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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005

Commission file number: 001-31321

NAUTILUS, INC.

(Exact name of Registrant as specified in its charter)

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

16400 S.E. Nautilus Drive
Vancouver, Washington 98683
(Address of principal executive offices, including zip code)

(360) 859-2900
(Issuer's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, no par value	New York Stock Exchange

Indicate by check mark whether 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 Exchange 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

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

The aggregate market value of the voting stock held by non-affiliates, computed by reference to the last sales price ($28.50) 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, 2005) was $912,088,949.

The number of shares outstanding of the Registrant's Common Stock as of March 1, 2006 was 32,800,986 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 2006 Annual Meeting of Stockholders.

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NAUTILUS, INC.

2005 FORM 10-K ANNUAL REPORT

PART I

Forward-Looking Statements

Certain statements contained in this Annual Report on Form 10-K, including, without limitation, statements containing the words "could," "may," "will," "should," "plan," "believes," "anticipates," "estimates," "predicts," "expects," "projections," "potential," "continue," and words of similar import, constitute "forward-looking statements." Investors are cautioned that all forward-looking statements involve risks and uncertainties and various factors could cause actual results to differ materially from those in the forward-looking statements. From time to time and in this Form 10-K, we may make forward-looking statements relating to our financial performance, including the following:

- *Anticipated revenues, expenses and gross margins;*
- *Seasonal patterns;*
- *Expense as a percentage of revenue;*
- *Anticipated earnings;*
- *New product introductions; and*
- *Future capital expenditures.*

Numerous factors could affect our actual results, including the following:

- *The availability of media time and fluctuating advertising rates;*
- *A decline in consumer spending due to unfavorable economic conditions;*
- *Our ability to effectively develop, market and sell future products;*
- *Our ability to get foreign sourced products through customs in a timely manner;*
- *Our ability to effectively identify and negotiate any future strategic acquisitions;*
- *Our ability to integrate any acquired businesses into our operations;*
- *Our ability to adequately protect our intellectual property;*
- *Introduction of lower priced competing products;*
- *Unpredictable events and circumstances relating to our international operations, including our use of foreign manufacturers;*
- *Government regulatory action; and*
- *Our ability to retain key employees.*

We describe certain of these and other key risk factors elsewhere in more detail in this Form 10-K. Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. Except to the extent required by federal securities laws, we undertake no obligation to update publicly any forward-looking statements to reflect new information, events, or circumstances after the date of this Form 10-K or to reflect the occurrence of unanticipated events.

Item 1. Business

OVERVIEW

Nautilus, Inc. (the "Company") is a leading marketer, developer and manufacturer of branded health and fitness products sold under such well-known brand names as Nautilus, Bowflex, Schwinn, StairMaster, Trimline and Pearl Izumi. Our products are distributed through diversified direct, retail and commercial sales channels, both domestically and internationally. We market and sell a variety of branded products that are targeted at specific locations where people shop or exercise. Nautilus, StairMaster and Pearl Izumi brands are most commonly marketed through the commercial and high-end specialty retail markets, while the Bowflex and Schwinn branded products are marketed primarily through the retail and direct channels. Our product marketing includes direct response marketing utilizing a combination of television commercials, infomercials, response mailings, the Internet, catalog, and inbound/outbound call centers. It also includes a sales force and dealer network marketing to retail organizations, health clubs, government agencies, hotels, corporate fitness centers, colleges, universities and assisted living facilities worldwide.

Founded in 1986, the Company has grown to over $630 million in annual sales through a combination of internal growth of our Bowflex brand and a series of strategic acquisitions of strong brands, including Nautilus International, Inc. ("Nautilus") in January 1999, the fitness division of Schwinn/GT Corp. and its affiliates ("Schwinn Fitness") in September 2001, StairMaster Sports/Medical, Inc. ("StairMaster") in February 2002, and DashAmerica, Inc. d/b/a Pearl Izumi USA ("Pearl Izumi") in July 2005. As a result of these acquisitions, we expanded our portfolio of leading brands, product lines, channels of distribution, product development capabilities and the size of our customer base. We now offer a specialized line of fitness apparel in retail channels and a comprehensive line of cardiovascular and strength, or weight resistance, products in the direct, retail and commercial fitness channels both domestically and internationally.

Our cardiovascular and strength product lines reflect a complete assortment of high-quality fitness equipment. Our Nautilus brand includes four distinct lines of strength equipment, plus free weights and benches, and both upright and recumbent exercise cycles. During 2004 and 2005, the Company developed a line of Nautilus cardiovascular equipment, including new ellipticals and treadmills, and began development of a commercial version of our popular TreadClimber cardio machine. During 2005, we continued to invest heavily in product development and introduced approximately 22 new products, including the next generation of our popular Bowflex TreadClimber cardio trainer, the Bowflex Revolution home gym, and Bowflex SelectTech dumbbells, specifically for women and teens. Our StairMaster brand is best known for steppers and stepmills designed for excellent lower-body and cardiovascular workouts, but also includes treadmills and ellipticals. Our Bowflex brand has been expanded to represent a complete line of fitness equipment, both strength and cardio, including multiple models of home gyms, plus strength cages, free weights, SelectTech dumbbells, benches, TreadClimbers and treadmills. Our Schwinn Fitness brand includes a popular line for indoor cycling, along with upright and recumbent exercise bikes, treadmills and ellipticals.

Our fitness apparel line is composed of high-end performance apparel and footwear targeted to consumers who are fitness and outdoor enthusiasts, especially for those interested in cycling and running activities. This apparel line is composed almost entirely of Pearl Izumi branded wear. Pearl Izumi is best known for its innovative and technically superior cycling apparel and has been expanded into the running apparel and footwear markets.

Our fitness products are in approximately 25% of U.S. retail doors that sell products within the scope of our business, and approximately 40% of specialty fitness doors. In addition, we work with more than 1,200 dealers in the U.S., a worldwide network of distributors in over 50 countries, and sales offices in Switzerland, Italy, Germany, the United Kingdom and China.

The Company acquired Belko Canada in May 2005, which has since been named Nautilus Fitness Canada. Nautilus Fitness Canada has served as our exclusive Canadian distributor since 1996. This acquisition has

strengthened our direct to consumer sales channel in Canada and enabled us to become more efficient in our sale of direct products in the Canadian market. We also sell products to commercial, retail, and specialty retail customers in Canada.

The Company was incorporated in California in 1986 and became a Washington corporation in 1993. On March 14, 2005, the Company changed its corporate name from The Nautilus Group, Inc. to Nautilus, Inc. Our common stock is listed on the New York Stock Exchange and trades under the symbol "NLS."

In 2005, we moved our headquarters to a new 483,000 square feet facility in order to accommodate our recent and future growth plans. Our principal executive offices are now located at 16400 SE Nautilus Drive, Vancouver, Washington 98683, and our telephone number is (360) 859-2900.

As used in this Form 10-K, the terms "we," "our," "us," "Nautilus" and "Company" refer to Nautilus, Inc. and its subsidiaries. The names Nautilus®, Bowflex®, Power Rod®, TreadClimber®, Schwinn® (fitness products), StairMaster®, Trimline® and Pearl iZUMi® are trademarks of the Company.

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 ("SEC") under the Securities Exchange Act of 1934 as amended ("Exchange Act"). You can inspect and copy our reports, proxy statements and other information filed with the SEC at the offices of the SEC's Public Reference Room in Washington, D.C. 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.nautilus.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 filed or furnished 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. The information found on our website is not part of this Form 10-K. You can also obtain copies of these reports by contacting our corporate relations department at (360) 859-2514.

The Company also maintains and directs customers to our websites, which can be found at www.nautilus.com. These websites contain Company and product information. None of the information on these websites is part of this Form 10-K.

Strategy

Pure Fitness

Our positioning of "Pure Fitness" is designed to enable us to achieve global category leadership by providing the tools and education to consumers worldwide to achieve a fit and healthy lifestyle. "Pure Fitness" will help enable consumers to answer the four main questions about how they go about achieving their health and fitness goals.

Question: What do I do to live a healthier and fit lifestyle?

Answer: Nautilus Institute: In 2005 we created the Nautilus Institute, which is a Company sponsored initiative formed to encourage more people to adopt a lifelong fitness habit by providing them with expert knowledge and guidance. The Nautilus Institute website can be found at www.nautilusinstitute.org.

Question: What do I use?

Answer: Nautilus Fitness Equipment: Our cardiovascular and strength or weight resistance product lines reflect a complete assortment of high-quality fitness equipment.

Question: What do I wear?

Answer: Nautilus Fitness Apparel: Our fitness apparel line is currently composed of high-performance apparel and footwear for cycling and running activities. We believe we can leverage our existing fitness equipment brands to broaden our product offerings to consumers within the market for performance apparel.

Question: What do I eat?

Answer: In the nutrition market, we have a continued strategic relationship with Champion Nutrition as supplier of nutritional supplements that are complementary with our fitness and healthy lifestyle product offerings and are marketed through our fitness equipment segment. We anticipate greatly expanding this business in the coming years.

Answering these questions will lead consumers to the trusted name Nautilus to help them achieve a fit and healthy lifestyle.

Market Research

Our market research indicates that while we possess distinct competitive advantages, we have not fully capitalized on the many opportunities available to us in the estimated $17.0 billion exercise equipment, performance apparel, and sports nutrition markets that we compete in. We are a leader in selling strength products through the direct marketing channel, but our research showed that approximately 80% of our target consumer market buys fitness products through the retail channel and 70% purchase cardio equipment. As a result, we continued moving into the retail market in 2005 by making additional products available through more retailers.

Operating Principles:

In 2003, we conducted a thorough due diligence process, in which we interviewed our internal team, spoke with industry consultants, and conducted the most comprehensive market research study in our history in order to help identify and realize our growth opportunities. We have targeted several areas as significant opportunities for growth, including leveraging our research and development capabilities to launch new products and repositioning our strength and cardiovascular products to better meet customer demand and shopping patterns. We also seek to improve operating efficiencies and cash flow by streamlining operations and maximizing business synergies, such as brand development, sales channels, marketing resources, and information resources.

Since the beginning of 2004, we have continued pursuing global category leadership by providing the tools and education necessary to help people achieve a fit and healthy lifestyle. At the core of this mission is an internal initiative called FIT #1, which is the foundation of our plan to create long-term stockholder value. FIT #1 stands for Financial rigor, Innovation, Trust and a drive to be #1 in the categories in which we compete. These are the core strategic elements around which we will structure our activities, enabling us to refocus our efforts and continue our growth. Financial rigor means we must ensure accurate and streamlined financial and forecasting processes. Innovation means we must apply creative solutions to both research and development and business operations. Trust means we must ensure we are taking care of our customers and stockholders and doing everything we can to serve them.

Focus on Innovation

We developed approximately 22 new products in 2005, and we continue to leverage our advanced research and development capabilities and our strong brand names to expand our existing product lines and launch new innovative products. Innovation is an important part of our strategy as we continue to emphasize the expansion and diversification of our product development capabilities in health and fitness products. We develop new products either from internally generated ideas or by acquiring or licensing patented technology from outside inventors and then enhancing the technology.

We have a modern test and prototype facility, along with a staff of designers and engineers. With the acquisition of Pearl Izumi, we have the basis for technically superior apparel products. Our additional research and development resources have allowed us to become fully integrated in the product development process, allowing us to take a new product concept from the beginning of feasibility studies straight through to production and continuing product review. This integration allows us a greater degree of control over the new product process, which should allow us to generate a higher quality product, increase our speed to market, and control our costs.

Research and development expense was $11.2 million, $6.8 million and $5.7 million for 2005, 2004, and 2003, respectively.

Leverage Sales Channels

We repositioned our products in 2005 to better meet consumer demand and shopping patterns and to expand our sales channels. This means offering more of the products consumers want (e.g., cardiovascular fitness equipment) in the places consumers want to buy our products (e.g., retail outlets). We are moving more of our products to the retail channel and are differentiating our products to specifically fit the needs of the consumer shopping in each sales channel. For example, we will sell different models of Bowflex in retail compared to the direct sales channel. This strategy will allow our partners to have differentiated products under the same brand, enabling each channel to provide the products its consumers demand.

Streamline Company Operations

Another foundational element of our strategy is our effort to reorganize from a channel focus to a consumer focus. Included in this focus change is a drive to leverage our expertise, experience and diversity of thought from across our organization to realize synergies, efficiencies and cost savings. In 2006 we will continue to adopt best practices across our locations. We are establishing a performance-driven culture based on teamwork that clearly ties employee compensation to both company and individual performance. We are seeking to develop a high-energy collaborative culture with a clear focus on the metrics that drive performance and create shareholder value.

We expect to benefit from of the considerable capital investments we made in 2005, which primarily consisted of an upgrade to our ERP systems and our new world headquarters facility. In 2006 we are committed to achieving operational excellence by structuring our efforts around the principles of Quality control, Customer service and Cost takeout or "QC^2" as it is known within our organization. Key elements of QC^2 include improving flexibility and efficiency in our domestic plants, working collaboratively with suppliers to take costs out of the system while improving quality and streamlining our distribution system.

BUSINESS SEGMENTS

Effective July 7, 2005, the closing date of the Company's acquisition of Pearl Izumi, the Company began operating as two reportable segments, the fitness equipment segment and the fitness apparel segment.

The fitness equipment segment is responsible for the design, production, selling and marketing of branded health and fitness products sold under the Nautilus, Bowflex, Schwinn Fitness, StairMaster, and Trimline brand names. Depending on the brand, our fitness equipment is sold through direct, commercial, retail, and specialty retail channels and international channels. Sales from our Bowflex home-gym product line across all sales channels, including related shipping revenue, accounted for approximately 44% of our aggregate net sales in 2005, down from 48% and 52% in 2004 and 2003, respectively, as we continue our strategies of diversifying our breadth of products in all channels. The fitness equipment segment also consists of corporate overhead costs consisting mainly of director costs, general legal and accounting fees, and salaries of corporate personnel. The treasury function is part of the fitness equipment segment so interest income from investments and interest expense from short-term borrowings are also included.

The fitness apparel segment is responsible for the design, production, selling and marketing of branded apparel and footwear products currently sold under the Pearl Izumi name. These products are primarily sold through four distinct sales channels that include wholesale direct, internet direct, retail stores leased by the Company, and international distributors. The domestic wholesale direct sales are made to independent bike dealers as well as to large outdoor retailing stores. The internet direct sales are comprised of product sales made directly to end consumers in the U.S. The Company leases 10 retail stores that sell primarily closeout fitness apparel and footwear items. The international distributor sales are made to independent bike dealers and a few large sporting good consortiums mainly located in Canada, Australia, Czech Republic, Switzerland, New Zealand, Norway, Russia, Slovenia England, Germany and China.

Detailed financial information about our two business segments is included in Note 3 of the Notes to Consolidated Financial Statements.

Sales outside the U.S. represented approximately $88.4 million, $66.5 million and $66.3 million for the years ended December 31, 2005, 2004 and 2003, respectively. Long-lived assets outside the U.S. were approximately $5.3 million, $0.4 million and $0.6 million at December 31, 2005, 2004 and 2003, respectively. Comparatively, sales within the U.S. represented approximately $542.9 million, $457.3 million and $432.5 million for the years ended December 31, 2005, 2004, and 2003, respectively. Long-lived assets within the U.S. were approximately $162.8 million, $93.4 million and $97.0 million at December 31, 2005, 2004 and 2003, respectively.

FITNESS EQUIPMENT SEGMENT

Direct to Consumer Sales Channel and Marketing

Through our direct-to-consumer sales and distribution channel, we market and sell our products directly to the end consumer. We market and sell a complete 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 also utilize extended 30-minute television “infomercials,” Internet advertising, our product websites, inquiry response mailings, catalog, and inbound/outbound call centers. By selling directly to consumers, we are able to fully realize premium price points paid for our products and drive our brand equity.

We have been highly successful with what we refer to as a “two-step” marketing approach. Our two-step approach focuses first on generating consumer interest in our products while eliciting consumer requests for product information. Development of this interest is achieved primarily through the use of spot commercials and infomercials, supplemented by Internet advertising. The second step focuses on converting the informational requests into sales, which we accomplish through a combination of response mailings and outbound calling.

Conversion of Inquiries into Sales

Customer Service Call Center and Order Processing. 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.

We contract with large telemarketing companies to receive and process information requests generated by our spot television advertising 24 hours per day. The telemarketing agents for these companies collect names, addresses and other basic information from callers but do not directly sell our products.

Internet. We use 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.

Consumer Finance Programs. We believe that convenient consumer financing is an important tool in our direct marketing sales efforts and that the availability of financing induces many of our consumers to make inquiries and purchases when they otherwise would not.

Because our high-quality fitness equipment generally requires a substantial investment, over 90% of our direct segment customers use either popular credit cards, such as VISA or MasterCard, or take advantage of the private Nautilus card, which is offered through a third party. Consumer financing through our private Nautilus card has risen to 66% of direct channel sales in 2005, compared to 64% in 2004 and 43% in 2003. We believe these financing programs will continue to be an important and effective marketing tool for customers purchasing products directly through our call center and product websites. Additionally this increase in consumer financing has an additional benefit to our Company in that these consumers generally have additional credit available to purchase additional products.

Seasonality

The effectiveness of our direct marketing is influenced by seasonal factors. We have found that second quarter influences on television viewership, such as the broadcast of national network season finales and seasonal weather factors, cause our spot 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 that is used indoors.

Commercial Sales Channel and Marketing

We market and sell our Nautilus, Schwinn, and StairMaster commercial fitness equipment through our sales force and selected dealers and retailers 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, and StairMaster commercial product lines through joint marketing programs with clubs, making fitness inviting for hotel guests and utilizing our knowledge from the Nautilus Institute to improve our product offerings.

We position ourselves as “The Health & Fitness Innovators” to encourage our commercial market customers and potential customers to think of us first when considering their fitness equipment and programming needs. Our strategy is to address the needs of the following three key constituencies of today’s health clubs by creating joint programs:

- Club owners (customer satisfaction and profit)
- Club staff (continuing education and career development)
- Club users (improved health and fitness)

Advertising. We advertise in select trade publications, including publications that reach key industry stakeholders, as well as directly to consumers. Specific placement is driven by marketing and product development events and ads are coded to assist us in measuring the effectiveness of each individual ad with respect to our objectives of increasing brand awareness and sales leads.

Direct Mail Promotions. 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.

Nautilus Institute. In 2005, we created the Nautilus Institute, which is a Company sponsored initiative formed to encourage more people to adopt a lifelong fitness habit by providing them with expert knowledge and guidance. This program will help people achieve lifelong fitness by exploring proper nutrition for all body types,

proper exercise routines and equipment to be used including cardiovascular and strength training. We believe the Nautilus Institute will help develop a body of knowledge that will lead us to the design of more effective and user-friendly products for our customers. The Nautilus Institute website can be found at www.nautilusinstitute.org.

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

Internet. We currently maintain and direct consumers to our websites, which can be found at www.nautilus.com. These websites contain Company and product information.

Retail and Specialty Retail Sales Channel and Marketing

In the retail sales channel, we market and sell a comprehensive line of consumer fitness equipment under the Nautilus, Bowflex, Schwinn Fitness, StairMaster and Trimline brand names through a network of 2,800 locations consisting of sporting good dealers, distributors and retailers. In the specialty retail sales channel, we market and sell a comprehensive line of consumer fitness equipment under the Nautilus, Schwinn Fitness, StairMaster and Bowflex brand names through a network of specialty retailers and independent bike dealers. The specialty retail channel represents a customer base comprised of high-end fitness enthusiasts who desire club quality equipment for the home.

In addition to products already offered through our retail and specialty retail sales channels, we intend to continue bringing products previously sold exclusively through our direct sales channel to retail and specialty retail. By leveraging the advertising dollars spent on direct marketing, we believe we can effectively sell our direct to consumer products through our retail sales channel where the majority of consumers purchase fitness products. The direct advertising not only generates revenue through direct to consumer sales, but it also creates brand and product awareness that lead to sales in our retail sales channel.

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 dollars to market 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, Bowflex, StairMaster and Trimline brands remain prominent in the minds of customers and consumers and drive consumers to their local retailers.

In-Store Promotions. We have developed a branded "store within a store" concept that allows the customer to buy the specific product for their specific need and allows them to envision how the different innovative assortments of fitness equipment could be positioned in the home.

Internet. The Company currently maintains and directs customers to our websites, which can be found at www.nautilus.com. These websites contain Company and product information.

International Sales Channel and Marketing

In 2005, our international sales channels included commercial, retail, specialty retail and direct. We market and sell Nautilus, Bowflex, Schwinn Fitness, StairMaster and Trimline brands to geographic locations outside of the United States using a combination of direct-marketing, our sales force, and a network of specialty and sporting goods dealers, distributors and retailers. We have integrated all of our brands from an operational standpoint and are distributing our products through a network of over 90 distributors in over 50 countries divided among three regions:

- Asia/Pacific

- Europe/Middle East/Africa
- Canada/South America

In each of these regions, we have responsible sales people and third party warehouses to deliver our products in a timely and cost effective manner. Communication amongst our business partners within each region is essential to our strategy so we may support our products, develop innovative marketing activities, and achieve global brand recognition.

In our largest international markets, Canada, the United Kingdom, Germany, and Italy, we operate our own offices, which possess a team of sales representatives that focus not only on selling to fitness clubs but also on selling to the government, hotel, and medical/paramedical markets. In Canada, we also market directly to consumers.

We have alliances with distributors in most markets to sell commercial products from our Nautilus, Schwinn, and StairMaster brands. By offering a complete line of strength and cardio products, we have greater ability to compete in the international marketplace where many customers prefer to buy from one supplier that can offer the broadest array of products at a competitive price. By building our portfolio of brand names, we have greater ability to compete in the international marketplace in which our main competitors have benefited for many years from the ability to negotiate “package deals.” We believe our brand names have strong recognition in the international marketplace, which will allow us to compete more effectively in the future.

Seasonality

In general, domestic and international sales in our commercial, retail, and specialty retail fitness equipment channels are highly seasonal. We believe that sales within these channels are considerably lower in the second quarter of the year compared to the other quarters. Our strongest quarter for these channels is generally the fourth quarter, followed by the third and first quarters. We believe the principal reason for this trend is the fitness industry’s preparation for the impact of New Year’s fitness resolutions and seasonal weather patterns that encourage more fitness activity indoors.

FITNESS APPAREL SEGMENT

We created a new business segment, the fitness apparel segment, through the acquisition of DashAmerica, Inc. d/b/a Pearl Izumi USA (“Pearl Izumi”) on July 7, 2005. The purchase price for Pearl Izumi was approximately $70.0 million including acquisition costs, net of cash acquired, plus $5.3 million in assumed debt. Pearl Izumi is a provider of fitness apparel and footwear for cyclists, runners and fitness enthusiasts. Our Pearl Izumi apparel products are sold through sporting good dealers, retailers, independent bike dealers and retail stores operated by the Company.

Pearl Izumi is known among fitness enthusiasts for its quality, innovation, and technically superior sports apparel and footwear. With our presence and leading fitness equipment brands in commercial, retail and specialty retail, we are positioned to expand those brands into fitness apparel to complement the Pearl Izumi brand.

The fitness apparel segment produces and distributes specialized performance-driven sports apparel and footwear. These products are primarily designed specifically for athletes, competitors and outdoor enthusiasts. We group our fitness apparel merchandise into five principal categories:

- Cycling apparel;
- Running apparel;
- Cycling footwear;
- Running footwear; and
- Active outdoor apparel.

During 2005, we distributed our fitness apparel products through approximately 3,200 retailers in over 27 countries. In 2006 the product mix of the fitness apparel segment will expand to include new product lines and brands of cycling and fitness products.

Fitness Apparel Channels and Marketing

The fitness apparel marketing activities have been focused in a number of different areas. We have placed print advertisements in a number of sport specific publications to increase the brand awareness and to promote new products. We also participate in a number of trade shows throughout the year, including hosting a booth at Interbike, which is the bicycle industry's showcase event. We also have booths at a number of sporting events. We encourage brand visibility via product seeding to ensure that our product is being used by a number of athletes. We also encourage brand visibility via product seeding to ensure that our product is being used by a number of athletes. Pearl Izumi was able to support various top Olympic athletes at the 2004 summer games as well as a number of other endurance athletes who use our products. We use a dedicated website to promote our fitness apparel products as well as to provide information to our consumers. The website can be found at www.pearlizumi.com. This website contains Company and product information. None of the information on these websites is part of this Form 10-K.

The fitness apparel segment has four distinct sales channels.

- Wholesale direct;
- International distributors;
- Company leased retail stores; and
- Internet sales.

The international and domestic wholesale direct sales channels are comprised of independent bike dealers and specialty run accounts as well as select large outdoor and sports retailers such as REI and Dicks. The primary drivers for our success in specialty channels are differentiated products, credibility with enthusiast consumers, and value added service. International distributor sales are made to exclusive distributors primarily in Canada, Australia, Czech Republic, Switzerland, New Zealand, Norway, Russia, Slovenia, Mexico, and Israel. The fitness apparel segment also leases 10 retail stores (9 in the U.S. and 1 in Europe), which sell primarily closeout items at favorable margins. Internet sales are comprised of product sales made directly to end consumers, primarily in the U.S.

Marketing activities for the fitness apparel segment have been focused to communicate to running, cycling and outdoor sports enthusiasts. Print advertisements in sport and enthusiast publications are utilized to increase the brand awareness as well as to promote new products and technologies. We also participate in a number of retail and consumer trade shows throughout the year including Interbike USA and Eurobike EU, which are the cycling industry's leading showcase events. We also attend a number of regional sporting events in conjunction with our retail partners where we educate consumers about our products and give them a positive experience with our brand.

In addition to consumer marketing, the fitness apparel segment focuses considerable effort on a marketing concept, which is labeled "Drive Retailer Success" ("DRS"). This program is focused on ensuring the ongoing health and prosperity of our retailers. As part of our DRS program, we offer the Pearl Izumi Managed Inventory program to retailers. This program, which involves auto stocking of inventory, serves to increase the breadth of product at retail selection and helps assure the best availability through the season.

Seasonality

Sales of our fitness apparel products are seasonal with stronger sales in the first and third quarters as retailers build inventories in anticipation of the Spring and Fall selling seasons. We expect sales during the fourth quarter to be the weakest as this time period typically aligns with the coldest months of the year in our target markets when many fitness and outdoor enthusiasts may be less active.

CONSUMER TRENDS

We believe our organic growth has benefited from a number of demographic and market trends that we expect will continue, including:

- Growing global consumer awareness of positive benefits of good fitness and nutrition;
- Expanding media attention worldwide on health and fitness;
- An aging population that is maintaining a more active lifestyle;
- Continued attention to appearance and health by consumers, which is expected to increase as the "baby-boomers" pass through their 40's, 50's, and 60's;
- High healthcare costs that are focusing more attention on preventative practices like exercise;
- Government financial support for health and fitness programs intended to combat the growing obesity crisis in the United States;
- Expansion of the market for sophisticated high-quality fitness equipment for the home due to consumers' continued demand for higher levels of efficiency in their workout regimes; and
- Expansion in the numbers of health club options fueled by increased consumer demand.

We believe these consumer trends bode well for our future growth prospects. Just as the "baby boomers," those Americans born between 1946 and 1964, started the modern fitness movement, we believe they will continue to be a driving force as they age. According to the Sporting Goods Manufacturers Association (the "SGMA"), the population of Americans fitting this demographic profile is estimated to be around 77 million. We believe baby boomers will use more of their increasing leisure time for exercise and more of their disposable income for fitness equipment purchases as they strive to counter the effects of aging.

Trends in Exercise Equipment

Since 1990, the fitness equipment industry has more than doubled in size and has been the most successful category of sporting goods. Interest in exercising with fitness equipment is supported by the increase in health club memberships in the U.S., which according to the SGMA, have increased almost 100% from 20.7 million in 1990 to 41.3 million in 2005. Consumer interest in health clubs has benefited the market for home fitness equipment as well as the commercial fitness equipment business. Consumers who utilize health clubs are exposed to an array of fitness equipment products and brand names, as well as education about the uses and benefits of fitness equipment. Many consumers want the same features and feel in equipment they buy for their home that they experience in clubs. American Sports Data research in 2004 found that 40% of all treadmill and stationary bike exercisers use this type of equipment most often in the comfort of their home.

