 31, 2007, and any amendments or supplements thereto, and to file this Power of Attorney and the Form 10-K, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission and the New York Stock Exchange, granting unto said attorney-in-fact and agent full power and authority to do and perform each requisite and necessary act to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, may do or cause to be done by virtue hereof.

Dated this 17th day of March, 2008.

Signature:

/s/ Edward J. Bramson

Edward J. Bramson



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**POWER OF ATTORNEY**

**MARVIN G. SIEGERT**

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Marvin G. Siegert, hereby constitutes and appoints Wayne M. Bolio or William D. Meadowcroft, severally and not jointly, his true and lawful attorney-in-fact and agent, for him and his name, place and stead, in any and all capacities, to sign the Form 10-K of Nautilus, Inc., a Washington corporation, for the fiscal year ended December 31, 2007, and any amendments or supplements thereto, and to file this Power of Attorney and the Form 10-K, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission and the New York Stock Exchange, granting unto said attorney-in-fact and agent full power and authority to do and perform each requisite and necessary act to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, may do or cause to be done by virtue hereof.

Dated this 17th day of March, 2008.

Signature:

/s/ Marvin G. Siegert

Marvin G. Siegert

**CERTIFICATION**

I, Robert S. Falcone, certify that:

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

March 17, 2008

Date

By: /s/ Robert S. Falcone

Robert S. Falcone,  
President and Chief Executive Officer

**CERTIFICATION**

I, William D. Meadowcroft, certify that:

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

March 17, 2008

Date

By: /s/ William D. Meadowcroft

William D. Meadowcroft,

Chief Financial Officer and Secretary

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

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

To my knowledge, the Annual Report on Form 10-K for the year ended December 31, 2007 (the “Form 10-K”) of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

March 17, 2008  
Date

By: /s/ Robert S. Falcone  
Robert S. Falcone,  
President and Chief Executive Officer

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

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

To my knowledge, the Annual Report on Form 10-K for the year ended December 31, 2007 (the “Form 10-K”) of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

March 17, 2008  
Date

By: /s/ William D. Meadowcroft  
William D. Meadowcroft,  
Chief Financial Officer and Secretary

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.