The U.S. manufacturing fitness equipment market in 2005 was $4.2 billion in sales and consists of two distinct market segments: home and institutional. The institutional, or commercial, fitness market is more visible to consumers, but the home market is much larger and has experienced much of the meaningful growth in the overall market. Based on statistics provided by the SGMA, 2005 sales of home equipment by manufacturers in wholesale dollars totaled approximately $3.4 billion, representing more than 80% of the overall fitness equipment market. In contrast, the SGMA reports that sales of commercial fitness equipment totaled approximately $0.8 billion in 2005.

According to the SGMA, the fitness equipment market increased an estimated 6% in 2005 as compared to 4% growth in 2004. SGMA indicates the outlook for 2006 is continued growth of approximately 5% in fitness equipment sales. The SGMA cites a stronger economy, growing consumer awareness of the value of exercise, the growth of health club memberships, lower or stable prices for equipment of improving quality and continued expansion of the new housing market where consumers have tended to build larger homes and more interest in fitness walking, strength training and fitness cycling as reasons for the growth expectation.

The international markets represent a strong opportunity for growth, driven by the continued fitness boom across Europe and the increasing focus on fitness and healthy lifestyles by more affluent consumers in Asia and Latin America. In fact, according to recent data published by IHRSA, there are approximately 27,000 health clubs in Europe, 12,200 in Latin America and 4,500 in the Asia/Australia market. For comparison, according to IHRSA there are approximately 26,800 clubs with approximately 41.3 million members operating in the U.S as of January 2004. According to the 2005 IHRSA European Market Report, health club memberships in the United Kingdom totaled 6.1 million in 2004 compared with 1.5 million in 1996, an increase of over 300%. Health club memberships in Germany totaled 4.5 million in 2004 compared with 3.3 million in 1995, an increase of 36%. We believe demand for U.S. products will increase, as foreign consumers increasingly demand the reliability, service and innovative designs provided by U.S. suppliers.

Trends in Apparel Products

We believe our future growth in the fitness apparel segment will come from a number of demographic and market trends that are currently in place and that we expect will continue, including:

- Growing awareness of health and fitness trends and the positive effects of exercise will lead to increased demand for performance apparel and footwear;
- High profile cycling stars have created a great deal of interest in cycling, which translates into increased sales for cycling apparel;
- An aging population is becoming more active and will purchase products for a longer period of time than previous generations;
- The increase in the use of health clubs and the opportunities within this segment in terms of specific fitness apparel will increase demand for our product;
- High healthcare costs are focusing more attention on exercise and fitness and will help increase participation and sales;
- Government support for programs that promote fitness will help increase sales; and
- Growth in the global economy, presenting future sales opportunities in additional countries.

According to SGMA International, athletic apparel and athletic footwear represented approximately 47% and 20%, respectively, of the estimated $55.7 billion U.S. Sporting Goods industry in 2005. SGMA International projects growth of approximately 8% and 8.5% in the markets for athletic apparel and athletic footwear, respectively, in 2006.

According to The Outdoor Industry Association and SGMA International, the most popular outdoor activities in 2003 were cycling with 87.0 million participants, hiking with 71.6 million participants and running with 36.2 million participants. The athletic apparel market is driven by functional and aspirational needs and 31% of the market is performance oriented, leading to growing demand for shopping specialty channels.

According to The Outdoor Industry Association, out of 142 million of U.S. active outdoor enthusiasts, 31% of outdoor enthusiasts were 44 or older. Cross-participation is high and growing – 88% of enthusiasts participate in more than one outdoor activity and 72% of cyclists also run and hike. As the number of baby-boomers interested in outdoor activities continues to increase, there will be more opportunities for cross selling of athletic footwear and apparel to different activity interest groups.

Trends in Nutrition Products

The market for nutritional supplements is large and yet is highly fragmented. According to the Nutrition Business Journal (the “NBJ”), United States nutritional supplement sales totaled $20.3 billion in 2004 compared to $19.8 billion in 2003, representing a 3% increase. Within the nutritional supplements industry we currently compete in the sports nutrition supplements and meal replacement categories, an estimated $2.1 billion market.

We believe that not only have such sports nutrition products gained wide acceptance as an essential component of a committed athletic lifestyle, but increasing numbers of consumers who aren't necessarily health club devotees are also turning to these products for their energy boosting and wellness benefits, often in lieu of traditional beverages and snacks. Opportunities exist to not only expand our presence in our existing nutrition categories but also to provide products for the broader $15.6 billion overall Sports Nutrition and Weight Loss market, as defined by NBJ.

COMPETITION

Fitness Equipment Segment

The markets for all of our products are highly competitive. The specific competitors vary by market and sales channel. We believe that our combination of recognized brand names, innovative and high quality products, multiple distribution channels, brand marketing awareness programs, and dependable customer service allows us to remain competitive in all of our current fitness equipment markets. Our main competitors are discussed by sales channel below.

Home Fitness Equipment. Our Bowflex strength and cardiovascular fitness products predominantly address this market. We believe the principal competitive factors affecting this portion of our business are product price, innovation, quality, brand name recognition, financing options, and customer service. 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 ICON Health and Fitness and Fitness Quest.

Commercial Fitness Equipment. Our Nautilus, Schwinn, and StairMaster brands compete against the products of numerous other commercial fitness equipment companies, including Life Fitness, Cybex, Star Trac, Precor, Techno Gym, and Johnson Health Technology. We believe the key competitive factors in this industry include price, quality, durability, diversity of features, financing options, product service network, and product innovation.

Specialty Retail Fitness. Our Nautilus, Bowflex, Schwinn Fitness, and StairMaster brands compete against the products of numerous other commercial and retail fitness equipment companies, including Life Fitness, Cybex, Star Trac, and Precor. We believe the key competitive factors in this industry include price, quality, durability, diversity of features, financing options, product service network, and product innovation.

Retail Fitness Equipment. Our Nautilus, Schwinn, Bowflex, StairMaster and Trimline brands compete against the products of numerous domestic retail fitness equipment companies including ICON Health & Fitness, HOIST Fitness Systems, Horizon Fitness, Fitness Quest, and Precor. The principal competitive factors in the retail fitness equipment industry include price, quality, brand name recognition, customer service and the ability to create and develop new, innovative products.

International Fitness Equipment. We market and sell Nautilus, Bowflex, Schwinn Fitness, StairMaster and Trimline brands to geographic locations outside of the Americas. These brands compete against the products of numerous other fitness equipment companies, including Life Fitness, Cybex, Star Trac, Precor, and Techno Gym. We believe the key competitive factors in this industry include price, quality, breadth of offering, durability, diversity of features, financing options, product service network, and product innovation.

Fitness Apparel Segment

With the acquisition of Pearl Izumi, we now compete within a specialized niche in the market for performance fitness apparel. We believe this market to be about $2 billion. Our principal competitors in the cycling apparel category consist of Sugoi, Cannondale, Castelli, Descente, and private label. Within the cycling footwear category, the competitors primarily consist of Sidi, Specialized and Shimano. We identify our main competitors within the running footwear category to be Mizuno, Brooks, Nike, New Balance, Adidas and Asics. Within the running apparel category, we believe the main competition to be the same listing of companies as with running footwear, with the addition of Sugoi.

EMPLOYEES

As of December 31, 2005, we employed approximately 1,550 employees, including eight executive officers. None of our employees are subject to any collective bargaining agreements.

INTELLECTUAL PROPERTY

We own many trademarks including the Nautilus®, Bowflex®, Power Rod®, TreadClimber®, Schwinn® Fitness, SelectTech®, StairMaster®, Trimline®, Pearl Izumi®, Microsensor®, Ultrasensor®, Syncroframe® and 3D Chamois® marks. Our trademarks, the great majority of which are either registered or protected by common law rights, are used on a variety of our products in the United States and around the world. We believe that our trademarks are of great value, assuring the consumer that the product being purchased is of high quality and provides a good value.

We also place significant value on product innovation, design and processes which, as much as trademarks, distinguish our products in the marketplace. We own many United States and foreign patents and have submitted additional applications for patent protection that are pending registration. We believe patents are important to our strategy and have identified the patents on our TreadClimber® products as among the most significant to our business. Although our Bowflex® trademark is protected as long as we continuously use it, the main U.S. patent on our Bowflex® Power Rod® resistance technology expired on April 27, 2004. The main U.S. patent in the large portfolio of patents related to our TreadClimber® line of cardiovascular equipment expires on December 13, 2013. The expiration of our patents could trigger the introduction of similar products by competitors.

Building our intellectual property portfolio is an important factor in maintaining our competitive position in the fitness equipment and apparel industries. If we do not, or are unable to, adequately protect our intellectual property, our sales and profitability could be adversely affected. We are very protective of these proprietary rights and take action to prevent counterfeit reproductions or other infringing products. As we expand our market share, geographic scope and product categories, intellectual property disputes are anticipated to increase making it more expensive and challenging to establish and protect our proprietary rights and to defend against claims of infringement by others. Refer to Item 3, Legal Proceedings, and Note 15 of the Notes to Consolidated Financial Statements for a discussion of significant intellectual property disputes.

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.

MANUFACTURING AND DISTRIBUTION

Fitness Equipment

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 applying the popular lean manufacturing philosophy to our manufacturing infrastructure. Our product components are manufactured primarily in the U.S. and Asia. We have not experienced any significant issues with availability of raw materials. From time to time, we have experienced issues with quality control and production of new products both domestically and abroad, especially during that latter part of 2005. While such unanticipated disruptions have adversely impacted our revenues and costs when they have occurred, we believe we have been able to react and correct the issues in a timely manner.

For our direct-marketed and retail products, we mainly use Asian suppliers to manufacture the components and finished goods. Whenever possible, we attempt to use at least two suppliers to manufacture each product component in order to improve flexibility, efficiency, and emphasis on product quality. We also have domestic operations in Texas that manufacture our various lines of consumer treadmills and the Bowflex TreadClimber product line.

Our commercial strength fitness products are manufactured in Virginia, and our commercial cardiovascular fitness products are primarily manufactured in Oklahoma. 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 greater color specification flexibility, build-to-order capability, and unique product configurations.

Domestically, we inspect, package, and ship our products from our facilities in Washington, Oregon, Virginia, Illinois, Texas, and Oklahoma. 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, Oklahoma, and Texas using various commercial truck lines. We distribute commercial strength fitness equipment from our Virginia warehouse facilities directly to customers primarily through our truck fleet. This method of distribution allows us to effectively control the set up and inspection of equipment at the end-user's facilities.

For international sales, we work with distributors in more than 50 countries, and we ship our products from leased facilities in the Netherlands, Switzerland, the United Kingdom and Germany. We also lease, on a month-to-month basis, flexible warehouse space in multiple countries in Asia and Europe, the largest of which is located in the Netherlands. This flexible warehouse space is devoted to international distribution of our products.

Fitness Apparel

Our apparel products are manufactured primarily in Asia and the U.S. The manufacturers are monitored closely to ensure conformity and quality in the products they produce.

Independent manufacturers in Asia purchase the raw materials needed according to our high standards to produce our garments from suppliers at prices and on terms negotiated by us. We are usually required to purchase any unused materials from the factories at the end of the season. For some of our products that are produced in the U.S., we are responsible for purchasing and shipping the raw material to our manufacturer. Although this arrangement exposes us to additional risks before a garment is manufactured, we believe that it increases our manufacturing flexibility and quality control. All of our costs are quoted in U.S. dollars to preclude us from any foreign exchange fluctuation risks.

Our quality control program is designed to ensure that our products meet the highest quality standards. A large portion of the quality control process occurs at the factories. The factories either ship the products to our warehouse facilities in the U.S. or Germany or drop ship direct to our customers.

For domestic sales we generally ship our products from our facilities in Colorado. We rely primarily on UPS to deliver our products. For European sales the products are shipped from our facilities in Germany. For international distributor shipments the products are either drop shipped to our customers or shipped from our facilities in Colorado or Germany.

Item 1A. Risk Factors

RISKS AND UNCERTAINTIES

Because of the following factors, as well as other variables affecting our operating results, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

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 30 and 60 second "spot" television commercials and 30-minute 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 hinder our product revenues and earnings.

The 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 environment. A decline in general economic conditions could further depress consumer spending, especially discretionary spending for premium priced products like ours. These poor economic conditions could in turn lead to substantial decreases in our net sales.

A decline in our ability to effectively develop, market and sell future products could adversely affect our ability to generate future revenues and earnings.

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 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 and different products that satisfy our marketing criteria. In addition, any new products that we market may not generate sufficient net sales or profits to recoup their development or acquisition costs.

During the fourth quarter of 2005, we were slow to ramp up manufacturing volumes on new product innovations. We moved into the fourth quarter with six complex new cardio products in the product ramp up stage in two of our domestic manufacturing facilities. We experienced some productivity issues in those products, including problems with component parts from our suppliers. As a result, not all of the products were in full production in time for us to realize the full benefits of these products in the quarter. This had a significant adverse impact on our fourth quarter revenues and earnings. If we were to continue to experience similar challenges in bringing new or existing products to market, we may again experience lower than expected financial results, as well as negatively impact our relationships with important customers.

We also may not be able to successfully acquire intellectual property 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.

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 United States or into 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, any of which could have a material adverse effect on us.

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, and could have a material adverse effect on our business, potentially resulting in cancelled orders by customers, unanticipated inventory accumulation, and reduced revenues and earnings.

Any failure by us to manage acquisitions and other significant transactions successfully could harm our financial results, business and prospects.

As we have done in the past, we may seek to acquire other businesses in the future. Integrating acquired businesses into our operations poses significant challenges, particularly with respect to corporate cultures and management teams. Failure to successfully effect the integration could adversely impact the revenue, earnings and business synergies we expect from the acquisitions. In addition, the process of integrating acquired businesses may be disruptive to our operations and may cause an interruption of, or a loss of momentum in, our core business.

Our future integration efforts may be jeopardized, and our actual return on investment from such acquisitions may be lower than anticipated, as a result of various factors, including the following:

- Challenges in the successful integration of the products, services or personnel of the acquired business into our operations;
- Loss of employees or customers that are key to the acquired business;
- Time and money spent by our management team focusing on the integration, which could distract it from our core operations;
- Our potential lack of experience in markets of the acquired businesses;
- Possible inconsistencies in standards, controls, procedures and policies among the combined companies and the need to implement our financial, accounting, information and other systems; and
- The need to coordinate geographically diverse operations.

Our 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 could 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.

The introduction of lower priced competing products could significantly harm our ability to generate future revenues and earnings.

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

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 revenue is derived from sales outside the United States. For the year ended December 31, 2005, international sales represented approximately 14% of consolidated net sales. In addition, a substantial portion of our products is manufactured outside of the United States. Accordingly, our future results could be materially adversely affected by a variety of factors, including changes in foreign currency exchange rates, changes in a specific country's or region's political or economic conditions, trade restrictions, import and export licensing requirements, the overlap of different tax structures or changes in international tax laws, changes in regulatory requirements, compliance with a variety of foreign laws and regulations and longer payment cycles in certain countries.

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

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

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

Our future success will depend in part on the continued service of key personnel, particularly Gregg Hammann, our President, Chief Executive Officer and Chairman of the Company's Board of Directors. Our

future success will also depend on our ability to attract and retain key managers, product development engineers, sales people, and others. We face intense competition for such individuals worldwide. Not being able to attract or retain these employees could have a material adverse effect on revenues and earnings.

Item 1B. Unresolved Staff Comments

No unresolved SEC staff comments were outstanding as of December 31, 2005.

Item 2. Properties

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

Location	Segment	Primary Function(s)	Owned or Leased	Lease Expiration	Approximate space
Washington	Fitness Equipment	Warehouse, production, and distribution	Leased	April 30, 2006	80,000 sq. feet
Washington	Fitness Equipment	Corporate headquarters, call center, warehouse	Leased	July 1, 2015	482,538 sq. feet
Washington	Fitness Equipment	Held for sale (sale completed in February 2006)	Owned		114,000 sq. feet
Oregon	Fitness Equipment	Warehouse, production, and distribution	Leased	February 14, 2012	250,000 sq. feet
Virginia	Fitness Equipment	Warehouse and distribution	Owned		105,000 sq. feet
Virginia	Fitness Equipment	Commercial equipment manufacturing	Owned		124,000 sq. feet
Virginia	Fitness Equipment	Engineering, prototyping, customer service, and administrative	Owned		27,000 sq. feet
Virginia	Fitness Equipment	Showroom	Owned		9,000 sq. feet
Virginia	Fitness Equipment	Commercial equipment sales and warehouse	Owned		29,500 sq. feet
Virginia	Fitness Equipment	Warehouse and distribution	Owned		86,000 sq. feet
Virginia	Fitness Equipment	Warehouse and distribution	Owned		65,000 sq. feet
Illinois	Fitness Equipment	Warehouse and distribution	Leased	December 31, 2008	139,000 sq. feet
Colorado	Fitness Equipment	Administrative, warehouse, production, testing, and distribution	Owned		86,000 sq. feet
Texas	Fitness Equipment	Warehouse and distribution	Owned		63,000 sq. feet
Texas	Fitness Equipment	Warehouse	Leased	Month-to-month	35,000 sq. feet
Texas	Fitness Equipment	Warehouse	Leased	Month-to-month	24,000 sq. feet
Texas	Fitness Equipment	Administrative, manufacturing, and warehouse	Owned		135,000 sq. feet
Oklahoma	Fitness Equipment	Manufacturing	Leased	December 31, 2011	125,000 sq. feet
Oklahoma	Fitness Equipment	Distribution	Leased	Month-to-month	22,500 sq. feet
Oklahoma	Fitness Equipment	Distribution	Leased	Month-to-month	22,500 sq. feet
Switzerland	Fitness Equipment	Administrative	Leased	December 31, 2007	4,112 sq. feet
Switzerland	Fitness Equipment	Warehouse and distribution	Leased	March 31, 2006	11,108 sq. feet
Germany	Fitness Equipment	Administrative and distribution	Leased	Month-to-month	2,798 sq. feet
United Kingdom	Fitness Equipment	Administrative, showroom, and warehouse	Leased	May 24, 2014	10,495 sq. feet
Italy	Fitness Equipment	Administrative and distribution	Leased	January 1, 2011	1,097 sq. feet
China	Fitness Equipment	Administrative	Leased	November 14, 2007	4,269 sq. feet
China	Fitness Equipment	Research and development	Leased	November 14, 2007	2,883 sq. feet
China	Fitness Equipment	Research and development	Leased	November 14, 2007	2,132 sq. feet
Canada	Fitness Equipment	Administrative and warehouse	Leased	Month-to-month	12,400 sq. feet
Canada	Fitness Equipment	Call center, distribution administration, warehouse, and showroom	Leased	April 1, 2010	32,000 sq. feet
California	Apparel	Retail Store	Leased	November 5, 2006	2,892 sq. feet
California	Apparel	Retail Store	Leased	August 1, 2007	2,800 sq. feet
California	Apparel	Retail Store	Leased	November 30, 2009	1,543 sq. feet
Colorado	Apparel	Apparel headquarters and warehouse	Leased	November 30, 2008	50,000 sq. feet
Colorado	Apparel	Retail Store	Leased	November 30, 2009	3,000 sq. feet
Georgia	Apparel	Retail Store	Leased	February 28, 2010	1,750 sq. feet
Germany	Apparel	European Apparel offices and warehouse	Leased	December 31, 2006	1,856 sq. meters
Hew Hampshire	Apparel	Retail Store	Leased	January 31, 2009	1,440 sq. feet
Illinois	Apparel	Retail Store	Leased	May 31, 2009	2,016 sq. feet
Oregon	Apparel	Retail Store	Leased	May 31, 2009	1,800 sq. feet
Utah	Apparel	Retail Store	Leased	December 31, 2006	2,500 sq. feet
Spain	Apparel	Retail Store	Leased	September 15, 2010	110 sq. meters

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

In November 2005, the Company proceeded to trial in Salt Lake City, Utah in a case filed by ICON Health & Fitness, Inc. ("ICON") claiming false advertising involving the Company's advertising and promotion going back to 1987 for certain elements of its Bowflex home gyms and claiming trademark infringement for the name placed on a treadmill belt sold in 2002. On November 15, 2005, the jury returned a verdict in favor of ICON in the amount of $7.8 million. The verdict is subject to review by the Court on the issues of liability and damages and will not become final until the Court has issued additional rulings. The Company has filed additional briefings requesting that the Court overturn and/or reduce the damages and the matter remains under consideration by the Court. The Company believes the jury's advisory verdict is inconsistent with the law and the evidence presented at trial and that the evidence does not support the damage award. Thus, the Company has not accrued any material amounts for this case. The Company will continue to vigorously contest this verdict.

In December 2002, the Company filed suit against ICON in the Federal District Court, Western District of Washington (the "District Court") alleging infringement by ICON of the Company's Bowflex patents and trademarks. The Company sought injunctive relief, monetary damages and its fees and costs. In October 2003, the District Court dismissed the patent infringement claims. The Company appealed the District Court's decision to the United States Court of Appeals for the Federal Circuit (the "Appeals Court") and in November 2003, the Appeals Court overruled the District Court and reinstated the patent infringement claims. In May 2005 the District Court again dismissed the patent infringement case against ICON. The Company has appealed this case to the Appeals Court, which has previously ruled in favor of Nautilus in two separate appeals on this matter.

In July 2003, the District Court ruled in favor of the Company on a motion for preliminary injunction on the issue of trademark infringement and entered an order barring ICON from using the trademark "CrossBow" on any exercise equipment. In its ruling, the District Court concluded that the Company showed "a probability of success on the merits and irreparable injury" on its trademark infringement claim. In August 2003, the Appeals Court granted ICON a temporary stay regarding the motion for a preliminary injunction, which enjoined ICON from using the trademark "CrossBow." This stay allowed ICON to continue using the trademark "CrossBow" until a decision was issued by the Appeals Court. In June 2004, the Appeals Court issued its decision upholding the issuance of an injunction, and preventing ICON from selling exercise equipment using the trademark "CrossBow" pending trial on the trademark issue. A trial date has been set for October 2006 in the District Court on this claim.

ICON had been using the term "CrossBar" on certain exercise equipment in response to the litigation regarding its use of "CrossBow." In July 2004, the Company filed an additional suit against ICON in the District Court alleging that ICON has further infringed on the Bowflex trademark by the use of the "CrossBar" trademark. ICON and the Company have now reached a voluntary resolution of that lawsuit, and the case has been dismissed.

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.

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

No matters were submitted to a vote of our stockholders during the quarter ended December 31, 2005.

PART II

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

Market Price of Our Common Stock

Our common stock is listed on the New York Stock Exchange and trades under the symbol "NLS." As of March 1, 2006, 32,800,986 shares of our common stock were issued and outstanding and held by 79 beneficial stockholders.

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

	High	Low	Dividends Paid
2005:			
Quarter 1	$24.59	$20.25	$ 0.10
Quarter 2	28.95	22.68	0.10
Quarter 3	29.65	22.07	0.10
Quarter 4	22.15	16.83	0.10
2004:			
Quarter 1	$17.08	$13.37	$ 0.10
Quarter 2	19.65	14.50	0.10
Quarter 3	23.10	16.95	0.10
Quarter 4	25.25	18.98	0.10

The total amount of dividends paid in 2005 and 2004 were $13.4 million and $13.1 million or $0.40 per share, respectively. 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 expansion plans.

Stockholder Matters

The following table provides information about the Company's equity compensation plans as of December 31, 2005:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	2,402,110	$ 17.41	3,978,284 (1)
Equity compensation plans not approved by security holders	—	—	—
Total	2,402,110	$ 17.41	3,978,284

(1) 125,000 performance units were granted in 2005, which reduces the remaining securities available for future issuance by 250,000 shares.

For further information on the Company's equity compensation plans, see Note 1 and 2 of the Notes to Consolidated Financial Statements.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
October 1, 2005 to October 31, 2005	—	$ —	—	$ 95,420,000
November 1, 2005 to November 30, 2005	637,900	17.33	637,900	84,364,000
December 1, 2005 to December 31, 2005	—	—	—	84,364,000
Total	637,900	$ 17.33	637,900	$ 84,364,000

(1) 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. In March 2006, the Company signed an amended revolving credit agreement, which provides that for the period commencing on January 1, 2006 until such time as the fixed charge coverage ratio shall be equal to or greater than 1.20 to 1.00, the Company may only make capital distributions for the repurchase of shares in an aggregate amount not to exceed $30 million.

Item 6. Selected Consolidated Financial Data

The selected consolidated financial data presented below for each year in the five-year period ended December 31, 2005 has been derived from our audited financial statements. The balance sheet data as of December 31, 2005 and 2004 and the statement of operations data for each of the years in the three year period ended December 31, 2005 have been derived from our audited financial statements included herein. The balance sheet data as of December 31, 2003, 2002, and 2001 and the statement of operations data for the years ended December 31, 2002 and 2001 have been derived from our audited financial statements not included in this document. The data presented below 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 Operations." Comparability of financial results is affected by the acquisition of Schwinn Fitness in September 2001, StairMaster in February 2002, and Pearl Izumi in July 2005. For further discussion of financial information related to the acquisition of Pearl Izumi, see Note 4 of the Notes to Consolidated Financial Statements. Also, certain amounts from previous years have been reclassified to conform to the 2005 presentation with no effect on previously reported consolidated net income or stockholders' equity.

In Thousands (except per share amounts)	2005	2004	2003	2002	2001
Statement of Operations Data					
Net sales	$ 631,310	$ 523,837	$ 498,836	$ 584,650	$ 363,862
Cost of sales	352,496	279,043	247,020	247,598	138,470
Gross profit	278,814	244,794	251,816	337,052	225,392
Operating expenses: Selling and marketing	179,656	156,577	149,245	145,258	99,813
General and administrative	48,826	31,033	37,098	26,017	15,574
Research and development	11,160	6,754	5,670	4,485	2,229
Royalties	5,368	5,968	7,987	10,108	7,363
Total operating expenses	245,010	200,332	200,000	185,868	124,979
Operating income	33,804	44,462	51,816	151,184	100,413
Other income (expense):					
Interest income, net	1,179	1,357	839	1,561	4,024
Other—net	310	(172)	1,098	202	381
Total other income—net	1,489	1,185	1,937	1,763	4,405
Income before income taxes	35,293	45,647	53,753	152,947	104,818
Income tax expense	12,293	15,662	19,351	55,060	38,235
Net income	$ 23,000	$ 29,985	$ 34,402	$ 97,887	$ 66,583
Basic earnings per share	$ 0.69	$ 0.92	$ 1.06	$ 2.84	$ 1.89
Diluted earnings per share	$ 0.68	$ 0.90	$ 1.04	$ 2.79	$ 1.85
Cash dividends per share	$ 0.40	$ 0.40	$ 0.40	$ —	$ —
Basic shares outstanding	33,303	32,757	32,580	34,499	35,184
Diluted shares outstanding	33,857	33,394	33,019	35,143	35,966
Balance Sheet Data					
Cash, cash equivalents, and short-term investments	$ 7,984	$ 104,585	$ 72,634	$ 49,297	$ 51,709
Working capital	106,971	169,549	138,711	109,023	84,366
Total assets	413,286	359,641	311,935	276,653	193,905
Long-term obligations	5,610	200	—	—	—
Stockholders' equity	252,466	252,036	226,128	202,423	147,414

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

The purpose of the Management's Discussion and Analysis of Financial Condition and Results of Operations (the "MD&A") is to provide readers with information necessary to understand the Company's financial condition, changes in financial condition, liquidity and capital resources, and results of operations, as well as our prospects for the future. Below is an index to the MD&A.

EXECUTIVE OVERVIEW

In 2005, we embarked on a growth plan designed to place the Company as the global leader in the fitness industry. Following the completion of our turnaround in 2004, we now offer a complete range of fitness products in virtually every business channel where consumers shop or exercise, and we continue to focus on our future with significant investments in product development, information systems, manufacturing, and marketing.

For the year, we delivered net sales of $631.3 million, a 20.5% increase from last year and the highest net sales in our Company's history. While the first three quarters of 2005 surpassed prior year revenue and profit, we fell short of our target in the fourth quarter. We managed to grow net sales in 2005, but experienced an earnings decline of 23.3% to $0.68 per diluted share. Interest in our products and innovation remained strong, but we did not execute operationally as well as we should have. We uncovered gaps in our go-to-market process for new products, with many delays due to manufacturing and distribution issues, resulting in higher than anticipated costs.

We have identified the issues in our manufacturing and distribution processes as well as in our information systems, and we have already corrected many of the issues. Despite this setback, we did realize a number of noteworthy achievements in 2005:

- We completed two important acquisitions – fitness apparel brand Pearl Izumi USA and the Canadian fitness equipment distributor, Belko Canada. Long popular with cyclists, the high-performance Pearl Izumi brand has been expanded to serve runners. We expect other sports categories will follow. Belko Canada has been the exclusive Canadian distributor of the Company since 1996. We are looking forward to expanding the reach of our Nautilus, Bowflex, Schwinn Fitness, StairMaster and Trimline brands in the specialty and commercial markets, and intensifying our marketing of all brands across Canada.
- We invested heavily in product development and introduced approximately 22 new products, including the next generation of our popular Bowflex TreadClimber cardio trainer, the Bowflex Revolution home gym, and Bowflex SelectTech dumbbells, specifically for women and teens. Our company has long been known for strength equipment, but now has a competitive offering of cardio equipment, which triples the addressable equipment market.
- We grew in all five channels of distribution, with a 20.5% overall increase in net sales, and a net sales increase of 53.5% in our retail channel as we broadened our reach into sporting goods stores, warehouse clubs and department stores. We are the leading equipment supplier in the direct and specialty retail channels, and we recently established a team in China to work with suppliers and expand our international market presence.

- We capitalized on the Nautilus brand with the launch of the Nautilus Institute, a research-based company initiative that provides the motivation and education to help more people live fit and healthy lives.
- We repurchased 830,700 shares of our stock for a total investment of $15.6 million and paid dividends to our stockholders of 40 cents per share, or $13.4 million.
- We invested $31.6 million in capital expenditures that positioned our Company to reap the benefits of improved efficiency for years to come. One significant portion of this investment consisted of an ERP system upgrade that will provide greater visibility to information to manage the business. Another significant portion of this investment was our new world headquarters facility in Vancouver, Washington, which allowed us to consolidate a large portion of our administrative operations and improve our Company's ability to better serve customers and attract talent to our Company.

Going forward, we expect to reap the benefits of the considerable capital investments we made in 2005. We have very strong demand for our leading fitness brands, but our operations and manufacturing must catch up with our growing sales demand.

We are excited about 2006 and believe it will represent continued growth and market share expansion. We believe that we have made the right investments to grow our business, and we are optimistic about the many initiatives we have underway, including leveraging our innovation pipeline and expanding our retail assortments, to enhance productivity and expand our margins. We are committed to achieving operational excellence by structuring our efforts around the principles of quality control, customer service and cost reduction.

CRITICAL ACCOUNTING POLICIES

This MD&A is based upon our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Senior management has discussed the development, selection and disclosure of these estimates with the Audit Committee of our Board of Directors. Actual results may differ from these estimates under different assumptions or conditions.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the financial statements. Management believes the following critical accounting policies reflect its more significant estimates and assumptions used in the preparation of the Consolidated Financial Statements.

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.

Stock-Based Compensation

Prior to January 1, 2006, we measured compensation expense for our stock-based employee compensation plans using the method prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." In Note 1 of the Notes to Consolidated Financial Statements, we provide pro forma disclosures of net income and earnings per share as if the method prescribed by Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," had been applied in measuring compensation expense. Effective January 1, 2006, we changed to recognize compensation expense for all options granted using a fair value approach, as required under SFAS No. 123R, "Share-Based Payment." We are currently evaluating whether to use the Black-Scholes or an alternative method of calculating the fair value of our equity awards. These methods require the use of estimates, and will have a significant impact on our financial position and results of operations which has not yet been determined.

Warranty Reserves

Accrued warranty expense includes the cost to manufacture (raw materials, labor and overhead) or purchase warranty parts from our suppliers as well as the cost to ship those parts to our customers. The cost of labor to install a warranted part on our manufactured commercial equipment is also included. The warranty reserve is based on our historical experience with each product. 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. Adjustments, if any are so indicated, are made to the warranty reserve to reflect our judgment regarding the likely effect of the warranty trends on future claims. If we were to experience a significant volume of warranty claims for a particular part or for a particular reason, we may need to make design changes to our product. If we believe it is necessary to implement those design changes to our installed base of products, our warranty costs could change materially. A change in warranty experience could have a significant impact on our financial position, results of operations and cash flows.

Legal Reserves

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 (at the balance sheet date) that an asset has been impaired or liability 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 (i.e., they are reflected in the financial statements in the period in which they are determined to be losses, with no retroactive restatement). 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, could have a significant impact on our financial position, results of operations and cash flows.

Sales Return Reserves

The sales return reserve is maintained based on our historical experience of direct-marketed product return rates during the period in which a customer can return a product for refund of the full purchase price, less

shipping and handling in certain instances. All direct marketed products have a six week 100% satisfaction guaranteed return period. We track product returns in order to identify any potential negative customer satisfaction trends. Our return reserve may be sensitive to a change in our customers' ability to pay during the trial period due to unforeseen economic circumstances and to different product introductions that might fulfill the customers' needs at a perceived better value. We also provide for estimated sales returns from distributors, retailers and specialty retailers as reductions to revenues and accounts receivable. The estimates are based on historical rates of product returns. Actual returns in any future period are inherently uncertain and thus may differ from the estimates. Any major change in the aforementioned factors may increase sales returns, which could have a significant impact on our financial position, results of operations and cash flows.

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 (standard or average, depending on location) 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.

Intangible Asset Valuation

Currently, intangible assets consist predominantly of the Nautilus®, Schwinn® Fitness, StairMaster® and Pearl iZUMi® trademarks, and goodwill associated with the acquisitions of Schwinn® Fitness, Belko Canada and Pearl iZUMi®. Management estimates affecting these trademark and goodwill valuations include determination of useful lives and estimates of future cash flows and fair values to perform an impairment analysis on an annual basis or more frequently if additional circumstances arise. Management estimates that the Nautilus®, StairMaster® and Pearl iZUMi® trademarks have an indefinite life while the Schwinn® Fitness trademark has an estimated useful live of 20 years. Any major change in the useful lives and/or the determination of an impairment associated with the valuation of the aforementioned intangible assets may result in asset value write-downs, which could have a significant impact on our results of operations in the period or periods in which the asset write-down is recorded.

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. No valuation allowance has been provided for deferred tax assets, since we anticipate the full amount of these assets should 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.

As a matter of course, the Company may be audited by federal, state and foreign tax authorities. We provide reserves for potential exposures when we consider it probable that a taxing authority may take a sustainable position on a matter contrary to our position. We evaluate these reserves, including interest thereon, on a quarterly basis to ensure that they have been appropriately adjusted for events that may impact our ultimate payment for such exposures. Management believes that an appropriate liability has been established for estimated exposures; however, actual results may differ materially from these estimates. To the extent the audits or other events result in a material adjustment to the accrued estimates, the effect would be recognized in income tax expense (benefit) in the Consolidated Statement of Operations in the period of the event.

RESULTS OF OPERATIONS

This MD&A should be read in conjunction with our Consolidated Financial Statements and related notes included elsewhere in this report. 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 frequently encountered by companies that operate in evolving markets. 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 Risks and Uncertainties beginning on page 17.

The Company acquired DashAmerica, Inc. d/b/a Pearl Izumi USA on July 7, 2005 for approximately $70.0 million including acquisition costs, net of cash acquired plus $5.3 million in assumed debt. Pearl Izumi is a provider of fitness apparel and footwear for cyclists, runners and fitness enthusiasts. Our Pearl Izumi apparel products are sold through sporting good dealers, retailers, independent bike dealers and Company owned retail outlets.

Prior to the acquisition of Pearl Izumi, the Company had predominantly operated in one industry segment: the design, production, marketing and selling of branded health and fitness products sold under the Nautilus, Bowflex, Schwinn Fitness, StairMaster and Trimline brand names. Following the acquisition, the Company began operating as two segments, the fitness equipment segment and the fitness apparel segment. This is how Company management now reviews the financial results, thus making it the basis under which financial information is presented and results are explained in this Form 10-K.

The following tables present certain consolidated financial data as a percentage of net sales and statement of operations data comparing results for 2005, 2004, and 2003:

Statement of Operations Data

	Year Ended December 31,		
	2005	2004	2003
Net sales	100.0%	100.0%	100.0%
Cost of sales	55.8	53.3	49.5
Gross profit	44.2	46.7	50.5
Operating expenses:			
Selling and marketing	28.4	29.9	29.9
General and administrative	7.7	5.9	7.4
Research and development	1.8	1.3	1.2
Royalties	0.9	1.1	1.6
Total operating expenses	38.8	38.2	40.1
Operating income	5.4	8.5	10.4
Other income - net	0.2	0.2	0.4
Income before income taxes	5.6	8.7	10.8
Income tax expense	2.0	3.0	3.9
Net income	3.6%	5.7%	6.9%

Statement of Operations Data

	Year Ended December 31,						
				2005-2004		2004-2003	
(In Thousands)	2005	2004	2003	$ change	% change	$ change	% change
Net sales	$ 631,310	$ 523,837	$ 498,836	$ 107,473	20.5%	$ 25,001	5.0%
Cost of sales	352,496	279,043	247,020	73,453	26.3%	32,023	13.0%
Gross profit	278,814	244,794	251,816	34,020	13.9%	(7,022)	-2.8%
Operating expenses:							
Selling and marketing	179,656	156,577	149,245	23,079	14.7%	7,332	4.9%
General and administrative	48,826	31,033	37,098	17,793	57.3%	(6,065)	-16.3%
Research and development	11,160	6,754	5,670	4,406	65.2%	1,084	19.1%
Royalties	5,368	5,968	7,987	(600)	-10.1%	(2,019)	-25.3%
Total operating expenses	245,010	200,332	200,000	44,678	22.3%	332	0.2%
Operating income	33,804	44,462	51,816	(10,658)	-24.0%	(7,354)	-14.2%
Other income - net	1,489	1,185	1,937	304	25.7%	(752)	-38.8%
Income before income taxes	35,293	45,647	53,753	(10,354)	-22.7%	(8,106)	-15.1%
Income tax expense	12,293	15,662	19,351	(3,369)	-21.5%	(3,689)	-19.1%
Net income	$ 23,000	$ 29,985	$ 34,402	$ (6,985)	-23.3%	$ (4,417)	-12.8%

COMPARISON OF THE YEARS ENDED DECEMBER 31, 2005 AND DECEMBER 31, 2004

Net Sales

Net sales were $631.3 million for 2005 compared to $523.8 million for 2004, an increase of $107.5 million or 20.5%. The acquisitions of Pearl Izumi and the Canadian distributor in 2005 represented $45.6 million of this increase in net sales.

Net sales from the fitness equipment segment were $607.3 million for 2005 compared to $523.8 million in 2004.

- Net sales from the commercial channel were $72.9 million in 2005 compared to $67.4 million in 2004, an increase of $5.5 million or 8.2%. The increase is primarily attributed to the introduction of the commercial grade TreadClimber during the second quarter of 2005, in addition to continued sales of the Nautilus Commercial Series treadmills that started shipping during the first quarter of 2005.
- Net sales from the specialty retail channel were $76.3 million in 2005 compared to $68.2 million in 2004, an increase of $8.1 million or 11.9%. The increase in net sales is due primarily to increased unit sales from new products introduced into the specialty channel during 2005, specifically the Bowflex SelectTech, TreadClimber and home-gym products.
- Net sales from the retail channel were $111.1 million in 2005 compared to $72.4 million in 2004, an increase of $38.7 million or 53.5%. The increase in net sales is a result of new products being introduced into the retail channel, specifically SelectTech, TreadClimber and new Bowflex home-gym products. The increase was also due to gaining additional retail customers as well as expanding the number of products offered at existing customer locations.
- Net sales from the direct channel were $293.9 million in 2005 compared to $266.5 million in 2004, an increase of $27.4 million or 10.3%. The increase in direct channel sales was due to increased sales volumes of Bowflex home gyms, TreadClimber products and SelectTech dumbbells. In addition, net sales increased approximately $12.4 million as the result of a price increase in certain TreadClimber and Bowflex home gym products that took place during 2005.
- Net sales from the international channel were $53.1 million in 2005 compared to $49.5 million in 2004, an increase of $3.7 million or 7.4%. The international channel represents fitness equipment sales outside of the Americas and includes sales through the commercial, retail and direct channels. The increase in net sales was attributed to continued formation of new commercial, retail and direct marketing relationships in Australia, Germany, New Zealand, and the United Kingdom.

Since the acquisition of Pearl Izumi, net sales from the fitness apparel segment totaled $24.0 million for 2005. The fitness apparel segment primarily sells high quality fitness apparel for cyclists, runners and fitness enthusiasts under the Pearl Izumi brand name.

Gross Profit

Gross profit was $278.8 million in 2005 compared to $244.8 million in 2004, an increase of $34.0 million or 13.9%. The acquisitions of Pearl Izumi and Belko Canada in 2005 represented $22.3 million of this increase in gross profit. Our overall gross profit margin decreased to 44.2% in 2005, compared to 46.7% in 2004. The fitness equipment segment’s gross profit was $267.8 million in 2005 compared to $244.8 million in 2004, an increase of $23.0 million or 9.4%. The gross profit margin for the fitness equipment segment was 44.1% in 2005 compared to 46.7% in 2004. The decrease in gross margin was attributed to a combination of drivers that include shift in product sales mix; inventory, warranty and factory-related costs and adjustments; higher transportation costs; and additional costs incurred to introduce and support several new product launches. This decline in 2005 gross margin as compared to 2004 was partially offset by the absence of additional warranty and product safety reinforcement related costs associated with doubling of the Bowflex Power Pro warranty and greater than anticipated customer response for the Bowflex Power Pro reinforcement kit during the first half of 2004. The fitness apparel segment’s gross profit was $11.0 million, with a gross profit margin of 45.9%.

Operating Expenses

Selling and Marketing

Selling and marketing expense was $179.7 million in 2005 compared to $156.6 million in 2004, an increase of $23.1 million or 14.7%. The acquisitions of Pearl Izumi and Belko Canada in 2005 represented $4.3 million of the increase in selling and marketing expenses. As a percentage of net sales, selling and marketing expense was 28.4% in 2005 compared to 29.9% in 2004. For the fitness equipment segment, selling and marketing expenses as a percentage of sales were 28.8% in 2005 compared to 29.9% in 2004. The decrease in fitness equipment segment selling and marketing expense as a percentage of net sales was primarily due to efficiencies gained in the Company's direct marketing efforts. Specifically, advertising expense as a percentage of direct channel sales decreased by approximately 4.1 percentage points. These gains were partially offset by the fees of an outside ad agency and ongoing market research projects designed to continue improving the effectiveness of the overall marketing program. Similar ad agency and market research expenses were not incurred during the majority of 2004.

General and Administrative

General and administrative expenses were $48.8 million for 2005 compared to $31.0 million for 2004, an increase of $17.8 million or 57.3%. As a percentage of net sales, general and administrative expenses increased to 7.7% in 2005 as compared to 5.9% in 2004. The acquisitions of Pearl Izumi and the Canadian distributor in 2005 represented $4.2 million of the increase in general and administrative expenses. Besides the increase associated with these acquisitions, general and administrative expenses increased primarily due to increased legal fees of approximately $5.7 million mostly related to litigation with ICON Health & Fitness, Inc. Consistent with our consumer-based business strategy to drive growth while investing in our future, general and administrative costs also increased approximately $8.3 million due to expenses associated with consolidating information systems. The primary drivers of the information systems costs were increased consulting fees, software license fees and wages. Additionally, we recorded one-time charges in 2005 and 2004, respectively, consisting of the payment of a civil penalty in the amount of $1.0 million to the Consumer Product Safety Commission and a $1.8 million pretax gain on the sale of land that reduced 2004 expense.

Research and Development

Research and development increased $4.4 million to $11.2 million in 2005 from $6.8 million in 2004, an increase of 65.2%. The acquisition of Pearl Izumi in 2005 represented $1.1 million of the increase in research and development expenses. Besides the increase associated with this acquisition, research and development expenses increased primarily due to higher staffing levels and prototype costs incurred to support the innovation component of our consumer driven business strategy.

Royalties

Royalty expense decreased 10.1% to $5.4 million in 2005 as compared to $6.0 million in 2004. Our direct and commercial/retail segments have several agreements under which we are obligated to pay royalty fees on certain products. The decrease in our royalty expense was primarily attributable to the April 2004 expiration of a royalty agreement related to the Bowflex patents. This decrease in Bowflex related royalties was partially offset by royalty expense associated with our TreadClimber and elliptical product sales. We are obligated to pay royalties, at the rate of 3% of TreadClimber sales, to the inventor of the main patent on the TreadClimber until this patent expires on December 13, 2013.

Effective Income Tax Rates

Income tax expense was $12.3 million in 2005 compared to $15.7 million in 2004, a decrease of $3.4 million or 21.5%. The decrease was primarily due to fluctuations in income before income taxes. The effective income tax rate increased from 34.3% in 2004 to 34.8% in 2005. The increase in the 2005 effective income tax rate compared to 2004 is primarily due to a nondeductible Consumer Product Safety Commission civil penalty.

Net Income

For the reasons discussed above, net income declined to $23.0 million in 2005 from $30.0 million in 2004, a decrease of 23.3%.

COMPARISON OF THE YEARS ENDED DECEMBER 31, 2004 AND DECEMBER 31, 2003

Net Sales

Net sales were $523.8 million for 2004 compared to $498.8 million for 2003, an increase of $25.0 million or 5.0%. The increase in net sales was due to several factors, including product innovation in the Bowflex home-gym line, strong demand for the Bowflex TreadClimber cardio products, and the introduction of Bowflex SelectTech dumbbells, coupled with more effective advertising placement and an increase in consumer financing approval rates. Additionally, sales of Bowflex branded products within the retail sales channel represented approximately $7.1 million of the overall increase in sales and our international operations that handle sales outside of the America's performed strongly, increasing net sales by $7.6 million to $43.9 million in 2004 from $36.3 million in 2003.

Gross Profit

Gross profit decreased by $7.0 million to $244.8 million in 2004 as compared to $251.8 million in 2003, or a 2.8% decline. The gross profit margin decreased to 46.7% in 2004 from 50.5% in 2003. The decline was primarily due to increased promotions to drive sales growth, a change in direct product sales mix from the higher margin Bowflex home gym products to the TreadClimber and SelectTech products, and to increased shipping costs due to the combination of carrier rate increase and certain sales promotions. Additionally, the decline in gross profit margin can be attributed to the expansion of sales into large volume, lower margin retail customers consistent with our diversification strategy.

Operating Expenses

Selling and Marketing

Selling and marketing expenses were $156.6 million for 2004 compared to $149.2 million for 2003, an increase of $7.3 million or 4.9%. As a percentage of net sales, overall selling and marketing expenses remained consistent in 2004 as compared to 2003 at 29.9%. This was mainly due to strong consumer demand for our Bowflex products and higher consumer financing approval rates, which allowed the Company to reduce the direct segment advertising expense by 6.3% while achieving the same sales volume. These savings were offset by an increase in consumer financing fees due to stronger financing utilization by our direct consumers of 63.8% in 2004 compared to 43.0% in 2003.

General and Administrative

General and administrative expenses were $31.0 million for 2004 compared to $37.1 million for 2003, a decrease of $6.1 million or 16.3%. As a percentage of net sales, general and administrative expenses decreased to 5.9% in 2004 as compared to 7.4% in 2003. This decrease was due primarily to reductions in 2004 wage and consulting costs associated with the implementation of our information systems, which was completed towards the end of 2003, as well as to a $1.8 million one-time gain on the sale of property incurred during the third quarter of 2004 which offset general and administrative expenses. Legal related costs also decreased by $1.5 million from 2003 to 2004 due mostly to developments in the ICON legal matters.

Research and Development

Research and development increased $1.1 million to $6.8 million in 2004 from $5.7 million in 2003. The increase in research and development was due primarily to additional employees added to support the ongoing innovation initiative within our Company.

Royalties

Royalty expense decreased 25.3% to $6.0 million in 2004 as compared to $8.0 million in 2003. We have several agreements under which we are obligated to pay royalty fees on certain products. The decrease in our royalty expense was primarily attributable to the April 2004 expiration of a royalty agreement related to the Bowflex patents. This decrease in Bowflex related royalties was partially offset by royalty expense associated with our TreadClimber and elliptical product sales.

Effective Income Tax Rates

The effective income tax rate decreased from 36.0% in 2003 to 34.3% in 2004. The decrease in the 2004 effective income tax rate is primarily due to tax reserve adjustments as a result of favorable resolutions of certain federal and state income tax issues, tax advantaged investment income and research and development credits.

Net Income

For the reasons discussed above, net income declined to $30.0 million in 2004 from $34.4 million in 2003, a decrease of 12.8%. Net income in the second half of the year actually increased by 35% compared to the prior year as we began experiencing the growth benefits of our turnaround strategy.

QUARTERLY RESULTS OF OPERATIONS

The following table presents our operating results for each of the quarters in the periods ended December 31, 2005 and 2004. The information for each of these quarters is unaudited and has been prepared on the same basis as the audited financial statements appearing elsewhere in this Annual Report on Form 10-K. In the opinion of management, all necessary adjustments have been included to present fairly the unaudited quarterly results when read together with our audited financial statements and the related notes. Certain amounts from previous periods have been reclassified to conform to the 2005 full-year presentation with no effect on previously reported consolidated net income or stockholders' equity. These operating results are not necessarily indicative of the results of any future period. Due to diversification towards the commercial and retail sales channels, we expect heightened seasonality in our fitness equipment business. We expect sales in the second quarter to be weakest while the fourth quarter should be our strongest. We expect the third quarter will generally be stronger than the first quarter. For the apparel business, the first quarter tends to be the strongest, followed by the third and second quarters, respectively. We expect apparel sales to be weakest in the fourth quarter.

While the first three quarters of 2005 surpassed prior year revenue and profit, we fell short of our target in the fourth quarter. We managed to grow net sales in 2005, but experienced an earnings decline of 23.3% to $0.68 per diluted share. Interest in our products and innovation remained strong, but we did not execute operationally as well as we should have. We uncovered gaps in our go-to-market process for new products, with many delays due to manufacturing and distribution issues, resulting in higher than anticipated costs.

In Thousands (except per share)	QUARTER ENDED March 31	June 30	September 30	December 31	Total
Fiscal 2005:					
Net sales	$ 156,388	$ 129,581	$ 163,308	$ 182,033	$ 631,310
Gross profit	76,773	58,054	72,286	71,701	278,814
Operating income	14,138	3,802	12,461	3,403	33,804
Net income	9,429	3,330	8,271	1,970	23,000
Earnings per share:					
Basic	0.28	0.10	0.25	0.06	0.69
Diluted	0.28	0.10	0.24	0.06	0.68
Fiscal 2004:					
Net sales	$ 130,896	$ 100,179	$ 123,182	$ 169,580	$ 523,837
Gross profit	56,856	49,321	58,605	80,012	244,794
Operating income	9,819	2,721	11,278	20,644	44,462
Net income	6,437	1,935	7,455	14,158	29,985
Earnings per share:					
Basic	0.20	0.06	0.23	0.43	0.92
Diluted	0.19	0.06	0.22	0.42	0.90

LIQUIDITY AND CAPITAL RESOURCES

Our operating, investing, and financing activities resulted in cash and cash equivalents of $8.0 million as of December 31, 2005. We used $9.6 million in our operating activities in 2005 compared to $47.0 million in net cash generated by our operating activities in 2004. Excluding assets acquired through acquisition, the changes in operating cash flow comparing 2005 to 2004 can be attributed to increases in trade receivables and inventories of $16.3 million and $33.3 million, respectively. The increase in trade receivables reflects our ongoing growth in sales channels with longer payment terms. More specifically, the direct-marketing model involves collecting cash at time of shipment, while sales through commercial and retail channels involve shipping product and subsequently collecting cash according to agreed upon payment terms. The majority of our sales growth during 2005 was in the commercial and retail sales channels. While inventories at the end of 2005 were higher than what we anticipated, the increase in inventories reflect unseasonably low levels at the end of 2004 due to supply chain issues.

Working capital was $107.0 million at December 31, 2005 compared to $169.5 million at December 31, 2004. The decrease in working capital is primarily due to the acquisitions of Pearl Izumi and Belko Canada. The combination of these acquisitions during 2005 reduced our cash, cash equivalents and short-term investments by $73.7 million.

Net cash used by investing activities was $17.6 million in 2005 compared with net cash used by investing activities in 2004 of $42.6 million. The largest single component of investing activities during 2005 was cash inflow associated with the liquidation of short-term investments in the amount of $85.3 million. Cash outflows associated with two acquisitions and capital expenditures exceeded cash received from investment liquidations in 2005. During 2005, the Company invested approximately $73.7 million to acquire Belko Canada and Pearl Izumi. Capital expenditures were $31.8 million in 2005 compared to $9.0 million in 2004. Capital expenditures during 2005 consisted of manufacturing equipment to support our new product offerings, information systems to support the implementation of a unified technology platform, and renovation costs associated with our new world headquarters. The capital expenditures in 2004 primarily consisted of manufacturing equipment and information systems and related equipment. In addition during the first quarter of 2005, the Company collected $3.0 million from the sale of a property in Las Vegas that occurred during the third quarter of 2004.

Net cash generated in financing activities was $16.5 million in 2005, which can be largely attributed to net borrowings of $40.1 million on a multi-year revolving credit facility established in the fourth quarter, as well as $5.6 million in proceeds from the exercise of stock options. This cash infusion was partially offset by cash dividends paid of $13.4 million and $15.6 million in repurchased stock. Net cash used in financing activities was $6.5 million in 2004, which can be attributed to cash dividends paid of $13.1 million offset by the proceeds from the exercise of stock options of $6.6 million.

On November 18, 2005, the Company entered into a five year unsecured credit agreement to include revolving loans, letters of credit and swing loans for a maximum commitment of $65.0 million, with sub-limits on the swing loans and letters of credit. The credit facility includes an option for the Company to reduce the maximum commitment from time to time. Under the credit agreement, borrowings will bear interest based upon the prime rate or Eurodollar rates with a provision for a spread over such rates based upon the Company’s consolidated leverage ratio. At December 31, 2005, the interest rate ranged from 5.025% to 5.275% and the Company had $40.1 million outstanding under the credit agreement. The credit agreement contains certain financial and non-financial covenants, which include but are not limited to a leverage ratio and fixed charge coverage ratio. The credit facility was amended in March 2006, which included a waiver for the fixed charge coverage ratio and certain technical covenants with which the Company was out of compliance.

Prior to executing the credit agreement, the Company had a line of credit for $10.0 million with a different financial institution. At December 31, 2005 and 2004, the Company had $8.7 million and $8.1 million, respectively in stand by letters of credit with Asian vendors reducing the available balance.

The Company issued a $1.5 million non-interest bearing promissory note ($1.3 million, net of imputed interest) as part of the purchase price in the Belko Canada acquisition which is payable in full in May, 2008. 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 requires payment of $300,000 in February 2006, and $150,000 per quarter beginning March 2007 through December 2016. The $0.9 million note requires payments of $150,000 per quarter beginning September 2005 through December 2006.

We believe our existing cash and cash equivalents balances, cash generated from operations and borrowings available under our lines of credit, will be sufficient to meet our working capital, stock repurchase, dividend and debt requirements for at least the next 12 months.

The Company's contractual obligations and commercial commitments (as defined in Item 303(a)(5) of Regulation S-K under the Securities Exchange Act of 1934) as of December 31, 2005 are as follows:

(In Thousands)	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt obligations	$ 6,273	707	478	2,080	3,008
Capital lease obligations	37	20	17	—	—
Operating lease obligations	33,960	5,439	10,383	7,409	10,729
Purchase obligations	68,323	66,176	2,147	—	—
Other long-term liabilities *	200	200	—	—	—
Total	$108,793	$ 72,542	$13,025	$ 9,489	$ 13,737

* Certain contractual obligations and commercial commitments are excluded from this table because they require imprecise measurement or are of a contingent nature (e.g., off-balance sheet arrangements described below).

Due to the majority of our inventory being sourced from Asia, the Company has long lead times for inventory purchases and needs to secure factory capacity from our vendors in advance. As a result, approximately $66.3 million of the $68.3 million in purchase obligations is for inventory purchases. This inventory is predominately related to anticipated sales in the first half of 2006.

OFF-BALANCE SHEET ARRANGEMENTS

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 equipment. While most of these financings are without recourse, in certain cases we may offer a guaranty or other recourse provisions. The purpose of these guaranties is to increase our selling opportunities to commercial customers that would not otherwise be able to obtain financing to purchase our equipment. At December 31, 2005 and 2004, the maximum contingent liability under all recourse provisions was approximately $4.1 million and $4.4 million, respectively. Refer to Note 1 of the Notes to Consolidated Financial Statements for further discussion of the accounting treatment for these arrangements. We expect an increase in these types of arrangements going forward.

INFLATION AND PRICE CHANGES

Although we cannot accurately anticipate the effect of inflation on our operations, with the exception of steel and fuel prices discussed below, we do not believe that inflation has had, or is likely in the foreseeable future to have, a material adverse effect on our financial position, results of operations or cash flows. However, increases in inflation over historical levels or uncertainty in the general economy could decrease discretionary consumer spending for products like ours.

During 2004, we experienced increases in the price of steel, a major component of our products, and during 2005 we experienced increases in distributions costs as the result of an increase in the price of fuel. To the extent these costs continue to increase, our gross margins in 2006 may continue to be negatively impacted. Effective August 1, 2005, we implemented a transportation surcharge passing some of the cost increases to the end consumer.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (revised 2004), *"Share-Based Payment"* ("SFAS No. 123R"), which will be effective for the Company's first quarter beginning January 1, 2006. The new standard will require us to expense stock options and other share based payments. The statement requires companies to assess the most appropriate model to calculate the value of the options. We currently use the Black-Scholes option-pricing model to value options and are currently assessing which model we will use in the future. We have not determined the financial impact of implementing SFAS No. 123R on the Company's financial statements.

In November 2004, the FASB issued SFAS No. 151, *"Inventory Costs"*. This statement clarifies the accounting for abnormal amounts of idle facility expense and freight and handling costs when those costs may be so abnormal as to require treatment as period charges. This statement is effective for the Company's first quarter beginning January 1, 2006. We do not anticipate this pronouncement will have a material impact on the consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We have primarily invested cash with banks and in liquid debt instruments purchased with maturity dates of less than one year. Our bank deposits may exceed federally insured limits, and there is risk of loss of the entire principal with any debt instrument. To reduce risk of loss, we limit our exposure to any individual debt issuer and require certain minimum ratings for debt instruments that we purchase.

Foreign Exchange Risk

The Company is exposed to foreign exchange risk from currency fluctuations, mainly in Europe and Canada. Given the relative size of the Company's current foreign operations, the Company does not believe the exposure to changes in applicable foreign currencies to be material, such that it could have a significant impact on our current or near-term financial position, results of operations, or cash flows. Management estimates the maximum impact on stockholders' equity of a 10% change in any applicable foreign currency to be $1.2 million.

Interest Rate Risk

The Company is exposed to market risk for changes in interest rates related to its credit agreements. The credit agreements are at variable interest rates and as of December 31, 2005, the Company had outstanding borrowings under the credit facility of $40.1 million. Due to the short-term nature of these borrowings, management believes that any reasonably possible near-term changes in related interest rates would not have a material impact on the Company's financial position, results of operations, or cash flows.

The Company has historically invested in liquid debt instruments purchased with maturity dates of less than one year. Due to the short-term nature of those investments, management believes that any reasonably possible near-term changes in related interest rates would not have a material impact on the Company's financial position, results of operations, or cash flows.

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Item 8. Consolidated 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, 2005 and 2004, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the 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, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, 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 16, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an adverse opinion on the effectiveness of the Company's internal control over financial reporting because of two material weaknesses.

DELOITTE & TOUCHE LLP

Portland, Oregon
March 16, 2006

NAUTILUS, INC.

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2005 AND 2004
(In Thousands, Except Share Data)

	2005	2004
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 7,984	$ 19,266
Short-term investments	—	85,319
Trade receivables (less allowance for doubtful accounts of $4,085 and $3,252 in 2005 and 2004, respectively)	116,908	95,593
Inventories	96,084	49,104
Prepaid expenses and other current assets	8,369	9,427
Short-term notes receivable	2,496	2,503
Asset held for sale	6,115	—
Current deferred tax assets	7,235	4,661
Total current assets	245,191	265,873
PROPERTY, PLANT AND EQUIPMENT, net	59,320	46,350
GOODWILL	64,404	29,755
OTHER ASSETS, net	44,371	17,663
TOTAL ASSETS	$413,286	$359,641
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 61,132	$ 57,861
Accrued liabilities	29,097	24,703
Short-term borrowings	40,147	—
Income taxes payable	3,810	10,803
Customer deposits	3,327	2,957
Current portion of long-term debt	707	—
Total current liabilities	138,220	96,324
NONCURRENT DEFERRED TAX LIABILITIES	16,990	11,081
OTHER NONCURRENT LIABILITIES	5,610	200
COMMITMENTS AND CONTINGENCIES (Notes 10 and 15)		
STOCKHOLDERS' EQUITY:		
Common stock - 75,000,000 shares authorized; no par value; issued and outstanding, 32,779,611 and 33,147,758 shares in 2005 and 2004, respectively	3,549	10,682
Unearned stock compensation	(1,947)	(1,204)
Retained earnings	248,123	238,474
Accumulated other comprehensive income	2,741	4,084
Total stockholders' equity	252,466	252,036
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$413,286	$359,641

See notes to consolidated financial statements.

NAUTILUS, INC.

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003
(In Thousands, Except Share and Per Share Data)

	2005	2004	2003
NET SALES	$ 631,310	$ 523,837	$ 498,836
COST OF SALES	352,496	279,043	247,020
Gross profit	278,814	244,794	251,816
OPERATING EXPENSES:			
Selling and marketing	179,656	156,577	149,245
General and administrative	48,826	31,033	37,098
Research and development	11,160	6,754	5,670
Related-party royalties	—	1,843	6,556
Third-party royalties	5,368	4,125	1,431
Total operating expenses	245,010	200,332	200,000
OPERATING INCOME	33,804	44,462	51,816
OTHER INCOME (EXPENSE):			
Interest income, net	1,179	1,357	839
Other, net	310	(172)	1,098
Total other income - net	1,489	1,185	1,937
INCOME BEFORE INCOME TAXES	35,293	45,647	53,753
INCOME TAX EXPENSE	12,293	15,662	19,351
NET INCOME	$ 23,000	$ 29,985	$ 34,402
BASIC EARNINGS PER SHARE	$ 0.69	$ 0.92	$ 1.06
DILUTED EARNINGS PER SHARE	$ 0.68	$ 0.90	$ 1.04
Weighted average shares outstanding:			
Basic shares outstanding	33,303,383	32,756,766	32,579,533
Diluted shares outstanding	33,856,896	33,394,160	33,018,694

See notes to consolidated financial statements.

NAUTILUS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003
(In Thousands, Except Share Data)

	Common Stock		Unearned Stock Compensation	Retained Earnings	Accumulated Other Comprehensive Income	Total
	Shares	Amount				
BALANCES, JANUARY 1, 2003	32,473,897		$ —	$ 201,238	$ 1,185	$202,423
Net income	—	—	—	34,402	—	34,402
Cumulative translation adjustment	—	—	—	—	2,079	2,079
Comprehensive income						36,481
Dividends paid	—	—	—	(13,030)	—	(13,030)
Unearned stock compensation	—	1,700	(1,700)	—	—	—
Amortization of unearned stock compensation	—	—	156	—	—	156
Options exercised	231,851	979	—	—	—	979
Stock repurchased	(100,300)	(392)	—	(1,030)	—	(1,422)
Tax benefit of exercise of nonqualified options	—	541	—	—	—	541
BALANCES, DECEMBER 31, 2003	32,605,448	2,828	(1,544)	221,580	3,264	226,128
Net income	—	—	—	29,985	—	29,985
Cumulative translation adjustment	—	—	—	—	820	820
Comprehensive income						30,805
Dividends paid	—	—	—	(13,091)	—	(13,091)
Amortization of unearned stock compensation	—	—	340	—	—	340
Options exercised	542,310	6,569	—	—	—	6,569
Tax benefit of exercise of nonqualified options	—	1,285	—	—	—	1,285
BALANCES, DECEMBER 31, 2004	33,147,758	10,682	(1,204)	238,474	4,084	252,036
Net income	—	—	—	23,000	—	23,000
Cumulative translation adjustment	—	—	—	—	(1,343)	(1,343)
Comprehensive income						21,657
Dividends paid	—	—	—	(13,351)	—	(13,351)
Unearned stock compensation		1,106	(1,106)	—	—	—
Amortization of unearned stock compensation	—	—	363	—	—	363
Options exercised	462,553	5,609	—	—	—	5,609
Stock repurchased	(830,700)	(15,636)	—	—	—	(15,636)
Tax benefit of exercise of nonqualified options	—	1,788	—	—	—	1,788
BALANCES, DECEMBER 31, 2005	32,779,611	$ 3,549	$ (1,947)	$ 248,123	$ 2,741	$252,466

See notes to consolidated financial statements.

NAUTILUS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003
(In Thousands)

	2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 23,000	$ 29,985	$ 34,402
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Depreciation and amortization	16,354	11,972	12,274
(Decrease) increase in allowance for notes receivable	—	(594)	594
Amortization of unearned stock compensation	363	340	156
(Gain) loss on disposal of property, plant and equipment	17	(1,214)	119
Tax benefit of exercise of nonqualified options	1,788	1,285	541
Deferred income taxes	(437)	860	(663)
Changes in assets and liabilities, net of the effect of acquisitions:			
Trade receivables	(16,261)	(19,702)	(23,966)
Inventories	(33,342)	4,693	11,650
Prepaid expenses and other assets	(1,564)	(1,036)	(837)
Trade payables	2,228	22,774	(6,672)
Income taxes payable	(4,600)	2,261	3,178
Accrued liabilities	2,315	(5,991)	12,214
Customer deposits	493	1,373	731
Net cash (used in) provided by operating activities	(9,646)	47,006	43,721
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property, plant and equipment	(31,771)	(9,043)	(7,017)
Proceeds from sale of property, plant and equipment	2,972	641	54
Net increase in other assets	(449)	(596)	(640)
Acquisitions, net of cash acquired	(73,689)	—	—
Purchases of short-term investments	(49,352)	(126,143)	(99,833)
Proceeds from maturities of short-term investments	134,671	92,106	66,129
Net decrease in notes receivable	8	453	474
Net cash used in investing activities	(17,610)	(42,582)	(40,833)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Cash dividends paid on common stock	(13,351)	(13,091)	(13,030)
Stock repurchases	(15,636)	—	(1,422)
Proceeds from exercise of stock options	5,609	6,569	979
Short-term borrowings, net	40,147	—	—
Principal payments on long-term debt	(300)	—	—
Net cash provided by (used in) financing activities	16,469	(6,522)	(13,473)
Effect of foreign currency exchange rate changes	(495)	12	218

(Continued)

NAUTILUS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003
(In Thousands)

	2005	2004	2003
NET DECREASE IN CASH AND CASH EQUIVALENTS	$(11,282)	$ (2,086)	$(10,367)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	19,266	21,352	31,719
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 7,984	$19,266	$ 21,352
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION -			
Cash paid for income taxes	$ 16,067	$10,831	$ 16,346
Cash paid for interest	$ 205	$	$
SUPPLEMENTAL DISCLOSURE OF OTHER NONCASH INVESTING ACTIVITY -			
Other receivable issued as part of the sale of land	$ —	$ 2,331	$ —
Other long term liability issued in conjunction with the acquisition of certain intangible assets	$ —	$ 200	$ —

(Concluded)

See notes to consolidated financial statements.

NAUTILUS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
THREE YEARS ENDED DECEMBER 31, 2005
(In Thousands, Except Share and Per Share Data)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization – Nautilus, Inc. and subsidiaries (the "Company"), a Washington corporation, is a leading marketer, developer, and manufacturer of branded health and fitness products sold under such well-known brands as Nautilus, Bowflex, Schwinn, StairMaster, Trimline and Pearl Izumi. These brands are distributed through well established direct to consumer, commercial, and retail channels. The Company's consumer and commercial fitness equipment products include a full line of cardiovascular and weight resistance products such as home gyms, free weight equipment, treadmills, indoor cycling equipment, steppers, ellipticals, treadclimbers and fitness accessories. The Company's fitness apparel products include an assortment of high-end performance apparel predominately marketed under the Pearl Izumi brand. The fitness apparel products are made for both men and women and can be classified into four main categories that include cycling, running, active outdoor, and accessories. These categories contain varying combinations of product lines that include base layer, footwear, jerseys, outerwear, shorts, tights, tops, gloves, socks, and other miscellaneous items.

Consolidation – The consolidated financial statements of the Company include Nautilus, Inc. and its wholly owned subsidiaries. All intercompany transactions have been eliminated in the preparation of the consolidated financial statements.

Use of Accounting Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates included in the preparation of the financial statements are related to revenue recognition, stock-based compensation, warranty reserves, legal reserves, sales return reserves, the allowance for doubtful accounts, inventory valuation, intangible asset valuation, and the income tax provision.

Cash and Cash Equivalents include cash on hand, cash deposited with banks and financial institutions, and highly liquid debt instruments purchased with original maturity dates of three months or less at the date of acquisition. 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.

Short-term investments – Substantially all short-term investments were comprised of investment grade variable rate debt obligations, which are asset-backed and categorized as available-for-sale. Accordingly, investments in these securities are recorded at cost, which approximated fair value due to their variable interest rates, which typically reset every 35 days. Despite the long-term nature of the investments' stated contractual maturities, we have the ability to quickly liquidate these securities. As a result of the resetting variable rates, we had no cumulative gross unrealized or realized holding gains or losses from these investments. All income generated from these investments was recorded as interest income.

Trade Receivables – The Company maintains an allowance for doubtful accounts receivable based upon our historical experience and the expected collectibility of all outstanding accounts receivable. Allowance for doubtful accounts receivable activity for the years ended December 31, 2005, 2004 and 2003 is as follows:

	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions*	Balance at End of Period
Allowance for doubtful accounts:				
2005	$ 3,252	$ 1,874	$ 1,041	$ 4,085
2004	2,686	985	419	3,252
2003	3,147	388	849	2,686

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

Inventories are stated at the lower of standard cost (standard or average, depending on location) or market. The Company evaluates the need for inventory valuation adjustments associated with obsolete, slow-moving and nonsaleable inventory by reviewing current transactions and forecasted product demand on a quarterly basis.

Asset Held for Sale consists entirely of the previous Company headquarters stated at net book value. The building was sold in February 2006 for approximately book value.

Property, Plant and Equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

Management reviews the investment in long-lived assets for possible impairment whenever events or circumstances indicate the carrying amount of an asset may not be recoverable. There have been no such events or circumstances in each of the three years in the period ended December 31, 2005. If there were an indication of impairment, management would prepare an estimate of future cash flows (undiscounted and without interest charges) expected to result from the use of the assets and their eventual disposition. If these cash flows were less than the carrying amount of the assets, an impairment loss would be recognized to write down the assets to their estimated fair value.

Goodwill and Other Assets consist of license agreements, patents, trademarks and goodwill. Long-lived and intangible assets that are determined to have finite lives are amortized using the straight-line method over their estimated useful lives of two to twenty years and are measured for impairment only 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 impairment as the excess of the carrying value of the asset over the estimate of its fair value.

Certain intangible assets with indefinite useful lives are evaluated for impairment at least annually. The remaining useful lives of intangible assets with finite useful lives are evaluated at least annually. The Company reviews and tests its goodwill and intangible assets for impairment in the fourth quarter of each year and when events or changes in circumstances indicate that the carrying amount of such assets may be impaired. Determination of fair value is based on estimated discounted future cash flows resulting from the use of the asset. The Company compares the implied fair value of goodwill and the estimated fair value of intangible assets to the carrying value. If the carrying value exceeds the estimate of fair value, the Company calculates impairment as the excess of the carrying value over the estimated fair value. The estimates of the fair value of goodwill and indefinite-lived intangible assets are based on a number of factors, including assumptions and estimates for projected sales, income, cash flows, and other operating performance measures. These assumptions and estimates may change in the future due to changes in economic conditions, in the Company’s ability to meet sales and profitability objectives, or changes in the Company’s business operations or strategic direction.

Any impairment charge would be classified as a component of general and administrative expenses. In the fourth quarter of 2005, the Company determined that goodwill and long-lived assets were not impaired.

Guarantees – From time to time, the Company arranges for commercial leases or other financing sources to enable certain of its commercial customers to purchase the Company's equipment. While most of these financings are without recourse, in certain cases the Company provides a guarantee or other recourse provisions to the independent finance company of all or a portion of the lease payments in order to facilitate the sale of the commercial equipment. 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 monitors the payment status of the lessee under these arrangements and provides a reserve under Statement of Financial Accounting Standards ("SFAS") No. 5, *Accounting for Contingencies*, in situations when collection of the lease payments is not probable. At December 31, 2005 and 2004, the maximum contingent liability under all such recourse and guarantee provisions, was approximately $4,095 and $4,433, respectively. As of December 31, 2005, lease terms on outstanding commercial customer financing arrangements were between 3 and 7 years. A reserve for estimated losses under recourse provisions of $70 and $79 has been recorded based on historical loss experience and is included in accrued expenses at December 31, 2005 and 2004, respectively. In accordance with Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, the Company has also recorded a liability and corresponding reduction of revenue of $78 and $146 for the years ended December 31, 2005 and 2004, respectively, for the estimated fair value of the Company's guarantees issued. The fair value of the guarantees was determined based on the estimated risk premium a bank or similar institution would require in order to extend financing to a customer in the absence of a third-party guarantee. This liability is being reduced over the life of each respective guarantee. In most cases if the Company is required to fulfill its obligations under the guarantee, it has the right to repossess the equipment from the commercial customer. It is not practical to estimate the approximate amount of proceeds that would be generated from the sale of these assets in such situations.

The Company has an agreement with a financing company to provide second tier financing for consumers. Under normal circumstances, funding for this reserve comes from a percentage of each sale held back by the financing company. In the event that the financing company experiences higher consumer default rates than specified under our contract, we are required to pay an additional amount to the financing company. As of December 31, 2005, we have accrued $400 for this liability.

Revenue Recognition – Revenue is recorded when products are shipped and the Company has no significant remaining obligations, persuasive evidence of an arrangement exists, the price to the buyer is fixed or determinable, and collectibility is reasonably assured or probable. For all of the Company's products, except Nautilus commercial equipment, revenue from product sales is recognized when title and risk of loss have passed. According to the Company's terms of sale, title and risk of loss pass to the customer upon delivery to the carrier. Revenue is recognized upon final installation for the Nautilus commercial equipment if the Company is responsible for installation.

Sales Returns – The sales return reserve is maintained based on our historical experience of direct-marketed product return rates during the period in which a customer can return a product for refund of the full purchase price, less shipping and handling in certain instances. The return periods for direct-marketed product lines are typically six weeks depending on the specific product. We track product returns in order to identify any potential negative customer satisfaction trends. The Company also provides for estimated sales returns from customers in our retail channel. The estimates are based on historical rates of product returns. Sales return reserve activity for the years ended December 31, 2005, 2004 and 2003 is as follows:

	Balance at Beginning of Period	Charged to Sales and Costs and Expenses	Deductions*	Balance at End of Period
Sales return reserves:				
2005	$ 4,955	$ 16,990(1)	$ 15,573	$ 6,372
2004	1,702	15,702	12,449	4,955
2003	2,550	8,346	9,194	1,702

* Deductions represent product returns.

(1) Includes $1.0 million from acquisitions that was not charged to expense.

The fitness equipment direct channel sales return reserve of $823 and $1,785 as of December 31, 2005 and 2004, respectively, is presented on the Consolidated Balance Sheets as part of accrued liabilities. The fitness equipment retail channel sales return reserve of $5,323 and $3,170 as of December 31, 2005 and 2004, respectively, are presented on the Consolidated Balance Sheets as a reduction of trade receivables. The fitness apparel channel sales return reserve of $227 as of December 31, 2005 is presented on the Consolidated Balance Sheets as part of accrued liabilities.

Warranty Costs – The Company's warranty policy provides for coverage of defects in materials and workmanship. Warranty periods on the Company's products range from two years to limited lifetime on the Bowflex lines of fitness products, and one to five years on Bowflex TreadClimbers, depending on the model and part, on a prorated basis. The commercial and retail line of fitness products include a lifetime warranty on the frame and structural parts, a four month to three year warranty on parts, labor, electronics, upholstery, grips and cables, and typically a five year warranty on motors. Warranty costs are estimated based on the Company's experience and are charged to cost of sales as sales are recognized or as such estimates change. Warranty reserve activity for the years ended December 31, 2005, 2004 and 2003 is as follows:

	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions*	Balance at End of Period
Warranty reserves:				
2005	$ 7,537	$ 11,114	$ 8,441	$ 10,210
2004	7,348	7,362	7,173	7,537
2003	5,358	5,845	3,855	7,348

* Deductions represent warranty claims paid out in the form of service costs and/or product replacements.

Research and Development – Internal research and development costs 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 are expensed when the contracted work has been performed.

Advertising – 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 expense was $79,306, $82,766 and $89,485 for the years ended December 31, 2005, 2004 and 2003, respectively.

Income Taxes – The Company uses the liability method of accounting for income taxes. 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 and the tax bases of existing assets and liabilities. A valuation allowance is 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 SFAS No. 5 "*Accounting for Contingencies.*" Further, the Company realized income tax benefits as a result of the exercise of non-qualified stock options and the exercise and subsequent sale of certain incentive stock options (disqualifying dispositions). For financial statement purposes, any reduction in income tax obligations as a result of these tax benefits has been credited to common stock.

Foreign Currency Translations – Excluding Switzerland, the accounts of our foreign operations are measured using the local currency as the functional currency. These accounts are then translated into U.S. dollars using exchange rates in effect at year-end for assets and liabilities and the weighted average exchange rates during the period for the results of operations. Translation gains and losses are accumulated as a separate component of stockholders' equity and comprehensive income. For our Swiss operations, the local currency, the Swiss Franc, is remeasured to the functional currency, the U.S. dollar, with the related gains or losses recognized in current period net income.

Foreign Currency Transactions – Foreign currency transaction gains and losses are a result of the effect of exchange rate changes on transactions denominated in currencies other than the functional currency, including U.S. dollars. Gains and losses on those foreign currency transactions are included in determining net income for the period in which exchange rates change. Net foreign currency transaction gains and (losses) were $999, ($175) and ($31) for the years ended December 31, 2005, 2004 and 2003, respectively.

Stock-Based Compensation – The Company measures compensation expense for its stock-based employee compensation plans using the method prescribed by Accounting Principles Board ("APB") Opinion No. 25, *"Accounting for Stock Issued to Employees,"* and furnishes the pro forma disclosures required under SFAS No. 148, *"Accounting for Stock-Based Compensation – Transition and Disclosure."*

The Company has not typically recognized compensation expense relating to employee stock options because it has typically granted options with an exercise price equal to the fair value of the stock on the effective date of grant. In July 2003, certain stock options were granted to the Company's President and Chief Executive Officer at an exercise price $2.00 (two dollars) per share below the market price on the day of the grant, for which the Company recognized compensation expense of $363, $340, and $156 in 2005, 2004, and 2003, respectively. This arrangement was amended December 31, 2005 to eliminate the original discount per share.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, *"Accounting for Stock-Based Compensation,"* using the Black-Scholes option pricing model:

	2005	2004	2003
Net income, as reported	$23,000	$29,985	$34,402
Add: Stock-based employee compensation expense included in reported net income, net of tax	237	223	100
Deduct: Stock-based employee compensation expense determined under fair value based method, net of tax	(1,854)	(2,967)	(3,215)
Net income, pro forma	$21,383	$27,241	$31,287
Basic earnings per share, as reported	$ 0.69	$ 0.92	$ 1.06
Basic earnings per share, pro forma	$ 0.64	$ 0.83	$ 0.96
Diluted earnings per share, as reported	$ 0.68	$ 0.90	$ 1.04
Diluted earnings per share, pro forma	$ 0.63	$ 0.82	$ 0.95

The pro forma amounts may not be indicative of the effects on reported net income for future years due to the effect of options vesting over a period of years, forfeitures, and the granting of stock compensation awards in future years.

Comprehensive Income is defined as net income as adjusted for changes to equity resulting from events other than net income or transactions related to an entity's capital structure. Comprehensive income for the years ended December 31, 2005, 2004 and 2003 equals net income plus or minus the effect of foreign currency translation adjustments. The foreign currency translation adjustments are due to the translation of the financial statements of our foreign subsidiaries. Accumulated other comprehensive income consists solely of cumulative foreign currency translation adjustments as of December 31, 2005, 2004 and 2003.

Fair Value of Financial Instruments – The carrying amounts of the Company's cash and cash equivalents, short-term investments, trade receivables, notes receivable, trade payables, accrued liabilities, and short-term borrowings approximate their estimated fair values due to the short-term maturities of those financial instruments. Given the relative size of the Company's long-term obligations, management does not expect the fair value to materially differ from the carrying value.

Recent Accounting Pronouncements – In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (revised 2004), *"Share-Based Payment"* ("SFAS No. 123R"), which will be effective for the Company's first quarter beginning January 1, 2006. The new standard will require us to expense stock options and other share based payments. The statement requires companies to assess the most appropriate model to calculate the value of the options. We currently use the Black-Scholes option-pricing model to value options and are currently assessing which model we will use in the future. We have not determined the financial impact of implementing SFAS No. 123R on the Company's financial statements. However, the impact under SFAS No. 123 is disclosed in Note 2 to these consolidated financial statements.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs." This statement clarifies the accounting for abnormal amounts of idle facility expense and freight and handling costs when those costs may be so abnormal as to require treatment as period charges. This statement is effective for the Company's first quarter beginning January 1, 2006. We do not anticipate this pronouncement will have a material impact on the consolidated financial statements.

Reclassifications – Certain amounts from 2004 and 2003 have been reclassified to conform to the 2005 presentation with no effect on previously reported consolidated net income or stockholders' equity.

2. STOCK-BASED COMPENSATION

On June 6, 2005 the shareholders of the Company approved the Nautilus, Inc. 2005 Long Term Incentive Plan (the "Plan"). The Plan permits flexibility in types of awards, and specific terms of awards, which will 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 Plan is 4,000,000, 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 option 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 stock unit awards which may be granted to any one participant in any one year under the Plan is 1,000,000.

The aggregate number of shares available for issuance under the Plan shall be reduced by two (2) shares for each share delivered in settlement of any stock appreciation rights, restricted stock, stock unit or performance unit award, and one (1) share for each share delivered in settlement of a stock option award.

At December 31, 2005, 3,978,284 shares are available for future issuance under the Plan. Stock options granted generally have an exercise price equal to the closing market price of the Company's stock on the day before the date of grant, and vesting periods vary by option granted, generally no longer than five years.

Stock Options

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for the grants in 2005, 2004 and 2003:

	2005	2004	2003
Dividend yield	2.2%	2.5%	3.5%
Risk-free interest rate	4.2%	4.3%	3.9%
Expected volatility	65.0%	48.0%	59.0%
Expected option lives	5.0 years	5.5 years	10 years
Weighted-average fair value of options granted per share	$ 11.10	$ 7.41	$ 4.75
Weighted-average fair value of options granted below market price per share	$ —	$ —	$ 4.83

A summary of the Company's stock option plans as of December 31, 2005, 2004 and 2003, and changes during the years ended on those dates is presented below.

	2005		2004		2003	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	2,748,563	$ 15.54	2,665,503	$ 13.92	1,599,987	$ 17.26
Granted	332,500	24.56	1,265,650	18.84	1,430,000	9.36
Forfeited or canceled	(341,400)	20.81	(640,280)	18.23	(132,633)	21.79
Exercised	(462,553)	12.86	(542,310)	12.11	(231,851)	4.22
Outstanding at end of year	2,277,110	$ 17.39	2,748,563	$ 15.54	2,665,503	$ 13.92
Options exercisable at end of year	721,886		677,942		792,796	

The following table summarizes information about stock options outstanding as of December 31, 2005:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number of Shares Exercisable	Weighted-Average Exercise Price
$10.39	799,500	7.54	$ 10.39	210,500	$ 10.39
$11.91 - $15.66	470,850	7.92	14.79	152,185	14.61
$15.71 - $23.02	302,910	6.09	21.01	118,035	21.34
$23.15	442,750	8.82	23.15	115,066	23.15
$23.36 - $34.05	250,100	4.50	29.19	115,100	32.27
$37.70	11,000	1.29	37.70	11,000	37.70
$10.39 - $37.70	2,277,110	7.31	$ 17.39	721,886	$ 19.15

Performance Units

The Company granted performance units during 2005 which entitles the Company's President and Chief Executive Officer to receive a share of the Company's common stock for each performance unit, for any completed fiscal year in which certain targets are met. The Company's stock price on the date of the grant was $17.70 per share and 125,000 performance units were issued and outstanding at December 31, 2005. The targets established are related to (1) the Company's Earnings Per Share reaching certain targets and (2) meeting or exceeding certain growth objectives in the Company's Earnings Per Share. The Company recognized $1,106 as unearned compensation in the consolidated statement of shareholders' equity for the performance units granted in 2005. The Company recorded expense of $23 related to amortizing this unearned compensation in 2005.

3. OPERATING SEGMENTS

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 operating segments are fitness equipment and fitness apparel. This is a restatement of previous operating segment disclosure that consisted of direct, commercial/retail, and corporate segments.

The fitness equipment segment includes the Nautilus, Bowflex, Schwinn, StairMaster, and Trimline brands and related operations involved in selling and marketing these branded fitness products to consumers through direct, commercial, retail, specialty retail, and international sales channels. The fitness equipment segment also consists of corporate overhead costs consisting mainly of director costs, general legal and accounting fees, and salaries of corporate personnel. The treasury function is part of the fitness equipment segment so interest income from investments and interest expense from short-term borrowings are also included. Accounting policies used by this segment are the same as those disclosed in Note 1.

The fitness apparel segment predominantly includes products sold under the Pearl Izumi brand (see note 4) and related operations involved in selling and marketing these branded apparel products to consumers through direct, commercial, retail, and international sales channels. Accounting policies used by this segment are the same as those disclosed in Note 1.

The geographic distribution of the Company's international net sales is mostly concentrated in the United Kingdom, Germany, and Canada. Sales outside the U.S. represented approximately 14%, 13% and 13% of consolidated net sales for the three years ended December 31, 2005, 2004 and 2003, respectively. Long-lived assets outside the U.S. were approximately $5.3 million, $0.4 million and $0.6 million at December 31, 2005, 2004 and 2003, respectively.

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

	Fitness Equipment	Fitness Apparel	Total
Year ended December 31, 2005:			
Net sales	$607,274	$24,036	$631,310
Interest income	1,162	17	1,179
Depreciation and amortization expense	15,245	731	15,976
Income tax expense	11,570	723	12,293
Gross profit	267,776	11,038	278,814
Segment net income	21,649	1,351	23,000
Segment assets	335,067	78,219	413,286
Additions to property, plant and equipment	31,428	343	31,771
Goodwill and other assets	51,173	57,602	108,775
Year ended December 31, 2004:			
Net sales	$523,837	$ —	$523,837
Interest income	1,357	—	1,357
Depreciation and amortization expense	11,972	—	11,972
Income tax expense	15,662	—	15,662
Gross profit	244,794	—	244,794
Segment net income	29,985	—	29,985
Segment assets	359,641	—	359,641
Additions to property, plant and equipment	9,043	—	9,043
Goodwill and other assets	47,418		47,418
Year ended December 31, 2003:			
Net sales	$498,836	$ —	$498,836
Interest income	839	—	839
Depreciation and amortization expense	12,274	—	12,274
Income tax expense	19,351	—	19,351
Gross profit	251,816	—	251,816
Segment net income	34,402	—	34,402
Segment assets	311,935	—	311,935
Additions to property, plant and equipment	7,017	—	7,017
Goodwill and other assets	47,021		47,021

4. ACQUISITIONS

On July 7, 2005, the Company acquired DashAmerica, Inc. d/b/a Pearl Izumi USA ("Pearl Izumi") for approximately $70,001 including acquisition costs, net of cash acquired, plus $5,263 in assumed debt. Pearl Izumi is a provider of fitness apparel and footwear for cyclists, runners and fitness enthusiasts. Pearl Izumi was acquired to enhance the Company's current product portfolio by offering high quality branded fitness apparel. The results of operations subsequent to the date of the Pearl Izumi acquisition are included in the consolidated financial statements of the Company.

The total cost of the Pearl Izumi acquisition has been allocated to the assets acquired and liabilities assumed as follows:

Trade receivables	7,855
Inventories	11,928
Prepaid and other current assets	4,765
Property, plant and equipment	1,835
Trade name (indefinite life)	20,000
Customer base (eight year life)	3,400
Developed technology (four year life)	2,500
In process research and development	250
Other assets	55
Goodwill	32,135
Current liabilities assumed	(3,537)
Long-term deferred tax liabilities	(5,922)
Long-term debt	(5,263)
Total acquisition cost	$70,001

The unaudited pro forma financial information below for the years ended December 31, 2005 and 2004 was prepared as if the transaction involving the acquisition of Pearl Izumi had occurred at the beginning of the earliest period presented.

	2005	2004
Net sales	$ 661,942	$ 550,322
Net income	24,989	31,858
Basic earnings per share	0.75	0.97
Diluted earnings per share	0.74	0.95

The unaudited pro forma financial information is not necessarily indicative of what actual results would have been had the transactions occurred at the beginning of the periods presented, nor does it purport to indicate the results of future operations of the Company.

During the second quarter of 2005, the Company acquired substantially all of the assets and assumed certain liabilities of our Canadian distributor, Belko Canada, now called Nautilus Fitness Canada, for approximately $5.3 million, including $1.6 million in other long-term liabilities, net of cash acquired. Nautilus Fitness Canada has served as the exclusive Canadian distributor since 1996. This acquisition has strengthened our direct to consumer sales channel in Canada and enabled us to become more efficient in our sale of direct products in the Canadian market. We also sell products to commercial, retail, and specialty retail customers in Canada. Disclosing open purchase price is fairly important.

5. INVENTORIES

Inventories at December 31 consisted of the following:

	2005	2004
Finished goods	$69,178	$31,170
Work-in-process	1,368	1,104
Parts and components	25,538	16,830
Inventories	$96,084	$49,104

6. PROPERTY, PLANT AND EQUIPMENT, net

Details of property, plant and equipment are summarized as follows at December 31:

	Estimated Useful Life (in years)	2005	2004
Land	N/A	$ 1,507	$ 1,935
Buildings and improvements	7 to 31.5	27,416	22,785
Computer equipment	2 to 5	40,556	29,213
Production equipment	3 to 5	26,030	18,876
Furniture and fixtures	5	5,182	1,713
Automobiles	7	211	431
Construction in process	N/A	2,220	3,395
Total property, plant and equipment		103,122	78,348
Accumulated depreciation		(43,802)	(31,998)
Property, plant and equipment, net		$ 59,320	$ 46,350

Construction in process consists of capitalizable costs associated with the renovation of the Company's new world headquarters and implementation of the Company's new information system that are not yet in service and therefore not yet being depreciated.

7. GOODWILL

The changes in the carrying amount of goodwill for the year ending December 31, 2005 are as follows:

	Fitness Equipment	Fitness Apparel	Total
Beginning of year balance	$ 29,755	$ —	$29,755
Belko Canada Acquisition	2,514	—	2,514
Pearl Izumi Acquisition	—	32,135	32,135
Balance as of December 31, 2005	$ 32,269	$32,135	$64,404

8. OTHER ASSETS, net

Details of other assets are summarized as follows at December 31:

	Estimated Useful Life (in years)	2005	2004
Indefinite life trademarks	N/A	$30,465	$10,465
Definite life trademarks	20	6,800	6,800
Patents	1 to 17	1,597	1,567
Customer base	8	3,400	—
Developed technology	4	2,500	—
Non-compete agreement	3	1,647	—
Other assets		1,195	789
Total other assets		47,604	19,621
Accumulated amortization			
Trademarks		(2,097)	(1,777)
Patents		(261)	(181)
Other assets		(875)	—
Other assets, net		$44,371	$17,663

Amortization of intangible assets for 2005 and 2004 was $1,275 and $401, respectively. The estimated amortization expense for the next five full succeeding years (2006 through 2010) is $2,111, $2,009, $1,673, $1,193, and $881 per year, respectively. Such estimated amortization will change if businesses or portions thereof are either acquired or disposed, or if changes in events or circumstances warrant the revision of estimated useful lives.

9. ACCRUED LIABILITIES

Accrued liabilities consisted of the following at December 31:

	2005	2004
Accrued payroll	$ 8,457	$ 8,581
Accrued warranty expense	10,210	7,537
Sales return reserve	1,049	1,785
Accrued other	9,381	6,800
Accrued liabilities	$29,097	$24,703

10. COMMITMENTS AND CONTINGENCIES

Product Warranty Matters – Our product warranty accrual reflects management's best estimate of probable liability under its product warranties. We determine the warranty accrual based on known product failures (if any), historical experience, and other currently available evidence.

Product Safety Matters – In February 2004, the Company was notified that the Consumer Product Safety Commission ("CPSC") was investigating whether the Company violated the reporting obligations of the Consumer Product Safety Act (the "Act") in connection with bench and lat tower incidents reported by users of the Bowflex Power Pro with lat tower attachment. Under the Act, the CPSC may assess penalties if it is determined that a product defect was not reported in accordance with the Act. The Company fully cooperated with this investigation. A civil penalty in the amount of $950 was levied against the Company by the CPSC and was paid during the first quarter of 2005.

Short-Term Borrowings – On November 18, 2005, the Company entered into a five year unsecured credit agreement to include revolving loans, letters of credit and swing loans for a maximum commitment of $65,000, with sub-limits on the swing loans and letters of credit. The credit agreement includes an option for the Company to reduce the maximum commitment from time to time. Under the credit agreement, borrowings will bear interest based upon the prime rate or Eurodollar rates with a provision for a spread over such rates based upon the Company's consolidated leverage ratio. At December 31, 2005, the interest rate ranged from 5.025% to 5.275% and the Company had $40,147 outstanding under the credit agreement. The credit agreement contains certain financial and non-financial covenants, which include but are not limited to a leverage ratio and fixed charge coverage ratio. The credit facility was amended in March 2006, which included a waiver for the fixed charge coverage ratio and certain technical covenants with which the Company was out of compliance.

At December 31, 2005, the Company had a line of credit for $10,000 with a financial institution. At December 31, 2005 and 2004, the Company had $8,696 and $8,121, respectively in stand by letters of credit with Asian vendors reducing the available balance.

The Company issued a $1,291 non-interest bearing promissory note, net of imputed interest as part of the purchase price in the Belko Canada acquisition payable in full in May 2008. As part of the acquisition of Pearl Izumi, the Company became obligated on two non-interest bearing notes of $4,403 and $855, net of imputed interest. The $4,403 note requires payment of $300 in February 2006, and $150 per quarter beginning March 2007 through December 2016. The $855 note requires payments of $150 per quarter beginning September 2005 through December 2006.

Operating Leases – The Company has operating leases for various domestic and international properties with functional uses predominantly ranging from, but not limited to, warehousing and distribution, product development, administration, and product sales. The Company also has operating leases for certain equipment mainly consisting of product delivery trucks used in our commercial fitness equipment business and product service vans for warranty related matters. Rent expense under all leases was $5,148, $2,921 and $3,215, in 2005, 2004 and 2003, respectively.

Obligations – Operating leases under which the Company is presently obligated expire over various terms through June 2015. Future minimum lease payments under the noncancellable operating leases are as follows:

2006	$ 5,439
2007	5,400
2008	4,983
2009	3,793
2010	3,616
Thereafter	10,729
Minimum lease payments	$ 33,960

11. INCOME TAXES

The income before income taxes was as follows for each of the three years ended December 31, 2005:

	2005	2004	2003
United States	$ 35,300	$ 43,168	$ 50,990
Foreign	(7)	2,479	2,763
Total	$ 35,293	$ 45,647	$ 53,753

The provision for income taxes consists of the following for the three years ended December 31, 2005:

	2005	2004	2003
Current:			
Federal	$11,118	$13,495	$18,996
State	849	861	731
Foreign	763	446	287
Total current	12,730	14,802	20,014
Deferred:			
Federal	(229)	884	(582)
State	361	48	(36)
Foreign	(569)	(72)	(45)
Total deferred	(437)	860	(663)
Total provision	$12,293	$15,662	$19,351

The components of the net deferred tax liability at December 31, 2005 and 2004 are as follows:

	2005	2004
Assets:		
Accrued liabilities	$ 6,713	$ 5,363
Allowance for doubtful accounts	677	637
Inventory valuation	990	614
Uniform capitalization	441	349
Net operating loss carryforward	123	—
Other	686	117
	9,630	7,080
Liabilities:		
Prepaid advertising	(984)	(617)
Other prepaids	(850)	(1,175)
Basis difference on long-lived assets	(16,990)	(11,080)
Undistributed earnings of foreign subsidiaries	(561)	(628)
	(19,385)	(13,500)
Net deferred tax liability	$ (9,755)	$ (6,420)

Deferred taxes are presented in the consolidated balance sheet at December 31, 2005 and 2004 as follows:

	2005	2004
Current deferred tax asset	$ 7,235	$ 4,661
Noncurrent deferred tax liabilities	(16,990)	(11,081)
Net deferred tax liability	$ (9,755)	$ (6,420)

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

	2005	2004	2003
U.S. statutory income tax rate	35.0%	35.0%	35.0%
State tax, net of federal benefit	1.7	1.2	1.8
Tax benefit related to U.S. export sales	(0.5)	(0.3)	(0.5)
Qualified domestic production activity deduction	(0.5)	—	—
Penalties	0.9	—	—
Impact of foreign results	0.6	—	—
Nondeductible operational expenses	0.4	0.3	0.2
Tax exempt interest	(1.1)	(0.8)	(0.3)
Research and development credit	(0.9)	(0.4)	(0.3)
Change in deferred tax measurement rate	0.8	—	—
Reduction in tax contingency reserve	(1.0)	(0.9)	—
Other	(0.6)	0.2	0.1
Total	34.8%	34.3%	36.0%

The Company has a federal U.S. net operating loss carryforward ("NOL") totaling $354, which will expire in 2025.

As of December 31, 2005, the Company did not provide for United States income taxes or foreign withholding taxes on a cumulative total of $5 of undistributed losses 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 studied the impact of the one-time favorable foreign dividend provision enacted on October 22, 2004 as part of the American Jobs Creation Act of 2004, and it has decided not to repatriate earnings of its foreign subsidiaries.

12. EARNINGS PER SHARE

Basic earnings per share is computed on the basis of the weighted average number of common shares outstanding. Diluted earnings 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 for the calculation of both basic and diluted earnings per share is the same as reported net income for all periods.

The calculation of weighted-average outstanding shares for the three years ended December 31, 2005 is as follows:

	2005	2004	2003
Basic shares outstanding	33,303,383	32,756,766	32,579,533
Dilutive effect of stock options	553,513	637,394	439,161
Diluted shares outstanding	33,856,896	33,394,160	33,018,694
Antidilutive stock options*	703,850	860,620	1,164,194

* Stock options not included in the calculation of diluted earnings per share for each respective year because they would be antidilutive.

13. STOCK REPURCHASE PROGRAM

In March 2005, the Company's Board of Directors authorized the repurchase of up to $100,000 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. During 2005, the Company acquired 830,700 shares of common stock at an average price of $18.82 per share for a total cost of $15,636. In March 2006, the Company signed an amended revolving credit agreement stating that for the period commencing on January 1, 2006 until such time as the fixed charge coverage ratio shall be equal to or greater than 1.20 to 1.00, the Company may only make capital distributions for the repurchase of shares in an aggregate amount not to exceed $30,000.

14. RELATED-PARTY TRANSACTIONS

Pearl Izumi GmbH purchased the assets of SHORE Sportworks GmbH, a company owned by Juergen Eckmann and Juergen Sprich in January 2004. Pearl Izumi GmbH later became a wholly-owned subsidiary of the Company through the 2005 acquisition of Pearl Izumi. Juergen Sprich is now the managing director for Pearl Izumi GmbH. Juergen Eckmann is now the Acting President of the Fitness Apparel Segment.

The purchase price for SHORE Sportsworks GmbH included a contingent consideration clause, along with stock in Pearl Izumi that was later purchased by the Company in the Pearl Izumi acquisition. The contingent consideration is a payment equal to 3% of the total year-over-year increase in net revenues from Pearl Izumi Europe, which also became a wholly-owned subsidiary through the Pearl Izumi acquisition, for each calendar year ending December 31, 2004, 2005 and 2006. When Nautilus purchased Pearl Izumi, the estimated contingent payments due in 2005 and 2006 were set up as a liability and deducted from the purchase price.

The Company incurred royalty expense under an agreement with a stockholder of the Company of $1,843 in 2004 and $6,556 in 2003, of which $18 was payable at December 31, 2004. In addition to the royalty agreement, the stockholder had separately negotiated an agreement dated June 18, 1992, when the Company was privately held, between the stockholder, the Company's former Chairman and Chief Executive Officer (the "former Chairman"), and a former director of the Company. That separate agreement stipulated that annual royalties above $90 would be paid 60% to the stockholder, 20% to the former Chairman, and 20% to the former director. Both of these agreements expired in April 2004.

15. LITIGATION

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 (at the balance sheet date) that an asset has been impaired or liability 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 (i.e., they are reflected in the financial statements in the period in which they are determined to be losses, with no retroactive restatement). 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, could have a significant impact on our financial position, results of operations and cash flows.

In November 2005, the Company proceeded to trial in Salt Lake City, Utah in a case filed by ICON Health & Fitness, Inc. ("ICON") claiming false advertising involving the Company's advertising and promotion going back to 1987 for certain elements of its Bowflex home gyms and claiming trademark infringement for the name placed on a treadmill belt sold in 2002. On November 15, 2005, the jury returned a verdict in favor of ICON in the amount of $7,800. The verdict is subject to review by the Court on the issues of liability and damages and will not become final until the Court has issued additional rulings. The Company has filed additional briefings requesting that the Court overturn and/or reduce the damages and the matter remains under consideration by the Court. The Company believes the jury's advisory verdict is inconsistent with the law and the evidence presented at trial and that the evidence does not support the damage award. Thus, the Company has not accrued any material amounts for this case. The Company will continue to vigorously contest this verdict.

In December 2002, the Company filed suit against ICON in the Federal District Court, Western District of Washington (the "District Court") alleging infringement by ICON of the Company's Bowflex patents and trademarks. The Company sought injunctive relief, monetary damages and its fees and costs. In October 2003, the District Court dismissed the patent infringement claims. The Company appealed the District Court's decision to the United States Court of Appeals for the Federal Circuit (the "Appeals Court") and in November 2003, the Appeals Court overruled the District Court and reinstated the patent infringement claims. In May 2005 the District Court again dismissed the patent infringement case against ICON. The Company has appealed this case to the Appeals Court, which has previously ruled in favor of Nautilus in two separate appeals on this matter.

In July 2003, the District Court ruled in favor of the Company on a motion for preliminary injunction on the issue of trademark infringement and entered an order barring ICON from using the trademark "CrossBow" on any exercise equipment. In its ruling, the District Court concluded that the Company showed "a probability of success on the merits and irreparable injury" on its trademark infringement claim. In August 2003, the Appeals Court granted ICON a temporary stay regarding the motion for a preliminary injunction, which enjoined ICON from using the trademark "CrossBow." This stay allowed ICON to continue using the trademark "CrossBow" until a decision was issued by the Appeals Court. In June 2004, the Appeals Court issued its decision upholding the issuance of an injunction and preventing ICON from selling exercise equipment using the trademark "CrossBow" pending trial on the trademark issue. A trial date has been set for October 2006 in the District Court on this claim.

ICON had been using the term "CrossBar" on certain exercise equipment in response to the litigation regarding its use of "CrossBow." In July 2004, the Company filed an additional suit against ICON in the District Court alleging that ICON has further infringed on the Bowflex trademark by the use of the "CrossBar" trademark. ICON and the Company have now reached a voluntary resolution of that lawsuit, and the case has been dismissed.

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.

16. EMPLOYEE BENEFIT PLAN

The Company adopted a 401(k) profit sharing plan (the "Plan") in 1999 covering substantially all employees over the age of 18. The Plan was amended in 2000 to allow for immediate eligibility in the Plan. Each participant in the Plan may contribute up to 50% of eligible compensation during any calendar year, subject to certain limitations. The 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 Company matching contributions. Employees are 25% vested in the matching contributions per year for the first four years of service. Expense for the plan was $507, $640 and $613 for the years ended December 31, 2005, 2004 and 2003, respectively.

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

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. The Company's management, with participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the fiscal year covered by this Annual Report on Form 10-K. Based upon that evaluation and the material weaknesses described below under "Management Report on Internal Control Over Financial Reporting," the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this Annual Report on Form 10-K, the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were ineffective.

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. The Company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) 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.

Inherent Limitation of Effectiveness of Controls

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment or breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's Assessment

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005. In making this assessment, management used the criteria set forth by the Committee of

Sponsoring Organizations of the Treadway Commission ("COSO") in "Internal Control-Integrated Framework." Management has excluded Pearl Izumi and Nautilus Fitness Canada from its assessment of internal control over financial reporting as of December 31, 2005, because they were acquired by the Company in purchase business combinations during 2005. Pearl Izumi and Nautilus Fitness Canada are wholly owned subsidiaries of the Company that represent 19% and 3%, respectively, of the consolidated total assets and 4% and 3%, respectively, of consolidated revenue as of and for the year ended December 31, 2005.

Based on management's assessment using the COSO criteria, management has concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2005 as a result of material weaknesses in internal controls as described below. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

In connection with the preparation of the Company's consolidated financial statements for the quarter and year ended December 31, 2005, and the related audit by the Company's independent auditors, the Company and its auditors determined that the Company had two internal control deficiencies that constituted "material weaknesses," as defined by the PCAOB Accounting Standard No. 2.

Management determined that the controls for testing of and training for the enterprise resource planning (ERP) system which was implemented in the fourth quarter of 2005 for the commercial, retail and specialty channels did not operate effectively. This failure resulted in material audit adjustments to net sales and cost of sales in the 2005 consolidated financial statements.

Management also determined that efforts to mitigate the impact of inadequate ERP testing and training resulted in insufficient resources being devoted to controls over analyzing and recording contingencies. Accordingly, such controls failed to operate effectively, resulting in material audit adjustments to the 2005 consolidated financial statements. These weaknesses, if left unremediated, could result in the failure to prevent or detect a material misstatement of net sales, cost of sales, inventory and various contingencies in the annual or interim financial statements.

Accordingly, management has concluded that the control deficiencies surrounding the testing of and training for the ERP implementation and surrounding analyzing and recording contingencies, constitute material weaknesses.

The Company's independent registered public accounting firm has audited management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, as stated in their report which appears on page 64 of this Form 10-K under the heading, *Report of Independent Registered Public Accounting Firm*.

Changes in Internal Controls

In the fourth quarter, the Company converted its commercial, retail and specialty fitness channels to its existing ERP application which now serves as the general ledger of record for the United States, is used to record commercial, retail and specialty fitness equipment sales in the United States, and is used as the system of record for most inventory transactions in the United States for all lines of business going forward.

Remediation Efforts on the Internal Controls Surrounding the ERP Implementation

The following remedial actions have been undertaken to address the material weakness in the controls for testing and training for the ERP system:

- Data migration issues have been identified and continue to be corrected by Company personnel.

- System users are receiving additional training on the effective and efficient use of the system to encourage data accuracy.
- System reporting is being enhanced based on identified business needs, including daily sales and standard margin reporting among numerous other reports.
- Enhancements to the operation of the system implementation controls are being developed. As such, the implementation of the ERP for International operations has been postponed until 2007 to enable the Company to effectively execute the implementation thereby limiting the risk of similar issues arising in future implementations.

The Company has made considerable progress in its efforts to remediate this material weakness since December 31, 2005. As on-going remediation continues, the Company is focusing upon training and education efforts so that operating effectiveness will be demonstrated over a period of time sufficient to conclude that the material weakness has been remediated.

Remediation Efforts on the Internal Controls Surrounding Analyzing and Recording Contingencies

The following remedial actions have been undertaken to address the material weakness in the controls for analyzing and recording contingencies:

- Additional training is being provided to the accountants responsible for determining the financial impact of each contingency.
- The importance of the review function is being reiterated to the senior members of the accounting department who have been assigned responsibility for review of accounting estimates.
- An additional level of review has been implemented requiring all significant accounting estimates be reported to and reviewed by the CFO and Controller on a monthly basis.

The Company has made considerable progress in its efforts to remediate this material weakness since December 31, 2005. As on-going remediation continues, the Company is focusing its training and education efforts so that operating effectiveness will be demonstrated over a period of time that is sufficient to conclude that the material weakness has been remediated.

Except for the implementation of the ERP system mentioned above, there have been no changes in the Company’s internal control over financial reporting during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited management's assessment, included in the accompanying "Management Report on Internal Control Over Financial Reporting," that Nautilus Inc. and subsidiaries (the "Company") did not maintain effective internal control over financial reporting as of December 31, 2005, because of the effect of the material weaknesses identified in management's assessment 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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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 significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management's assessment: the Company did not maintain adequate controls over the testing of and training for the enterprise resource planning ("ERP") system implementation for the commercial, retail and specialty channels; and, in addition, as a result of the Company's accounting department's efforts to mitigate ERP system set-up issues, data migration issues and reporting limitations, insufficient resources were devoted to controls over analyzing and recording contingencies. The failure in the operation of the controls around the ERP implementation resulted in material audit adjustments to net sales and cost of sales in the consolidated financial statements. As a result of the

insufficient resources devoted to controls over analyzing and recording contingencies, material audit adjustments to the consolidated financial statements were required. These control deficiencies, if unremediated, could result in the failure to prevent or detect a material misstatement of net sales, cost of sales, inventory, and various contingencies in the annual or interim financial statements. Due to the misstatements which resulted in the adjustment of the Company's consolidated financial statements and the potential for additional misstatements from these material weaknesses, there is more than a remote likelihood that a material misstatement of the financial statements would not be prevented or detected. These material weaknesses were 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, 2005, of the Company and this report does not affect our report on such financial statements.

In our opinion, management's assessment that the Company did not maintain effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, because of the effect of the material weaknesses described 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, 2005, 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 period ended December 31, 2005, of the Company and our report dated March 16, 2006 expressed an unqualified opinion on those financial statements.

DELOITTE & TOUCHE LLP

Portland, Oregon
March 16, 2006

Item 9B. Other Information

The following summarizes certain Company events otherwise required to be disclosed in a current report on Form 8-K. Because these events occurred within four business days of the filing of this annual report on Form 10-K, they are being disclosed herein in lieu of a separate 8-K filing.

Item 1.01. Entry into a Material Definitive Agreement.

On March 10, 2006, the Company entered into a First Amendment Agreement with KeyBank National Association and U.S. Bank National Association, amending their original Credit Agreement dated November 18, 2005. In the amendment, the lenders waived a default as of December 31, 2005 regarding maintaining a fiscal quarter end fixed charge coverage ratio of 1.2 to 1. The ratio is calculated as of the end of each fiscal quarter on a rolling four-fiscal quarter basis. The amendment reduces the required ratio through the fiscal quarter ending September 30, 2006 to .75 to 1, and excludes the expenditures of $5,112,753, $4,902,310, and $3,223,326 in the second through fourth fiscal quarters of 2005 from the consolidated capital expenditures component of the calculation.

Until the fixed charge coverage ratio equals or exceeds 1.2 to 1, the Company may not make capital distributions for the repurchase of shares of its stock in an aggregate amount exceeding $30,000,000, but may do so thereafter if there is no outstanding event of default.

The amendment allows for interest payments to be made on subordinated indebtedness if there is no outstanding event of default. The amendment also retroactively amended certain technical provisions.

A copy of the amendment is attached hereto as Exhibit 10.28 and is incorporated herein. The foregoing description of the amendment does not purport to be complete and is qualified in its entirety by reference to such exhibit.

Item 2.03. Creation of a Direct Financial Obligation or an obligation Under an Off-Balance Sheet Arrangement of a Registrant.

The terms of the amended direct financial obligation are summarized in the Item 1.01 disclosure set forth above.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this item is included under the captions *Election of Directors*, *Executive Officers*, and *Section 16(a) Beneficial Ownership Reporting Compliance*, respectively, in the Company's Proxy Statement for its 2006 Annual Meeting of Stockholders and is incorporated herein by reference.

The Company has adopted the Nautilus, Inc. Code of Business Conduct and Ethics, which is a code of conduct and ethics that applies to all employees, directors and officers, including the Company's principal executive officer, principal financial officer and principal accounting officer. The Code of Business Conduct and Ethics is available on the Company's website, www.nautilus.com.

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 2006 Annual Meeting of Stockholders 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 *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters* in the Company's Proxy Statement for its 2006 Annual Meeting of Stockholders and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

The information required by this item is included under the caption *Certain Relationships and Related Transactions* in the Company's Proxy Statement for its 2006 Annual Meeting of Stockholders and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this item is included under the caption *Independent Registered Public Accounting Firm* in the Company's Proxy Statement for its 2006 Annual Meeting of Stockholders 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 70 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 16, 2006

NAUTILUS, INC.

By: /s/ GREGGORY C. HAMMANN

Greggory C. Hammann,
Chief Executive Officer, President and
Chairman of the Board

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 16, 2006:

Signature	Title
/s/ GREGGORY C. HAMMANN **Greggory C. Hammann**	Chief Executive Officer, President and Chairman of the Board (Principal Executive Officer)
/s/ WILLIAM D. MEADOWCROFT **William D. Meadowcroft**	Chief Financial Officer and Secretary (Principal Financial and Accounting Officer)
* **Peter A. Allen**	Director
* **Robert S. Falcone**	Director
* **Frederick T. Hull**	Director
* **Donald W. Keeble**	Director
* **Paul F. Little**	Director
* **Diane L. Neal**	Director
* **Marvin G. Siegert**	Director

*By: /s/ WILLIAM D. MEADOWCROFT March 16, 2006

William D. Meadowcroft
Attorney-In-Fact

EXHIBIT INDEX

Exhibit No.	Description
2.1	Agreement and Plan of Merger dated as of June 17, 2005 by and among Nautilus, DashAmerica, Inc. d/b/a Pearl Izumi USA, PI Acquisition Company, Inc, and DAI Escrow Holdings – Incorporated by reference to Exhibit 2.1 of the Company's Form 8-K, as filed with the Commission on July 13, 2005.
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.
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*	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.
10.5*	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.
10.6*	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.
10.7*	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.
10.8	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.
10.9	Trademark License Agreement 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.

Exhibit No.	Description
10.10	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.
10.11	Revolving Credit Agreement, with Addendum, dated June 27, 2002, by and between the Company and U.S. Bank National Association – Incorporated by reference to Exhibit 10.1 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.
10.12	Demand Master Promissory Note, by and between the Company and Keybank National Association - Incorporated by reference to Exhibit 10 of the Company's Form 8-K, as filed with the Commission on August 23, 2005.
10.13	Credit Agreement, by and among the Company, KeyBank National Association, and U.S. Bank National Association, dated November 18, 2005.
10.14	Lease agreement, dated November 23, 2004 between Columbia Tech Center LLC and The Nautilus Group, Inc. – Incorporated by reference to Exhibit 99.1 of the Company's Form 8-K, as filed with the Commission on November 30, 2004.
10.15*	Executive Employment Agreement, dated July 2, 2003, by and between the Company and Gregg Hammann – Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the three months ended September 30, 2003, as filed with the Commission on November 14, 2003.
10.16*	First Amendment to Nonstatutory Stock Option Agreement dated December 31, 2005, by and between the Company and Greggory C. Hammann – Incorporated by reference to Exhibit 10.1 of the Company's Form 8-K, as filed with the Commission on January 5, 2006.
10.17*	Executive Employment Agreement, dated January 29, 2004, by and between the Company and Timothy Hawkins – Incorporated by reference to Exhibit 10.11 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.
10.18*	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.
10.19*	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.
10.20*	Amended and Restated Executive Employment Agreement dated December 1, 2005, by and between the Company and Greggory C. Hammann – Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K, as filed with the Commission on December 7, 2005.
10.21*	Performance Unit Agreement dated December 1, 2005, by and between the Company and Greggory C. Hammann – Incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K, as filed with the Commission on December 7, 2005.
10.22*	Executive Employment Agreement dated June 30, 2005, by and between the Company and Juergen Eckmann.
10.23*	2005 Compensation of Executive Officers - Incorporated by reference to the Company's Current Report on Form 8-K, as filed with the Commission on April 1, 2005.

Exhibit No.	Description
10.24*	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.
10.25*	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.
10.26*	Annual Base Salary of William D. Meadowcroft – Incorporated by reference to the Company's Current Report on Form 8-K, as filed with the Commission on November 3, 2005.
10.27*	2005 Non-Employee Director Compensation – Incorporated by reference to the Company's Current Report on Form 8-K, as filed with the Commission on June 10, 2005.
10.28	First Amendment Agreement with KeyBank National Association, and U.S. Bank National Association dated March 10, 2006.
21	Subsidiaries of Nautilus, Inc.
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.
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.

Exhibit 10.13

CREDIT AGREEMENT

among

NAUTILUS, INC.,
as Borrower,

THE LENDERS NAMED HEREIN,
as Lenders,

KEYBANK NATIONAL ASSOCIATION,
as Lead Arranger, Sole Book Runner and Administrative Agent,

and

U.S. BANK NATIONAL ASSOCIATION,
as Syndication Agent

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dated as of
November 18, 2005

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(The schedules and exhibits to this agreement have been omitted. Copies of the schedules and exhibits will be supplementally furnished to the Commission upon request.)

This CREDIT AGREEMENT (as the same may from time to time be amended, restated or otherwise modified, this "Agreement") is made effective as of the 18th day of November, 2005 among:

(a) NAUTILUS, INC., a Washington corporation ("Borrower");

(b) the lenders listed on Schedule 1 hereto and each other Eligible Transferee, as hereinafter defined, that becomes a party hereto pursuant to Section 10.10 hereof (collectively, the "Lenders" and, individually, each a "Lender");

(c) KEYBANK NATIONAL ASSOCIATION, as lead arranger, sole book runner and administrative agent for the Lenders under this Agreement ("Agent"); and

(d) U.S. BANK NATIONAL ASSOCIATION, as syndication agent ("Syndication Agent").

WITNESSETH:

WHEREAS, Borrower, Agent and the Lenders desire to contract for the establishment of credits in the aggregate principal amounts hereinafter set forth, to be made available to Borrower upon the terms and subject to the conditions hereinafter set forth;

NOW, THEREFORE, it is mutually agreed as follows:

ARTICLE I. DEFINITIONS

Section 1.1. Definitions. As used in this Agreement, the following terms shall have the following meanings:

"Acquisition" shall mean any transaction or series of related transactions for the purpose of or resulting, directly or indirectly, in (a) the acquisition of all or substantially all of the assets of any Person (other than a Company), or any business or division of any Person (other than a Company), (b) the acquisition of in excess of fifty percent (50%) of the stock (or other equity interest) of any Person (other than a Company), or (c) the acquisition of another Person (other than a Company) by a merger, amalgamation or consolidation or any other combination with such Person.

"Advantage" shall mean any payment (whether made voluntarily or involuntarily, by offset of any deposit or other indebtedness or otherwise) received by any Lender in respect of the Obligations, if such payment results in that Lender having less than its pro rata share of the Obligations then outstanding.

"Affiliate" shall mean any Person, directly or indirectly, controlling, controlled by or under common control with a Company and "control" (including the correlative meanings, the

terms “controlling”, “controlled by” and “under common control with”) shall mean the power, directly or indirectly, to direct or cause the direction of the management and policies of a Company, whether through the ownership of voting securities, by contract or otherwise.

“Agent” shall mean that term as defined in the first paragraph hereof.

“Agent Fee Letter” shall mean the Agent Fee Letter between Borrower and Agent, dated as of the Closing Date, as the same may from time to time be amended, restated or otherwise modified.

“Agreement” shall mean that term as defined in the first paragraph hereof.

“Applicable Facility Fee Rate” shall mean:

(a) for the period from the Closing Date through November 30, 2005, fifteen (15.0) basis points; and

(b) commencing with the Consolidated financial statements of Borrower for the fiscal quarter ending September 30, 2005, the number of basis points set forth in the following matrix, based upon the result of the computation of the Leverage Ratio, shall be used to establish the number of basis points that will go into effect on December 1, 2005 and thereafter:

Leverage Ratio	Applicable Facility Fee Rate
Greater than or equal to 2.50 to 1.00	25.0
Greater than or equal to 2.00 to 1.00 but less than 2.50 to 1.00	20.0
Greater than or equal to 1.50 to 1.00 but less than 2.00 to 1.00	17.5
Less than 1.50 to 1.00	15.0

After December 1, 2005, changes to the Applicable Facility Fee Rate shall be effective on the first day of each month following the date upon which Agent should have received, pursuant to Section 5.3(a) and (b) hereof, the Consolidated financial statements of Borrower. The above matrix does not modify or waive, in any respect, the requirements of Section 5.7 hereof, the rights of Agent and the Lenders to charge the Default Rate, or the rights and remedies of Agent and the Lenders pursuant to Articles VII and VIII hereof. Notwithstanding anything herein to the contrary, during any period when Borrower shall have failed to timely deliver the Consolidated financial statements pursuant to Section 5.3(a) or (b) hereof, or the Compliance Certificate pursuant to Section 5.3(c) hereof, until such time as the appropriate Consolidated financial statements and Compliance Certificate are delivered, the Applicable Facility Fee Rate shall be the highest rate per annum indicated in the above pricing grid regardless of the Leverage Ratio at such time.

"Applicable Margin" shall mean:

(a) for the period from the Closing Date through November 30, 2005, sixty-five (65.0) basis points for Eurodollar Loans and zero (0.0) basis points for Base Rate Loans; and

(b) commencing with the Consolidated financial statements of Borrower for the fiscal quarter ending September 30, 2005, the number of basis points (depending upon whether Loans are Eurodollar Loans or Base Rate Loans) set forth in the following matrix, based upon the result of the computation of the Leverage Ratio, shall be used to establish the number of basis points that will go into effect on December 1, 2005 and thereafter:

Leverage Ratio	Applicable Basis Points for Eurodollar Loans	Applicable Basis Points for Base Rate Loans
Greater than or equal to 2.50 to 1.00	115.0	0.0
Greater than or equal to 2.00 to 1.00 but less than 2.50 to 1.00	100.0	0.0
Greater than or equal to 1.50 to 1.00 but less than 2.00 to 1.00	82.5	0.0
Greater than or equal to 1.00 to 1.00 but less than 1.50 to 1.00	75.0	0.0
Less than 1.00 to 1.00	65.0	0.0

After December 1, 2005, changes to the Applicable Margin shall be effective on the first day of each month following the date upon which Agent should have received, pursuant to Section 5.3(a) and (b) hereof, the Consolidated financial statements of Borrower. The above matrix does not modify or waive, in any respect, the requirements of Section 5.7 hereof, the rights of Agent and the Lenders to charge the Default Rate, or the rights and remedies of Agent and the Lenders pursuant to Articles VII and VIII hereof. Notwithstanding anything herein to the contrary, during any period when Borrower shall have failed to timely deliver the Consolidated financial statements pursuant to Section 5.3(a) or (b) hereof, or the Compliance Certificate pursuant to Section 5.3(c) hereof, until such time as the appropriate Consolidated financial statements and Compliance Certificate are delivered, the Applicable Margin shall be the highest rate per annum indicated in the above pricing grid regardless of the Leverage Ratio at such time.

"Assignment Agreement" shall mean an Assignment and Acceptance Agreement in the form of the attached Exhibit E.

"Authorized Officer" shall mean a Financial Officer or other individual authorized by a Financial Officer in writing (with a copy to Agent) to handle certain administrative matters in connection with this Agreement.

"Base Rate" shall mean a rate per annum equal to the greater of (a) the Prime Rate or (b) one-half of one percent (.50%) in excess of the Federal Funds Effective Rate. Any change in the Base Rate shall be effective immediately from and after such change in the Base Rate.

"Base Rate Loan" shall mean a Revolving Loan described in Section 2.2(a) hereof, that shall be denominated in Dollars and on which Borrower shall pay interest at a rate equal to the Derived Base Rate.

"Borrower" shall mean that term as defined in the first paragraph hereof.

"Borrower Investment Policy" shall mean the investment policy of Borrower as in effect on the Closing Date, attached hereto as Exhibit F, together with such modifications as approved from time to time by the Board of Directors of Borrower.

"Business Day" shall mean any day that is not a Saturday, Sunday or other day on which national banks are authorized or required to close in Cleveland, Ohio, and, if the applicable Business Day relates to a Eurodollar Loan, a day of the year on which dealings in deposits are carried on in the London interbank Eurodollar market.

"Capital Distribution" shall mean a payment made, liability incurred or other consideration given by a Company to any Person that is not a Company, for the purchase, acquisition, redemption, repurchase or retirement of any capital stock or other equity interest of such Company or as a dividend, return of capital or other distribution (other than any stock dividend, stock split or other equity distribution payable only in capital stock or other equity of such Company) in respect of such Company's capital stock or other equity interest.

"Capitalized Lease Obligations" shall mean obligations of any of the Companies for the payment of rent for any real or personal property under leases or agreements to lease that, in accordance with GAAP, have been or should be capitalized on the books of the lessee and, for purposes hereof, the amount of any such obligation shall be the capitalized amount thereof determined in accordance with GAAP.

"Change in Control" shall mean (a) the acquisition of, or, if earlier, the approval by Borrower's shareholders or directors of the acquisition of, ownership or voting control, directly or indirectly, beneficially or of record, on or after the Closing Date, by any Person or group (within the meaning of Rule 13d-3 of the SEC under the Securities Exchange Act of 1934, as then in effect), of shares representing more than twenty-five percent (25%) of the aggregate ordinary Voting Power represented by the issued and outstanding capital stock of Borrower; (b) the occupation of a majority of the seats (other than vacant seats) on the board of directors or other governing body of Borrower by Persons who were neither (i) nominated by the board of directors or other governing body of Borrower nor (ii) appointed by directors so nominated; or (c) the occurrence of a change in control, or other similar provision, as defined in any Material Indebtedness Agreement.

"Closing Date" shall mean the effective date of this Agreement as set forth in the first paragraph of this Agreement.

"Closing Fee Letter" shall mean the Closing Fee Letter among Borrower, Agent and the Lenders, dated as of the Closing Date.

"Code" shall mean the Internal Revenue Code of 1986, as amended, together with the rules and regulations promulgated thereunder.

"Commitment" shall mean the obligation hereunder of the Lenders, during the Commitment Period, to make Loans (including their respective pro rata shares of Swing Loans) and to participate in the issuance of Letters of Credit pursuant to the Revolving Credit Commitment, up to the Total Commitment Amount.

"Commitment Percentage" shall mean, for each Lender, the percentage set forth opposite such Lender's name under the column headed "Commitment Percentage", as listed in Schedule 1 hereto.

"Commitment Period" shall mean the period from the Closing Date to November 17, 2010 or such earlier date on which the Commitment shall have been terminated pursuant to Article VIII hereof.

"Companies" shall mean Borrower and all Subsidiaries.

"Company" shall mean Borrower or a Subsidiary.

"Compliance Certificate" shall mean a Compliance Certificate in the form of the attached Exhibit D.

"Consideration" shall mean, in connection with an Acquisition, the aggregate consideration paid, including borrowed funds, cash, the issuance of securities or notes, the assumption or incurring of liabilities (direct or contingent), the payment of consulting fees or fees for a covenant not to compete and any other consideration paid for such Acquisition.

"Consolidated" shall mean the resultant consolidation, without duplication, of the financial statements of Borrower and its Subsidiaries in accordance with GAAP, including principles of consolidation consistent with those applied in preparation of the consolidated financial statements referred to in Section 6.14 hereof.

"Consolidated Capital Expenditures" shall mean, for any period, the amount of capital expenditures of Borrower, as determined on a Consolidated basis and in accordance with GAAP.

"Consolidated Depreciation and Amortization Charges" shall mean, for any period, the aggregate of all depreciation and amortization charges for fixed assets, leasehold improvements and general intangibles (excluding goodwill) of Borrower for such period, as determined on a Consolidated basis and in accordance with GAAP.

"Consolidated EBITDAR" shall mean, for any period, as determined on a Consolidated basis and in accordance with GAAP, Consolidated Net Earnings for such period plus the aggregate amounts deducted in determining such Consolidated Net Earnings in respect of (a) Consolidated Interest Expense, (b) Consolidated Income Tax Expense, (c) Consolidated Depreciation and Amortization Charges, (d) (i) extraordinary or unusual non-cash losses not incurred in the ordinary course of business but that were counted in the net income calculation for such period, minus (ii) extraordinary or unusual non-cash gains not incurred in the ordinary course of business but that were counted in the net income calculation for such period, and (e) Consolidated Rent Expense.

"Consolidated Fixed Charges" shall mean, for any period, as determined on a Consolidated basis and in accordance with GAAP, the aggregate of (a) Consolidated Interest Expense (including, without limitation, the "imputed interest" portion of capital leases, synthetic leases and asset securitizations, if any), (b) Consolidated Income Tax Expense paid in cash, (c) Consolidated Rent Expense, (d) current maturities of long-term Indebtedness (excluding the Loans and Letters of Credit), and (e) Capital Distributions.

"Consolidated Funded Indebtedness" shall mean, at any date, all Indebtedness (including, but not limited to, current, long-term and Subordinated Indebtedness, if any) of Borrower, as determined on a Consolidated basis and in accordance with GAAP.

"Consolidated Income Tax Expense" shall mean, for any period, all provisions for taxes based on the gross or net income of Borrower (including, without limitation, any additions to such taxes, and any penalties and interest with respect thereto), and all franchise taxes of Borrower, as determined on a Consolidated basis and in accordance with GAAP.

"Consolidated Interest Expense" shall mean, for any period, the interest expense of Borrower for such period, as determined on a Consolidated basis and in accordance with GAAP.

"Consolidated Net Earnings" shall mean, for any period, the net income (loss) of Borrower for such period, as determined on a Consolidated basis and in accordance with GAAP.

"Consolidated Net Worth" shall mean, at any date, the stockholders' equity of Borrower, determined as of such date on a Consolidated basis and in accordance with GAAP.

"Consolidated Rent Expense" shall mean, for any period, as determined on a Consolidated basis and in accordance with GAAP, the amount of (a) all fixed rental expenses of Borrower arising under all operating leases of real property for such period, less (b) any sublease (operating) rents received by Borrower for such period for the sublease to persons other than Affiliates of any such real property. In the case of any lease or sublease covering both real property and personal property, the component of rental expense or rental income relating to the personal property (other than fixtures) shall be excluded from the determination of Consolidated Rent Expense.

"Control Agreement" shall mean a Deposit Account Control Agreement or a Securities Account Control Agreement.

"Controlled Group" shall mean a Company and each Person required to be aggregated with a Company under Code Section 414(b), (c), (m) or (o).

"Credit Event" shall mean the making by the Lenders of a Loan, the conversion by the Lenders of a Base Rate Loan to a Eurodollar Loan, the continuation by the Lenders of a Eurodollar Loan after the end of the applicable Interest Period, the making by the Swing Line Lender of a Swing Loan, or the issuance by the Fronting Lender of a Letter of Credit.

"Credit Party" shall mean Borrower and any Subsidiary or other Affiliate that is a Guarantor of Payment.

"Default" shall mean an event or condition that constitutes, or with the lapse of any applicable grace period or the giving of notice or both would constitute, an Event of Default, and that has not been waived by the Required Lenders (or, if applicable, all of the Lenders) in writing.

"Default Rate" shall mean (a) with respect to any Loan, a rate per annum equal to two percent (2%) in excess of the rate otherwise applicable thereto, and (b) with respect to any other amount, if no underlying rate is specified or available, a rate per annum equal to two percent (2%) in excess of the Derived Base Rate from time to time in effect.

"Deposit Account Control Agreement" shall mean each Deposit Account Control Agreement among a Credit Party, Agent and a depository institution, substantially in the form of the attached Exhibit J, executed and delivered to Agent, for the benefit of the Lenders on or after the Closing Date, as the same may from time to time be amended, restated or otherwise modified or replaced.

"Derived Base Rate" shall mean a rate per annum equal to the sum of the Applicable Margin (from time to time in effect) for Base Rate Loans plus the Base Rate.

"Derived Eurodollar Rate" shall mean a rate per annum equal to the sum of the Applicable Margin (from time to time in effect) for Eurodollar Loans plus the Eurodollar Rate.

"Derived Swing Loan Rate" shall mean a rate per annum equal to (a) Agent's cost of funds as quoted to Borrower by Agent and agreed to by Borrower, plus (b) the Applicable Margin (from time to time in effect) applicable to Eurodollar Loans.

"Disposition" shall mean the lease, transfer or other disposition of assets (whether in one or more transaction) by a Company, other than a sale, lease, transfer or other disposition made by a Company in the ordinary course of business.

"Dollar" or the sign $ shall mean lawful money of the United States of America.

"Domestic Subsidiary" shall mean a Subsidiary that is not a Foreign Subsidiary.

"Dormant Subsidiary" shall mean a Company that (a) is not a Credit Party, (b) has aggregate assets of less than Five Hundred Thousand Dollars ($500,000), (c) has aggregate sales of less than Five Hundred Thousand Dollars ($500,000) during each fiscal year of Borrower, and (d) has no direct or indirect Subsidiaries with aggregate assets or sales for all such Subsidiaries of more than Five Hundred Thousand Dollars ($500,000).

"Eligible Transferee" shall mean a commercial bank, financial institution or other "accredited investor" (as defined in SEC Regulation D) that is not Borrower, a Subsidiary or an Affiliate.

"Environmental Laws" shall mean all provisions of law (including the common law), statutes, ordinances, codes, rules, guidelines, policies, procedures, orders-in-council, regulations, permits, licenses, judgments, writs, injunctions, decrees, orders, awards and standards promulgated by a Governmental Authority or by any court, agency, instrumentality, regulatory authority or commission of any of the foregoing concerning environmental health or safety and protection of, or regulation of the discharge of substances into, the environment.

"ERISA" shall mean the Employee Retirement Income Security Act of 1974, as amended from time to time, and the regulations promulgated pursuant thereto.

"ERISA Event" shall mean (a) the imposition of an excise tax or the assessment of liability on a Company or of the imposition of a Lien on the assets of a Company; (b) the engagement by a Controlled Group member in a non-exempt "prohibited transaction" (as defined under ERISA Section 406 or Code Section 4975) or a breach of a fiduciary duty under ERISA that could result in liability to a Company; (c) the application by a Controlled Group member for a waiver from the minimum funding requirements of Code Section 412 or ERISA Section 302 or a Controlled Group member is required to provide security under Code Section 401(a)(29) or ERISA Section 307; (d) the occurrence of a Reportable Event with respect to any Pension Plan as to which notice is required to be provided to the PBGC; (e) the withdrawal by a Controlled Group member from a Multiemployer Plan in a "complete withdrawal" or a "partial withdrawal" (as such terms are defined in ERISA Sections 4203 and 4205, respectively); (f) the reorganization under ERISA Section 4241 of a Multiemployer Plan involving a Controlled Group; (g) the failure of an ERISA Plan (and any related trust) that is intended to be qualified under Code Sections 401 and 501 to be so qualified or the failure of any "cash or deferred arrangement" under any such ERISA Plan to meet the requirements of Code Section 401(k); (h) the taking by the PBGC of any steps to terminate a Pension Plan or appoint a trustee to administer a Pension Plan, or the taking by a Controlled Group member of any steps to terminate a Pension Plan in a "distressed termination" as described in ERISA; (i) the failure by a Controlled Group member or an ERISA Plan to satisfy any requirements of law applicable to an ERISA Plan; (j) the commencement, existence or threatening of a claim, action, suit, audit or investigation with respect to an ERISA Plan, other than a routine claim for benefits; or (k) any incurrence by or any expectation of the incurrence by a Controlled Group member of any liability for post-retirement benefits under any Welfare Plan, other than as required by ERISA Section 601, et. seq. or Code Section 4980B.

"ERISA Plan" shall mean an "employee benefit plan" (within the meaning of ERISA Section 3(3)) that a Controlled Group member at any time sponsors, maintains, contributes to, has liability with respect to or has an obligation to contribute to such plan.

"Eurocurrency Liabilities" shall have the meaning assigned to that term in Regulation D of the Board of Governors of the Federal Reserve System, as in effect from time to time.

"Eurodollar" shall mean a Dollar denominated deposit in a bank or branch outside of the United States.

"Eurodollar Loan" shall mean a Revolving Loan described in Section 2.2(a) hereof, that shall be denominated in Dollars and on which Borrower shall pay interest at a rate based upon the Eurodollar Rate.

"Eurodollar Rate" shall mean, with respect to a Eurodollar Loan, for any Interest Period, a rate per annum equal to the quotient obtained (rounded upwards, if necessary, to the nearest 1/16th of 1%) by dividing (a) the rate of interest, determined by Agent in accordance with its usual procedures (which determination shall be conclusive absent manifest error) as of approximately 11:00 A.M. (London time) two Business Days prior to the beginning of such Interest Period pertaining to such Eurodollar Loan, as listed on British Bankers Association Interest Rate LIBOR 01 or 02 as provided by Reuters (or, if for any reason such rate is unavailable from Reuters, from any other similar company or service that provides rate quotations comparable to those currently provided by Reuters) as the rate in the London interbank market for Dollar deposits in immediately available funds with a maturity comparable to such Interest Period, provided that, in the event that such rate quotation is not available for any reason, then the Eurodollar Rate shall be the average (rounded upward to the nearest 1/16th of 1%) of the per annum rates at which deposits in immediately available funds in Dollars for the relevant Interest Period and in the amount of the Eurodollar Loan to be disbursed or to remain outstanding during such Interest Period, as the case may be, are offered to Agent (or an affiliate of Agent, in Agent's discretion) by prime banks in any Eurodollar market reasonably selected by Agent, determined as of 11:00 A.M. (London time) (or as soon thereafter as practicable), two Business Days prior to the beginning of the relevant Interest Period pertaining to such Eurodollar Loan hereunder; by (b) 1.00 minus the Reserve Percentage.

"Event of Default" shall mean an event or condition that shall constitute an event of default as defined in Article VII hereof.

"Excluded Taxes" shall mean net income taxes (and franchise taxes imposed in lieu of net income taxes) and business and occupation taxes imposed in the State of Washington that are imposed on Agent or a Lender by any Governmental Authority located in the jurisdiction where Agent or such Lender is organized or in a state of the United States where such Lender maintains a lending office.

"Existing Letter of Credit" shall mean that term as defined in Section 2.2(b)(vi) hereof.

"Federal Funds Effective Rate" shall mean, for any day, the rate per annum (rounded upward to the nearest one one-hundredth of one percent (1/100 of 1%)) announced by the Federal Reserve Bank of New York (or any successor) on such day as being the weighted average of the rates on overnight federal funds transactions arranged by federal funds brokers on the previous trading day, as computed and announced by such Federal Reserve Bank (or any successor) in substantially the same manner as such Federal Reserve Bank computes and announces the weighted average it refers to as the "Federal Funds Effective Rate" as of the Closing Date.

"Financial Officer" shall mean any of the following officers: chief executive officer, president, chief financial officer or vice president-controller. Unless otherwise qualified, all references to a Financial Officer in this Agreement shall refer to a Financial Officer of Borrower.

"Fixed Charge Coverage Ratio" shall mean, as determined for the most recently completed four fiscal quarters of Borrower, on a Consolidated basis and in accordance with GAAP, the ratio of (a) (i) Consolidated EBITDAR, minus (ii) Consolidated Capital Expenditures, to (b) Consolidated Fixed Charges; provided, however, that (A) with respect to any Acquisition, Borrower shall make pro forma adjustments in the calculation of the Fixed Charge Coverage Ratio using the historical financial information of the division or entity acquired, and (B) with respect to any Disposition or a division or entity, Borrower shall make pro forma adjustments in the calculation of the Fixed Charge Coverage Ratio using the historical financial information of the disposed division or entity; but, in each case of (A) or (B), only so long as Borrower shall have provided to Agent and the Lenders sufficient written evidence to support such pro forma adjustments, in form and substance satisfactory to Agent.

"Foreign Subsidiary" shall mean a Subsidiary that is organized outside of the United States.

"Fronting Lender" shall mean, (a) as to any Letter of Credit transaction hereunder, Agent as issuer of the Letter of Credit, or, in the event that Agent either shall be unable to issue or shall agree that another Lender may issue a Letter of Credit, such other Lender as shall agree to issue the Letter of Credit in its own name, but on behalf of the Lenders hereunder; or (b) as to any Existing Letter of Credit, U.S. Bank National Association.

"GAAP" shall mean generally accepted accounting principles in the United States as then in effect, which shall include the official interpretations thereof by the Financial Accounting Standards Board, applied on a basis consistent with the past accounting practices and procedures of Borrower.

"Governmental Authority" shall mean any nation or government, any state, province or territory or other political subdivision thereof, any governmental agency, department, authority, instrumentality, regulatory body, court, central bank or other governmental entity exercising executive, legislative, judicial, taxing, regulatory or administrative functions of or pertaining to government, any securities exchange.

"Guarantor" shall mean a Person that shall have pledged its credit or property in any manner for the payment or other performance of the indebtedness, contract or other obligation of another and includes (without limitation) any guarantor (whether of payment or of collection), surety, co-maker, endorser or Person that shall have agreed conditionally or otherwise to make any purchase, loan or investment in order thereby to enable another to prevent or correct a default of any kind.

"Guarantor of Payment" shall mean each of the Companies designated a "Guarantor of Payment" on Schedule 2 hereto, each of which is executing and delivering a Guaranty of Payment, and any other Domestic Subsidiary that shall be required to deliver a Guaranty of Payment to Agent subsequent to the Closing Date pursuant to Section 5.20(a) hereof.

"Guaranty of Payment" shall mean each Guaranty of Payment, substantially in the form of the attached Exhibit H, executed and delivered on or after the Closing Date in connection with this Agreement by the Guarantors of Payment, as the same may from time to time be amended, restated or otherwise modified or replaced.

"Hedge Agreement" shall mean any (a) hedge agreement, interest rate swap, cap, collar or floor agreement, or other interest rate management device entered into by a Company with any Person in connection with any Indebtedness of such Company, or (b) currency swap agreement, forward currency purchase agreement or similar arrangement or agreement designed to protect against fluctuations in currency exchange rates entered into by a Company.

"Indebtedness" shall mean, for any Company (excluding in all cases trade payables payable in the ordinary course of business by such Company), without duplication, (a) all obligations to repay borrowed money, direct or indirect, incurred, assumed, or guaranteed, (b) all obligations for the deferred purchase price of capital assets, (c) all obligations under conditional sales or other title retention agreements, (d) all obligations (contingent or otherwise) under any letter of credit or banker's acceptance, (e) all net obligations under any currency swap agreement, interest rate swap, cap, collar or floor agreement or other interest rate management device or any Hedge Agreement, (f) all synthetic leases, (g) all lease obligations that have been or should be capitalized on the books of such Company in accordance with GAAP, (h) all obligations of such Company with respect to asset securitization financing programs to the extent that there is recourse against such Company or such Company is liable (contingent or otherwise) under any such program, (i) all obligations to advance funds to, or to purchase assets, property or services from, any other Person in order to maintain the financial condition of such Person, (j) all indebtedness of any partnership in which such Company is a general partner that would otherwise satisfy the definition of Indebtedness, (k) any other transaction (including forward sale or purchase agreements) having the commercial effect of a borrowing of money entered into by such Company to finance its operations or capital requirements, and (l) any guaranty of any obligation described in subparts (a) through (k) hereof.

"Interest Adjustment Date" shall mean the last day of each Interest Period.

"Interest Period" shall mean, with respect to a Eurodollar Loan, the period commencing on the date such Eurodollar Loan is made and ending on the last day of such period, as selected

by Borrower pursuant to the provisions hereof, and, thereafter (unless, with respect to a Eurodollar Loan, such Eurodollar Loan is converted to a Base Rate Loan), each subsequent period commencing on the last day of the immediately preceding Interest Period and ending on the last day of such period, as selected by Borrower pursuant to the provisions hereof. The duration of each Interest Period for a Eurodollar Loan shall be one month, two months, three months or six months, in each case as Borrower may select upon notice, as set forth in Section 2.5 hereof; provided that if Borrower shall fail to so select the duration of any Interest Period for a Eurodollar Loan at least three Business Days prior to the Interest Adjustment Date applicable to such Eurodollar Loan, Borrower shall be deemed to have converted such Eurodollar Loan to a Base Rate Loan at the end of the then current Interest Period.

"Landlord's Waiver" shall mean a landlord's waiver or mortgagee's waiver, substantially in the form of the attached Exhibit L, each in form and substance satisfactory to Agent, delivered by a Company in connection with this Agreement, as such waiver may from time to time be amended, restated or otherwise modified or replaced.

"Letter of Credit" shall mean a standby letter of credit that shall be issued by the Fronting Lender for the account of Borrower or a Guarantor of Payment, including amendments thereto, if any, and shall have an expiration date no later than the earlier of (a) one year after its date of issuance, or (b) thirty (30) days prior to the last day of the Commitment Period.

"Letter of Credit Commitment" shall mean the commitment of the Fronting Lender, on behalf of the Lenders, to issue Letters of Credit in an aggregate face amount of up to Twenty Million Dollars ($20,000,000).

"Letter of Credit Exposure" shall mean, at any time, the sum of (a) the aggregate undrawn amount of all issued and outstanding Letters of Credit, and (b) the aggregate of the draws made on Letters of Credit that have not been reimbursed by Borrower or converted to a Revolving Loan pursuant to Section 2.2(b)(iv) hereof.

"Leverage Ratio" shall mean, as determined on a Consolidated basis and in accordance with GAAP, the ratio of (a) the sum of (i) Consolidated Funded Indebtedness (as of the last day of the most recently completed fiscal quarter of Borrower), plus (ii) six times the Consolidated Rent Expense (for the most recently completed four fiscal quarters of Borrower), to (b) Consolidated EBITDAR (for the most recently completed four fiscal quarters of Borrower); provided, however, that (A) with respect to any Acquisition, Borrower shall make pro forma adjustments in the calculation of the Leverage Ratio using the historical financial information of the acquired entity for the relevant periods, and (B) with respect to any Disposition, Borrower shall make pro forma adjustments in the calculation of the Leverage Ratio using the historical financial information of the disposed entity; but, in each case of (A) or (B), only so long as Borrower shall have provided to Agent and the Lenders sufficient written evidence to support such pro forma adjustments, in form and substance satisfactory to Agent.

"Lien" shall mean any mortgage, deed of trust, security interest, lien (statutory or other), charge, assignment, hypothecation, encumbrance on, pledge or deposit of, or conditional sale, leasing (other than operating leases), sale with a right of redemption or other title retention agreement and the vendor-lessor's interest under any capitalized lease with respect to any property (real or personal) or asset.

"Loan" shall mean a Revolving Loan or a Swing Loan granted to Borrower by the Lenders in accordance with Section 2.2(a) or (c) hereof.

"Loan Documents" shall mean, collectively, this Agreement, each Note, each Guaranty of Payment, all documentation relating to each Letter of Credit, each Springing Security Document, the Agent Fee Letter and the Closing Fee Letter, as any of the foregoing may from time to time be amended, restated or otherwise modified or replaced, and any other document delivered pursuant thereto.

"Material Adverse Effect" shall mean a material adverse effect on (a) the business, operations, property, condition (financial or otherwise) or prospects of Borrower, (b) the business, operations, property, condition (financial or otherwise) or prospects of the Companies taken as a whole, (c) the ability of any Credit Party to perform its obligations under any Loan Document, or (d) the validity or enforceability of this Agreement or any of the other Loan Documents or the ability to judicially enforce payment of the principal of or interest on any Loan or any guaranty thereof or security therefor, or any other material rights or remedies of Agent or the Lenders hereunder or thereunder.

"Material Indebtedness Agreement" shall mean any debt instrument, lease (capital, operating or otherwise), guaranty, contract, commitment, agreement or other arrangement evidencing any Indebtedness of any Company or the Companies in excess of the amount of Five Million Dollars ($5,000,000).

"Maximum Amount" shall mean, for each Lender, the amount set forth opposite such Lender's name under the column headed "Maximum Amount" as set forth on Schedule 1 hereto, subject to decreases determined pursuant to Section 2.9 hereof and assignments of interests pursuant to Section 10.10 hereof; provided, however, that the Maximum Amount for the Swing Line Lender shall exclude the Swing Line Commitment (other than its pro rata share), and the Maximum Amount of the Fronting Lender shall exclude the Letter of Credit Commitment (other than its pro rata share).

"Maximum Rate" shall mean that term as defined in Section 2.3(d) hereof.

"Multiemployer Plan" shall mean a Pension Plan that is subject to the requirements of Subtitle E of Title IV of ERISA.

"Non-Credit Party Exposure" shall mean the aggregate amount, incurred on or after the Closing Date, of loans by a Credit Party to, investments by a Credit Party in, guaranties by a Credit Party of Indebtedness of, and Letters of Credit issued to or for the benefit of, a Foreign Subsidiary.

"Note" shall mean a Revolving Credit Note or the Swing Line Note, or any other promissory note delivered pursuant to this Agreement.

"Notice of Loan" shall mean a Notice of Loan in the form of the attached Exhibit C.

"Obligations" shall mean, collectively, (a) all Indebtedness and other obligations incurred by Borrower to Agent, the Fronting Lender, the Swing Line Lender, or any Lender pursuant to this Agreement and the other Loan Documents, and includes the principal of and interest on all Loans and all obligations pursuant to Letters of Credit, (b) each extension, renewal or refinancing of the foregoing, in whole or in part, (c) the facility and other fees and any prepayment fees payable hereunder, (d) all fees and charges in connection with Letters of Credit, and (e) all Related Expenses.

"Organizational Documents" shall mean, with respect to any Person (other than an individual), such Person's Articles (Certificate) of Incorporation, operating agreement or equivalent formation documents, and Regulations (Bylaws), or equivalent governing documents, and any amendments to any of the foregoing.

"Other Taxes" shall mean any and all present or future stamp or documentary taxes or any other excise, ad valorem or property taxes, goods and services taxes, harmonized sales taxes and other sales taxes, use taxes, value added taxes, charges or similar taxes or levies arising from any payment made hereunder or from the execution, delivery or enforcement of, or otherwise with respect to, this Agreement or any other Loan Document.

"Participant" shall mean that term as defined in Section 10.11 hereof.

"Patriot Act" shall mean Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, USA Patriot Act, Title III of Pub. L. 107-56, signed into law October 26, 2001, as amended from time to time.

"PBGC" shall mean the Pension Benefit Guaranty Corporation, or its successor.

"Pension Plan" shall mean an ERISA Plan that is a "pension plan" (within the meaning of ERISA Section 3(2)).

"Permitted Foreign Subsidiary Loans and Investments" shall mean:

(a) the investments by Borrower or a Domestic Subsidiary in a Foreign Subsidiary, existing as of the Closing Date and set forth on Schedule 5.11 hereto;

(b) the loans by Borrower or a Domestic Subsidiary to a Foreign Subsidiary, in such amounts existing as of the Closing Date and set forth on Schedule 5.11 hereto;

(c) any investment by a Foreign Subsidiary in, or loan from a Foreign Subsidiary to, or guaranty from a Foreign Subsidiary of Indebtedness of, a Company;

(d) any obligations among Borrower and its Subsidiaries, or any thereof, for sales of inventory (as that term is defined in the Uniform Commercial Code, as in effect from time to time in Ohio) in the ordinary course of business; and

(e) any Non-Credit Party Exposure (exclusive of the amounts permitted under subparts (a), (b), (c) and (d) hereof) with respect to a Foreign Subsidiary, not otherwise permitted under this definition, up to the aggregate amount of Five Hundred Thousand Dollars ($500,000) for such Foreign Subsidiary so long as the Non-Credit Party Exposure to all Foreign Subsidiaries incurred pursuant to this subpart (d) does not exceed the aggregate amount of One Million Dollars ($1,000,000) at any time outstanding.

"Permitted Investment" shall mean an investment of a Company in the stock (or other debt or equity instruments) of a Person (other than a Company), so long as (a) the Company making the investment is a Credit Party; and (b) the aggregate amount of all such investments of all Companies does not exceed, at any time, an aggregate amount of Five Million Dollars ($5,000,000).

"Person" shall mean any individual, sole proprietorship, partnership, joint venture, unincorporated organization, corporation, limited liability company, unlimited liability company, institution, trust, estate, government or other agency or political subdivision thereof or any other entity.

"Pledge Agreement" shall mean each of the Pledge Agreements, substantially in the form of the attached Exhibit I, relating to the Pledged Securities, executed and delivered to Agent, for the benefit of the Lenders, by Borrower or a Guarantor of Payment, as applicable, dated as of the Closing Date, and any other such Pledge Agreement executed by any other Subsidiary on or after the Closing Date, as any of the foregoing may from time to time be amended, restated or otherwise modified or replaced.

"Pledged Securities" shall mean all of the shares of capital stock or other equity interest of a Subsidiary of Borrower (other than Foreign Subsidiaries of Dashamerica, Inc.), whether now owned or hereafter acquired or created, and all proceeds thereof; provided, however, that Pledged Securities (a) shall only include up to sixty-five percent (65%) of the shares of capital stock or other equity interest of any first-tier Foreign Subsidiary, and (b) shall not include the shares of capital stock or other equity interests of any lower-tier Foreign Subsidiary. Schedule 3 hereto lists, as of the Closing Date, all of the Pledged Securities.

"Prime Rate" shall mean the interest rate established from time to time by Agent as Agent's prime rate, whether or not such rate shall be publicly announced; the Prime Rate may not be the lowest interest rate charged by Agent for commercial or other extensions of credit. Each change in the Prime Rate shall be effective immediately from and after such change.

"Register" shall mean that term as described in Section 10.10(i) hereof.

"Regularly Scheduled Payment Date" shall mean the last day of each March, June, September and December of each year.

"Related Business" shall mean the development, manufacture, purchase and resale of, or provision of goods or services related to, fitness, nutrition or apparel, and related activities.

"Related Expenses" shall mean all reasonable costs, liabilities and expenses (including, without limitation, losses, damages, penalties, claims, actions, attorneys' fees, legal expenses, judgments, suits and disbursements) (a) incurred by Agent, or imposed upon or asserted against Agent or any Lender in any attempt by Agent and the Lenders to (i) obtain, preserve, perfect or enforce any Loan Document or any security interest evidenced by any Loan Document; (ii) obtain payment, performance or observance of any and all of the Obligations; or (iii) maintain, insure, audit, collect, preserve, repossess or dispose of any of the collateral securing the Obligations or any part thereof, including, without limitation, costs and expenses for appraisals, assessments and audits of any Company or any such collateral; or (b) incidental or related to (a) above, including, without limitation, interest thereupon from the date incurred, imposed or asserted until paid at the Default Rate.

"Related Writing" shall mean each Loan Document and any other assignment, mortgage, security agreement, guaranty agreement, subordination agreement, financial statement, audit report or other writing furnished by any Credit Party, or any of its officers, to Agent or the Lenders pursuant to or otherwise in connection with this Agreement.

"Reportable Event" shall mean any of the events described in Section 4043 of ERISA except where notice is waived by the PBGC.

"Required Lenders" shall mean the holders of at least fifty-one percent (51%) of the Total Commitment Amount, or, if there is any borrowing hereunder, the holders of at least fifty-one percent (51%) of the aggregate amount of the Revolving Credit Exposure (excluding the Swing Line Exposure); provided that, if there shall be two or more Lenders, Required Lenders shall constitute at least two Lenders.

"Requirement of Law" shall mean, as to any Person, any law, treaty, rule or regulation or determination or policy statement or interpretation of an arbitrator or a court or other Governmental Authority, in each case applicable to or binding upon such Person or any of its property.

"Reserve Percentage" shall mean for any day that percentage (expressed as a decimal) that is in effect on such day, as prescribed by the Board of Governors of the Federal Reserve System (or any successor) for determining the maximum reserve requirement (including, without limitation, all basic, supplemental, marginal and other reserves and taking into account any transitional adjustments or other scheduled changes in reserve requirements) for a member bank of the Federal Reserve System in Cleveland, Ohio, in respect of Eurocurrency Liabilities. The Eurodollar Rate shall be adjusted automatically on and as of the effective date of any change in the Reserve Percentage.

"Responsible Officer" shall mean a chief executive officer or chief financial officer of a Company.

"Restricted Payment" shall mean, with respect to any Company, any amount paid by such Company in repayment, redemption, retirement or repurchase, directly or indirectly, of any Subordinated Indebtedness.

"Revolving Credit Commitment" shall mean the obligation hereunder, during the Commitment Period, of (a) each Lender to make Revolving Loans up to the Maximum Amount for such Lender, (b) the Fronting Lender to issue and each Lender to participate in Letters of Credit pursuant to the Letter of Credit Commitment, and (c) the Swing Line Lender to make and each Lender to participate in Swing Loans pursuant to the Swing Line Commitment.

"Revolving Credit Exposure" shall mean, at any time, the sum of (a) the aggregate principal amount of all Revolving Loans outstanding, (b) the Swing Line Exposure, and (c) the Letter of Credit Exposure.

"Revolving Credit Note" shall mean a Revolving Credit Note executed and delivered pursuant to Section 2.4(a) hereof.

"Revolving Loan" shall mean a Loan granted to Borrower by the Lenders in accordance with Section 2.2(a) hereof.

"SEC" shall mean the United States Securities and Exchange Commission, or any governmental body or agency succeeding to any of its principal functions.

"Secured Obligations" shall mean, collectively, (a) the Obligations, and (b) all obligations and liabilities of the Companies owing to Lenders under Hedge Agreements.

"Securities Account Control Agreement" shall mean each Securities Account Control Agreement among a Credit Party, Agent and a broker, substantially in the form of the attached Exhibit K, executed and delivered to Agent, for the benefit of the Lenders on or after the Closing Date, as the same may from time to time be amended, restated or otherwise modified or replaced.

"Security Agreement" shall mean each Security Agreement, substantially in the form of the attached Exhibit G, executed and delivered by Borrower and each Guarantor of Payment in favor of Agent, for the benefit of the Lenders, dated as of the Closing Date, and any other such Security Agreement executed on or after the Closing Date, for the benefit of the Lenders, as the same may from time to time be amended, restated or otherwise modified or replaced.

"Springing Security Documents" shall mean each Security Agreement, each Pledge Agreement, each Control Agreement, each Landlord's Waiver and any other document pursuant to which any Lien is granted by a Company to Agent, for the benefit of the Lenders, as security for the Secured Obligations, or any part thereof, and each other agreement executed in connection with any of the foregoing, as any of the foregoing may from time to time be amended, restated or otherwise modified or replaced.

"Subordinated" shall mean, as applied to Indebtedness, Indebtedness that shall have been subordinated (by written terms or written agreement being, in either case, in form and substance satisfactory to Agent and the Required Lenders) in favor of the prior payment in full of the Obligations.

"Subsidiary" shall mean (a) a corporation more than fifty percent (50%) of the Voting Power of which is owned, directly or indirectly, by Borrower or by one or more other subsidiaries of Borrower or by Borrower and one or more subsidiaries of Borrower, (b) a partnership, limited liability company or unlimited liability company of which Borrower, one or more other subsidiaries of Borrower or Borrower and one or more subsidiaries of Borrower, directly or indirectly, is a general partner or managing member, as the case may be, or otherwise has an ownership interest greater than fifty percent (50%) of all of the ownership interests in such partnership, limited liability company or unlimited liability company, or (c) any other Person (other than a corporation, partnership, limited liability company or unlimited liability company) in which Borrower, one or more other subsidiaries of Borrower and one or more subsidiaries of Borrower, directly or indirectly, has at least a majority interest in the Voting Power or the power to elect or direct the election of a majority of directors or other governing body of such Person.

"Swing Line Commitment" shall mean the commitment of the Swing Line Lender to make Swing Loans to Borrower up to the aggregate amount at any time outstanding of Ten Million Dollars ($10,000,000).

"Swing Line Exposure" shall mean, at any time, the aggregate principal amount of all Swing Loans outstanding.

"Swing Line Lender" shall mean KeyBank National Association, as holder of the Swing Line Commitment.

"Swing Line Note" shall mean the Swing Line Note executed and delivered pursuant to Section 2.4(b) hereof.

"Swing Loan" shall mean a loan granted to Borrower by the Swing Line Lender under the Swing Line Commitment, in accordance with Section 2.2(c) hereof.

"Swing Loan Maturity Date" shall mean, with respect to any Swing Loan, the earlier of (a) fifteen (15) days after the date such Swing Loan is made, or (b) the last day of the Commitment Period.

"Syndication Agent" shall mean that term as defined in the first paragraph hereof.

"Taxes" shall mean any and all present or future taxes of any kind, including but not limited to, levies, imposts, duties, surtaxes, charges, fees, deductions or withholdings now or hereafter imposed, levied, collected, withheld or assessed by any Governmental Authority (together with any interest, penalties, fines, additions to taxes or similar liabilities with respect thereto) other than Excluded Taxes.

"Total Commitment Amount" shall mean Sixty-Five Million Dollars ($65,000,000).

"Triggering Event Date" shall mean the earlier of (a) the first date that the Leverage Ratio is equal to or greater than 2.00 to 1.00, or (b) the date that an Event of Default occurs.

"U.C.C. Financing Statement" shall mean a financing statement filed or to be filed in accordance with the Uniform Commercial Code, as in effect from time to time, in the relevant state or states.

"Voting Power" shall mean, with respect to any Person, the exclusive ability to control, through the ownership of shares of capital stock, partnership interests, membership interests or otherwise, the election of members of the board of directors or other similar governing body of such Person. The holding of a designated percentage of Voting Power of a Person means the ownership of shares of capital stock, partnership interests, membership interests or other interests of such Person sufficient to control exclusively the election of that percentage of the members of the board of directors or similar governing body of such Person.

"Welfare Plan" shall mean an ERISA Plan that is a "welfare plan" within the meaning of ERISA Section 3(l).

Section 1.2. Accounting Terms. Any accounting term not specifically defined in this Article I shall have the meaning ascribed thereto by GAAP.

Section 1.3. Terms Generally. The foregoing definitions shall be applicable to the singular and plurals of the foregoing defined terms.

ARTICLE II. AMOUNT AND TERMS OF CREDIT

Section 2.1. Amount and Nature of Credit.

(a) Subject to the terms and conditions of this Agreement, the Lenders, during the Commitment Period and to the extent hereinafter provided, shall make Loans to Borrower, participate in Swing Loans made by the Swing Line Lender to Borrower, and issue or participate in Letters of Credit at the request of Borrower, in such aggregate amount as Borrower shall request pursuant to the Commitment; provided, however, that in no event shall the Revolving Credit Exposure be in excess of the Total Commitment Amount.

(b) Each Lender, for itself and not one for any other, agrees to make Loans, participate in Swing Loans, and issue or participate in Letters of Credit, during the Commitment Period, on such basis that, immediately after the completion of any borrowing by Borrower or the issuance of a Letter of Credit:

(i) the aggregate outstanding principal amount of Loans made by such Lender (other than Swing Loans made by the Swing Line Lender), when combined with such Lender's pro rata share, if any, of the Letter of Credit Exposure and the Swing Line Exposure, shall not be in excess of the Maximum Amount for such Lender; and

(ii) the aggregate outstanding principal amount of Loans (other than Swing Loans) made by such Lender shall represent that percentage of the aggregate principal amount then outstanding on all Loans (other than Swing Loans) that shall be such Lender's Commitment Percentage.

Each borrowing (other than Swing Loans which shall be risk participated on a pro rata basis) from the Lenders shall be made pro rata according to the respective Commitment Percentages of the Lenders.

(c) The Loans may be made as Revolving Loans as described in Section 2.2(a) hereof and as Swing Loans as described in Section 2.2(c) hereof, and Letters of Credit may be issued in accordance with Section 2.2(b) hereof.

Section 2.2. Revolving Credit.

(a) Revolving Loans. Subject to the terms and conditions of this Agreement, during the Commitment Period, the Lenders shall make a Revolving Loan or Revolving Loans to Borrower in such amount or amounts as Borrower may from time to time request, but not exceeding in aggregate principal amount at any time outstanding hereunder the Total Commitment Amount, when such Revolving Loans are combined with the Letter of Credit Exposure and the Swing Line Exposure. Borrower shall have the option, subject to the terms and conditions set forth herein, to borrow Revolving Loans, maturing on the last day of the Commitment Period, by means of any combination of Base Rate Loans or Eurodollar Loans. Subject to the provisions of this Agreement, Borrower shall be entitled under this Section 2.2(a) to borrow funds, repay the same in whole or in part and re-borrow hereunder at any time and from time to time during the Commitment Period.

(b) Letters of Credit.

(i) Generally. Subject to the terms and conditions of this Agreement, during the Commitment Period, the Fronting Lender shall, in its own name, on behalf of the Lenders, issue such Letters of Credit for the account of a Credit Party, as Borrower may from time to time request. Borrower shall not request any Letter of Credit (and the Fronting Lender shall not be obligated to issue any Letter of Credit) if, after giving effect thereto, (A) the Letter of Credit Exposure would exceed the Letter of Credit Commitment or (B) the Revolving Credit Exposure would exceed the Total Commitment Amount. The issuance of each Letter of Credit shall confer upon each Lender the benefits and liabilities of a participation consisting of an undivided pro rata interest in the Letter of Credit to the extent of such Lender's Commitment Percentage.

(ii) Request for Letter of Credit. Each request for a Letter of Credit shall be delivered to Agent (and to the Fronting Lender, if the Fronting Lender is a Lender other than Agent) by an Authorized Officer not later than 10:00 A.M. (Pacific time) three

Business Days prior to the day upon which the Letter of Credit is to be issued. Each such request shall be in a form acceptable to Agent (and the Fronting Lender, if the Fronting Lender is a Lender other than Agent) and shall specify the face amount thereof, the account party, the beneficiary, the intended date of issuance, the expiry date thereof, and the nature of the transaction to be supported thereby. Concurrently with each such request, Borrower, and any Guarantor of Payment for whose account the Letter of Credit is to be issued, shall execute and deliver to the Fronting Lender an appropriate application and agreement, being in the standard form of the Fronting Lender for such letters of credit, as amended to conform to the provisions of this Agreement if required by Agent. Agent shall give the Fronting Lender and each Lender notice of each such request for a Letter of Credit.

(iii) Standby Letters of Credit. With respect to each Letter of Credit and the drafts thereunder, if any, whether issued for the account of Borrower or any other Credit Party, Borrower agrees to (A) pay to Agent, for the pro rata benefit of the Lenders, a non-refundable commission based upon the face amount of such Letter of Credit, which shall be paid quarterly in arrears, on each Regularly Scheduled Payment Date, at the rate of the Applicable Margin for Eurodollar Loans (in effect on the Regularly Scheduled Payment Date) multiplied by the face amount of such Letter of Credit; (B) pay to Agent, for the sole benefit of the Fronting Lender that is issuing or has issued such Letter of Credit, an additional Letter of Credit fee, which shall be paid on each date that such Letter of Credit shall be issued, amended or renewed at the rate of one-eighth percent (1/8%) of the face amount of such Letter of Credit; and (C) pay to Agent, for the sole benefit of the Fronting Lender that is issuing or has issued such Letter of Credit, such other issuance, amendment, negotiation, draw, acceptance, telex, courier, postage and similar transactional fees as are generally charged by the Fronting Lender of such Letter of Credit under its fee schedule as in effect from time to time.

(iv) Refunding of Letters of Credit with Revolving Loans. Whenever a Letter of Credit shall be drawn, Borrower shall immediately reimburse Agent for the amount drawn. Agent will forward such payment to the Fronting Lender on the Letter of Credit that was drawn. In the event that the amount drawn shall not have been reimbursed to Agent by Borrower on the date of the drawing of such Letter of Credit, Borrower shall be deemed to have requested a Revolving Loan, subject to the provisions of Sections 2.2(a) and 2.5 hereof, in the amount drawn. Such Revolving Loan shall be evidenced by the Revolving Credit Notes (or, if a Lender has not requested a Revolving Credit Note, by the records of Agent and such Lender). Each Lender agrees to make a Revolving Loan on the date of such notice, subject to no conditions precedent whatsoever. Each Lender acknowledges and agrees that its obligation to make a Revolving Loan pursuant to Section 2.2(a) hereof when required by this Section 2.2(b)(iv) shall be absolute and unconditional and shall not be affected by any circumstance whatsoever, including, without limitation, the occurrence and continuance of a Default or Event of Default, and that its payment to Agent, for the account of the Fronting Lender, of the proceeds of such Revolving Loan shall be made without any offset, abatement, recoupment, counterclaim, withholding or reduction whatsoever and whether or not such Lender’s Revolving Credit Commitment shall have been reduced or terminated. Borrower irrevocably authorizes

and instructs Agent to apply the proceeds of any borrowing pursuant to this Section 2.2(b)(iv) to reimburse, in full (other than the Fronting Lender's pro rata share of such borrowing), the Fronting Lender for the amount drawn on such Letter of Credit. Each such Revolving Loan shall be deemed to be a Base Rate Loan unless otherwise requested by and available to Borrower hereunder. Each Lender is hereby authorized to record on its records relating to its Revolving Credit Note (or, if such Lender has not requested a Revolving Credit Note, its records relating to Revolving Loans) such Lender's pro rata share of the amounts paid and not reimbursed on the Letters of Credit.

(v) Participation in Letters of Credit. If, for any reason, Agent (and the Fronting Lender if the Fronting Lender is a Lender other than Agent) shall be unable to or, in the opinion of Agent, it shall be impracticable to, convert any Letter of Credit to a Revolving Loan pursuant to the preceding subsection, Agent (and the Fronting Lender if the Fronting Lender is a Lender other than Agent) shall have the right to request that each Lender purchase a participation in the amount due with respect to such Letter of Credit, and Agent shall promptly notify each Lender thereof (by facsimile or telephone, confirmed in writing). Upon such notice, but without further action, the Fronting Lender hereby agrees to grant to each Lender, and each Lender hereby agrees to acquire from the Fronting Lender, an undivided participation interest in the amount due with respect to such Letter of Credit in an amount equal to such Lender's Commitment Percentage of the principal amount due with respect to such Letter of Credit. In consideration and in furtherance of the foregoing, each Lender hereby absolutely and unconditionally agrees, upon receipt of notice as provided above, to pay to Agent, for the account of the Fronting Lender, such Lender's ratable share of the amount due with respect to such Letter of Credit (determined in accordance with such Lender's Commitment Percentage). Each Lender acknowledges and agrees that its obligation to acquire participations in the amount due under any Letter of Credit that is drawn but not reimbursed by Borrower pursuant to this subsection (v) shall be absolute and unconditional and shall not be affected by any circumstance whatsoever, including, without limitation, the occurrence and continuance of a Default or Event of Default, and that each such payment shall be made without any offset, abatement, recoupment, counterclaim, withholding or reduction whatsoever and whether or not such Lender's Revolving Credit Commitment shall have been reduced or terminated. Each Lender shall comply with its obligation under this subsection (v) by wire transfer of immediately available funds, in the same manner as provided in Section 2.5 hereof with respect to Revolving Loans. Each Lender is hereby authorized to record on its records such Lender's pro rata share of the amounts paid and not reimbursed on the Letters of Credit. In addition, each Lender agrees to risk participate in the Existing Letters of Credit as provided in subsection (vi) below.

(vi) Existing Letters of Credit. Schedule 2.2 hereto contains a description of all letters of credit issued by a Lender for the account of a Credit Party and outstanding on, and to continue in effect after, the Closing Date. Each such letter of credit issued by a bank that is or becomes a Lender under this Agreement on the Closing Date (each, an "Existing Letter of Credit") shall constitute a "Letter of Credit" for all purposes of this Agreement, issued, for purposes of Section 2.2(b) hereof, on the Closing Date. Borrower, Agent and the Lenders hereby agree that, from and after such date, the terms

of this Agreement shall apply to the Existing Letters of Credit, superseding any other agreement theretofore applicable to them to the extent inconsistent with the terms hereof (including but not limited to the fees payable under subsection (iii) above). Notwithstanding anything to the contrary in any reimbursement agreement applicable to the Existing Letters of Credit, the fees payable in connection with each Existing Letter of Credit shall accrue from the Closing Date at the rate provided in Section 2.2(b)(iii) hereof, and shall be shared with the Lenders in accordance with subsection (iii) above.

(c) Swing Loans.

(i) Generally. Subject to the terms and conditions of this Agreement, during the Commitment Period, the Swing Line Lender shall make a Swing Loan or Swing Loans to Borrower in such amount or amounts as Borrower, through an Authorized Officer, may from time to time request; provided that Borrower shall not request any Swing Loan if, after giving effect thereto, (A) the Revolving Credit Exposure would exceed the Total Commitment Amount, or (B) the Swing Line Exposure would exceed the Swing Line Commitment. Such request shall be made in accordance with Section 2.5 hereof. At the time of such request, Agent shall provide a quote for the proposed interest rate for the requested Swing Loan. Upon agreement by Borrower (which may be verbal), Agent shall make the Swing Loan. Each Swing Loan shall be due and payable on the Swing Loan Maturity Date applicable thereto. Borrower shall not request that more than two Swing Loans be outstanding at any time.

(ii) Refunding of Swing Loans. If the Swing Line Lender so elects, by giving notice to Borrower and the Lenders, Borrower agrees that the Swing Line Lender shall have the right, in its sole discretion, to require that any Swing Loan be refinanced as a Revolving Loan. Such Revolving Loan shall be a Base Rate Loan unless otherwise requested by and available to Borrower hereunder. Upon receipt of such notice by Borrower and the Lenders, Borrower shall be deemed, on such day, to have requested a Revolving Loan in the principal amount of the Swing Loan in accordance with Sections 2.2(a) and 2.5 hereof (other than the requirement set forth in Section 2.5(d) hereof). Such Revolving Loan shall be evidenced by the Revolving Credit Notes (or, if a Lender has not requested a Revolving Credit Note, by the records of Agent and such Lender). Each Lender agrees to make a Revolving Loan on the date of such notice, subject to no conditions precedent whatsoever. Each Lender acknowledges and agrees that such Lender's obligation to make a Revolving Loan pursuant to Section 2.2(a) hereof when required by this Section 2.2(c)(ii) is absolute and unconditional and shall not be affected by any circumstance whatsoever, including, without limitation, the occurrence and continuance of a Default or Event of Default, and that its payment to Agent, for the account of the Swing Line Lender, of the proceeds of such Revolving Loan shall be made without any offset, abatement, recoupment, counterclaim, withholding or reduction whatsoever and whether or not such Lender's Revolving Credit Commitment shall have been reduced or terminated. Borrower irrevocably authorizes and instructs Agent to apply the proceeds of any borrowing pursuant to this Section 2.2(c)(ii) to repay in full such Swing Loan. Each Lender is hereby authorized to record on its records relating to its Revolving Credit Note (or, if such Lender has not requested a Revolving Credit Note, its records relating to Revolving Loans) such Lender's pro rata share of the amounts paid to refund such Swing Loan.

(iii) Participation in Swing Loans. If, for any reason, Agent is unable to or, in the opinion of Agent, it is impracticable to, convert any Swing Loan to a Revolving Loan pursuant to the preceding Section 2.2(c)(ii), then on any day that a Swing Loan is outstanding (whether before or after the maturity thereof), Agent shall have the right to request that each Lender purchase a participation in such Swing Loan, and Agent shall promptly notify each Lender thereof (by facsimile or telephone, confirmed in writing). Upon such notice, but without further action, the Swing Line Lender hereby agrees to grant to each Lender, and each Lender hereby agrees to acquire from the Swing Line Lender, an undivided participation interest in such Swing Loan in an amount equal to such Lender's Commitment Percentage of the principal amount of such Swing Loan. In consideration and in furtherance of the foregoing, each Lender hereby absolutely and unconditionally agrees, upon receipt of notice as provided above, to pay to Agent, for the benefit of the Swing Line Lender, such Lender's ratable share of such Swing Loan (determined in accordance with such Lender's Commitment Percentage). Each Lender acknowledges and agrees that its obligation to acquire participations in Swing Loans pursuant to this Section 2.2(c)(iii) is absolute and unconditional and shall not be affected by any circumstance whatsoever, including, without limitation, the occurrence and continuance of a Default or an Event of Default, and that each such payment shall be made without any offset, abatement, recoupment, counterclaim, withholding or reduction whatsoever and whether or not such Lender's Revolving Credit Commitment shall have been reduced or terminated. Each Lender shall comply with its obligation under this Section 2.2(c)(iii) by wire transfer of immediately available funds, in the same manner as provided in Section 2.5 hereof with respect to Revolving Loans to be made by such Lender.

Section 2.3. Interest.

(a) Revolving Loans.

(i) Base Rate Loan. Borrower shall pay interest on the unpaid principal amount of a Base Rate Loan outstanding from time to time from the date thereof until paid at the Derived Base Rate from time to time in effect. Interest on such Base Rate Loan shall be payable, commencing December 31, 2005, and on each Regularly Scheduled Payment Date thereafter and at the maturity thereof.

(ii) Eurodollar Loans. Borrower shall pay interest on the unpaid principal amount of each Eurodollar Loan outstanding from time to time, fixed in advance on the first day of the Interest Period applicable thereto through the last day of the Interest Period applicable thereto (but subject to changes in the Applicable Margin for Eurodollar Loans), at the Derived Eurodollar Rate. Interest on such Eurodollar Loan shall be payable on each Interest Adjustment Date with respect to an Interest Period (provided that if an Interest Period shall exceed three months, the interest must be paid every three months, commencing three months from the beginning of such Interest Period).

(b) Swing Loans. Borrower shall pay interest to Agent, for the sole benefit of the Swing Line Lender (and any Lender that shall have purchased a participation in such Swing Loan), on the unpaid principal amount of each Swing Loan outstanding from time to time from the date thereof until paid at a fixed rate equal to the Derived Swing Loan Rate applicable to such Swing Loan. Interest on each Swing Loan shall be payable on the Swing Loan Maturity Date applicable thereto. Each Swing Loan shall bear interest for a minimum of one day.

(c) Default Rate. Anything herein to the contrary notwithstanding, if an Event of Default shall occur, (i) the principal of each Loan and the unpaid interest thereon shall bear interest, until paid, at the Default Rate, (ii) the fee for the aggregate undrawn amount of all issued and outstanding Letters of Credit shall be increased by two percent (2%) in excess of the rate otherwise applicable thereto, and (iii) in the case of any other amount not paid when due from Borrower hereunder or under any other Loan Document, such amount shall bear interest at the Default Rate.

(d) Limitation on 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 (the "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 Loans or, if it exceeds such unpaid principal, refunded to Borrower. 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, (i) characterize any payment that is not principal as an expense, fee, or premium rather than interest, (ii) exclude voluntary prepayments and the effects thereof, and (iii) amortize, prorate, allocate, and spread in equal or unequal parts the total amount of interest throughout the contemplated term of the Obligations.

Section 2.4. Evidence of Indebtedness.

(a) Revolving Loans. Upon request of a Lender, to evidence the obligation of Borrower to repay the Revolving Loans made by such Lender and to pay interest thereon, Borrower shall execute a Revolving Credit Note in the form of the attached Exhibit A, payable to the order of such Lender in the principal amount of its Revolving Credit Commitment, or, if less, the aggregate unpaid principal amount of Revolving Loans made by such Lender; provided, however, that failure of a Lender to request a Revolving Credit Note shall in no way detract from Borrower's obligations to such Lender hereunder.

(b) Swing Loan. Upon request of the Swing Line Lender, to evidence the obligation of Borrower to repay the Swing Loans and to pay interest thereon, Borrower shall execute a Swing Line Note in the form of the attached Exhibit B, and payable to the order of the Swing Line Lender in the principal amount of the Swing Line Commitment, or, if less, the aggregate unpaid principal amount of Swing Loans made by the Swing Line Lender; provided, however, that failure of the Swing Line Lender to request a Swing Line Note shall in no way detract from Borrower's obligations to the Swing Line Lender hereunder.

Section 2.5. Notice of Credit Event; Funding of Loans.

(a) Notice of Credit Event. Borrower, through an Authorized Officer, shall provide to Agent a Notice of Loan prior to (i) 10:00 A.M. (Pacific time) on the proposed date of borrowing or conversion of any Base Rate Loan, (ii) 10:00 A.M. (Pacific time) three Business Days prior to the proposed date of borrowing, conversion or continuation of any Eurodollar Loan, and (iii) 11:00 A.M. (Pacific time) on the proposed date of borrowing of any Swing Loan. Borrower shall comply with the notice provisions set forth in Section 2.2(b)(ii) hereof with respect to Letters of Credit.

(b) Funding of Loans. Agent shall notify each Lender of the date, amount and Interest Period (if applicable) promptly upon the receipt of a Notice of Loan, and, in any event, by 1:00 P.M. (Pacific time) on the date such Notice of Loan is received. On the date that the Credit Event set forth in such Notice of Loan is to occur, each such Lender shall provide to Agent, not later than 2:00 P.M. (Pacific time), the amount in Dollars, in federal or other immediately available funds, required of it. If Agent shall elect to advance the proceeds of such Loan prior to receiving funds from such Lender, Agent shall have the right, upon prior notice to Borrower, to debit any account of Borrower or otherwise receive such amount from Borrower, on demand, in the event that such Lender shall fail to reimburse Agent in accordance with this subsection. Agent shall also have the right to receive interest from such Lender at the Federal Funds Effective Rate in the event that such Lender shall fail to provide its portion of the Loan on the date requested and Agent shall elect to provide such funds.

(c) Conversion of Loans. At the request of Borrower to Agent, subject to the notice and other provisions of this Section 2.5, the Lenders shall convert a Base Rate Loan to one or more Eurodollar Loans at any time and shall convert a Eurodollar Loan to a Base Rate Loan on any Interest Adjustment Date applicable thereto. Swing Loans may be converted by the Swing Line Lender to Revolving Loans in accordance with Section 2.2(c)(ii) hereof.

(d) Minimum Amount. Each request for:

(i) a Base Rate Loan shall be in an amount of not less than One Million Dollars ($1,000,000), increased by increments of Five Hundred Thousand Dollars ($500,000);

(ii) a Eurodollar Loan shall be in an amount of not less than Five Million Dollars ($5,000,000), increased by increments of One Million Dollars ($1,000,000); and

(iii) a Swing Loan shall be in an amount of not less than Five Hundred Thousand Dollars ($500,000).

(e) Interest Periods. Borrower shall not request that Eurodollar Loans be outstanding for more than eight different Interest Periods at the same time.

Section 2.6. Payment on Loans and Other Obligations.

(a) Payments Generally. Each payment made hereunder by a Credit Party shall be made without any offset, abatement, recoupment, counterclaim, withholding or reduction whatsoever.

(b) Payments from Borrower. All payments (including prepayments) to Agent of the principal of or interest on each Loan or other payment, including but not limited to principal, interest, fees or any other amount owed by Borrower under this Agreement, shall be made in Dollars. All payments described in this subsection (b) shall be remitted to Agent, at the address of Agent for notices referred to in Section 10.4 hereof for the account of the Lenders (or the Fronting Lender or the Swing Line Lender, as appropriate) not later than 10:00 A.M. (Pacific time) on the due date thereof in immediately available funds. Any such payments received by Agent after 10:00 A.M. (Pacific time) shall be deemed to have been made and received on the next Business Day.

(c) Payments to Lenders. Upon Agent's receipt of payments hereunder, Agent shall immediately distribute to each Lender its ratable shares, if any, of the amount of principal, interest, and facility and other fees received by Agent for the account of such Lender. Payments received by Agent shall be delivered to the Lenders in Dollars in immediately available funds. As among Borrower and the Lenders, immediately available funds received by Agent that Agent is to distribute to the Lenders shall be deemed received by the appropriate Lenders on receipt of such funds by Agent. Each Lender shall record any principal, interest or other payment, the principal amounts of Base Rate Loans, Eurodollar Loans, Swing Loans and Letters of Credit, all prepayments and the applicable dates, including Interest Periods, with respect to the Loans made, and payments received by such Lender, by such method as such Lender may generally employ; provided, however, that failure to make any such entry shall in no way detract from the obligations of Borrower under this Agreement or any Note. The aggregate unpaid amount of Loans, types of Loans, Interest Periods and similar information with respect to the Loans and Letters of Credit set forth on the records of Agent shall be rebuttably presumptive evidence with respect to such information, including the amounts of principal, interest and fees owing to each Lender.

(d) Timing of Payments. Whenever any payment to be made hereunder, including, without limitation, any payment to be made on any Loan, shall be stated to be due on a day that is not a Business Day, such payment shall be made on the next Business Day and such extension of time shall in each case be included in the computation of the interest payable on such Loan; provided, however, that, with respect to a Eurodollar Loan, if the next Business Day shall fall in the succeeding calendar month, such payment shall be made on the preceding Business Day and the relevant Interest Period shall be adjusted accordingly.

Section 2.7. Prepayment.

(a) Right to Prepay. Borrower shall have the right at any time or from time to time to prepay, on a pro rata basis for all of the Lenders (except with respect to Swing Loans that have not been funded by the other Lenders, which shall be paid to the Swing Line Lender), all or any part of the principal amount of the Loans, as designated by Borrower. Such payment shall include interest accrued on the amount so prepaid to the date of such prepayment and any

amount payable under Article III hereof with respect to the amount being prepaid. Prepayments of Base Rate Loans shall be without any premium or penalty, other than any prepayment fees, penalties or other charges that may be contained in any Hedge Agreement.

(b) Notice of Prepayment. Borrower shall give Agent notice of prepayment of a Base Rate Loan or Swing Loan by no later than 10:00 A.M. (Pacific time) on the Business Day such prepayment is to be made and written notice of the prepayment of any Eurodollar Loan not later than 11:00 A.M. (Pacific time) three Business Days before the Business Day on which such prepayment is to be made.

(c) Minimum Amount. Each prepayment of a Eurodollar Loan shall be in the principal amount of not less than the lesser of the entire outstanding principal balance thereof or Five Million Dollars ($5,000,000), or, with respect to a Swing Loan, the principal balance of such Swing Loan, except in the case of a mandatory payment pursuant to Section 2.11 or Article III hereof.

Section 2.8. Facility and Other Fees; Reduction of Commitment.

(a) Facility Fee. Borrower shall pay to Agent, for the ratable account of the Lenders, as a consideration for the Commitment, a facility fee from the Closing Date to and including the last day of the Commitment Period, payable quarterly, at a rate per annum equal to (i) the Applicable Facility Fee Rate in effect on the payment date, multiplied by (ii) the average daily Total Commitment Amount in effect during such quarter. The facility fee shall be payable in arrears, on December 31, 2005 and continuing on each Regularly Scheduled Payment Date thereafter, and on the last day of the Commitment Period.

(b) Agent Fee. Borrower shall pay to Agent, for its sole benefit, the fees set forth in the Agent Fee Letter.

Section 2.9. Reduction of Commitment. Borrower may at any time and from time to time permanently reduce in whole or ratably in part the Total Commitment Amount to an amount not less than the then existing Revolving Credit Exposure, by giving Agent not fewer than three Business Days' (or thirty (30) days if the Commitment is to be reduced or terminated in its entirety) written notice of such reduction, provided that any such partial reduction shall be in an aggregate amount, for all of the Lenders, of not less than Ten Million Dollars ($10,000,000), increased by increments of One Million Dollars ($1,000,000). Agent shall promptly notify each Lender of the date of each such reduction and such Lender's proportionate share thereof. After each such reduction, the facility fees payable hereunder shall be calculated upon the Total Commitment Amount as so reduced. If Borrower reduces to zero the Revolving Credit Commitment, on the effective date of such reduction (Borrower having prepaid in full the unpaid principal balance, if any, of the Loans, together with all interest and facility and other fees accrued and unpaid, and provided that no Letter of Credit Exposure or Swing Line Exposure shall exist), all of the Notes shall be delivered to Agent marked "Canceled" and Agent shall redeliver such Notes to Borrower. Any partial reduction in the Total Commitment Amount shall be effective during the remainder of the Commitment Period.

Section 2.10. Computation of Interest and Fees. Interest on Loans and facility and other fees and charges hereunder shall be computed on the basis of a year having three hundred sixty (360) days and calculated for the actual number of days elapsed.

Section 2.11. Mandatory Payments.

(a) If, at any time, the Revolving Credit Exposure shall exceed the Total Commitment Amount as then in effect, Borrower shall, as promptly as practicable, but in no event later than the next Business Day, pay an aggregate principal amount of the Revolving Loans sufficient to bring the Revolving Credit Exposure within the Total Commitment Amount.

(b) If, at any time, the Swing Line Exposure shall exceed the Swing Line Commitment, Borrower shall, as promptly as practicable, but in no event later than the next Business Day, prepay an aggregate principal amount of the Swing Loans sufficient to bring the Swing Line Exposure within the Swing Line Commitment.

(c) Unless otherwise designated by Borrower, each prepayment pursuant to Section 2.11(a) hereof shall be applied in the following order (i) first, on a pro rata basis for the Lenders, to outstanding Base Rate Loans, and (ii) second, on a pro rata basis for the Lenders, to outstanding Eurodollar Loans (to Eurodollar Loans with the earliest Interest Adjustment Dates first), provided that if the outstanding principal amount of any Eurodollar Loan shall be reduced to an amount less than the minimum amount set forth in Section 2.5 hereof as a result of such prepayment, then such Eurodollar Loan shall be converted into a Base Rate Loan on the date of such prepayment. Any prepayment of a Eurodollar Loan or Swing Loan pursuant to this Section 2.11 shall be subject to the prepayment penalties set forth in Article III hereof.

Section 2.12. Springing Security Interest.

(a) Generally. On the Closing Date, Borrower and each Guarantor of Payment shall execute and deliver to Agent, for the benefit of the Lenders, the Springing Security Documents required to be delivered pursuant to Section 4.2 hereof. Agent and the Lenders acknowledge that the Springing Security Documents will be held in escrow by Agent and that any Lien granted by Borrower or a Guarantor of Payment in the Springing Security Documents shall not be effective until the Triggering Event Date.

(b) Automatic and Retroactive Effect. On the Triggering Event Date the Springing Security Documents shall be automatically released from escrow and be fully effective retroactively as of the Closing Date, without Agent or any Lender taking any action or providing notice of any kind to Borrower or any Guarantor of Payment.

(c) Perfection of Security Interests of Agent and the Lenders. At any time on or after the Triggering Event Date, Agent shall be authorized to take all such action (including, but not limited to, filing U.C.C. Financing Statements and other appropriate filings in the appropriate filing offices) that Agent, in its reasonable judgment deems advisable under the circumstances, in order to perfect the Liens granted to Agent, for the benefit of the Lenders, pursuant to the Springing Security Documents. Borrower hereby authorizes Agent to take such action and make

such filings, on behalf of itself and each Guarantor of Payment, on or after the Triggering Event Date, without providing notice of any kind to Borrower or any Guarantor of Payment. Borrower shall pay all filing and recording fees and taxes in connection with the filing or recordation of such U.C.C. Financing Statements and security interests and shall immediately reimburse Agent therefore if Agent pays the same. Such amounts shall be Related Expenses hereunder. After the Triggering Event Date, Borrower and each Guarantor of Payment agree to execute such additional security documents and take such additional action, promptly upon request of Agent, as Agent shall deem necessary or appropriate in order to create or perfect a Lien in favor of Agent, for the benefit of the Lenders, in any property of any Credit Party in which a Lien is required to be granted to Agent, for the benefit of the Lenders, pursuant to any of the Loan Documents. The provisions in this Section 2.12 shall control over the provisions of the Springing Security Documents.

ARTICLE III. ADDITIONAL PROVISIONS RELATING TO EURODOLLAR LOANS; INCREASED CAPITAL; TAXES

Section 3.1. Requirements of Law.

(a) If, after the Closing Date, (i) the adoption of or any change in any Requirement of Law or in the interpretation or application thereof or (ii) the compliance by any Lender with any request or directive (whether or not having the force of law) from any central bank or other Governmental Authority:

(A) shall subject any Lender to any tax of any kind whatsoever with respect to this Agreement, any Letter of Credit or any Eurodollar Loan made by it, or change the basis of taxation of payments to such Lender in respect thereof (except for Excluded Taxes, and for other Taxes which are governed by Section 3.2 hereof);

(B) shall impose, modify or hold applicable any reserve, special deposit, compulsory loan or similar requirement against assets held by, deposits or other liabilities in or for the account of, advances, loans or other extensions of credit by, or any other acquisition of funds by, any office of such Lender that is not otherwise included in the determination of the Eurodollar Rate; or

(C) shall impose on such Lender any other condition;

and the result of any of the foregoing is to increase the cost to such Lender of making, converting into, continuing or maintaining Eurodollar Loans or issuing or participating in Letters of Credit, or to reduce any amount receivable hereunder in respect thereof, then, in any such case, Borrower shall pay to such Lender, promptly after receipt of a written request therefor, any additional amounts necessary to compensate such Lender for such increased cost or reduced amount receivable. If any Lender becomes entitled to claim any additional amounts pursuant to this subsection (a), such Lender shall promptly notify Borrower (with a copy to Agent) of the event by reason of which it has become so entitled.

(b) If any Lender shall have determined that, after the Closing Date, the adoption of or any change in any Requirement of Law regarding capital adequacy or in the interpretation or application thereof or compliance by such Lender or any corporation controlling such Lender with any request or directive regarding capital adequacy (whether or not having the force of law) from any Governmental Authority shall have the effect of reducing the rate of return on such Lender's or such corporation's capital as a consequence of its obligations hereunder, or under or in respect of any Letter of Credit, to a level below that which such Lender or such corporation could have achieved but for such adoption, change or compliance (taking into consideration the policies of such Lender or corporation with respect to capital adequacy), then from time to time, upon submission by such Lender to Borrower (with a copy to Agent) of a written request therefor (which shall include the method for calculating such amount), Borrower shall promptly pay or cause to be paid to such Lender such additional amount or amounts as will compensate such Lender for such reduction.

(c) A certificate as to any additional amounts payable pursuant to this Section 3.1 submitted by any Lender to Borrower (with a copy to Agent) shall be conclusive absent manifest error. In determining any such additional amounts, such Lender may use any reasonable method of averaging and attribution that it shall deem applicable or appropriate. The obligations of Borrower pursuant to this Section 3.1 shall survive the termination of this Agreement and the payment of the Loans and all other amounts payable hereunder.

Section 3.2. Taxes.

(a) All payments made by any Credit Party under any Loan Document shall be made free and clear of, and without deduction or withholding for or on account of any Taxes or Other Taxes. If any Taxes or Other Taxes are required to be deducted or withheld from any amounts payable to Agent or any Lender thereunder, the amounts so payable to Agent or such Lender shall be increased to the extent necessary to yield to Agent or such Lender (after deducting, withholding and payment of all Taxes and Other Taxes) interest or any such other amounts payable hereunder at the rates or in the amounts specified in the Loan Documents.

(b) In addition, the Credit Parties shall pay Taxes and Other Taxes to the relevant Governmental Authority in accordance with applicable law.

(c) Whenever any Taxes or Other Taxes are required to be withheld and paid by a Credit Party, such Credit Party shall timely withhold and pay such taxes to the relevant Governmental Authorities. As promptly as possible thereafter, Borrower shall send to Agent for its own account or for the account of the relevant Lender, as the case may be, a certified copy of an original official receipt received by such Credit Party showing payment thereof or other evidence of payment reasonably acceptable to Agent or such Lender. If such Credit Party shall fail to pay any Taxes or Other Taxes when due to the appropriate Governmental Authority or fails to remit to Agent the required receipts or other required documentary evidence, such Credit Party and Borrower shall indemnify Agent and the appropriate Lenders on demand for any incremental taxes, interest or penalties that may become payable by Agent or such Lender as a result of any such failure.

(d) Each Lender that is not (i) a citizen or resident of the United States of America, (ii) a corporation, partnership or other entity created or organized in or under the laws of the United States of America (or any jurisdiction thereof), or (iii) an estate or trust that is subject to federal income taxation regardless of the source of its income (any such Person, a "Non-U.S. Lender") shall deliver to Borrower and Agent two copies of either U.S. Internal Revenue Service Form W-8BEN or Form W-8ECI, or, in the case of a Non-U.S. Lender claiming exemption from U.S. federal withholding tax under Section 871(h) or 881(c) of the Code with respect to payments of "portfolio interest", a statement with respect to such interest and a Form W-8BEN, or any subsequent versions thereof or successors thereto, properly completed and duly executed by such Non-U.S. Lender claiming complete exemption from, or a reduced rate of, U.S. federal withholding tax on all payments by Credit Parties under this Agreement and the other Loan Documents. Such forms shall be delivered by each Non-U.S. Lender on or before the date it becomes a party to this Agreement or such other Loan Document. In addition, each Non-U.S. Lender shall deliver such forms or appropriate replacements promptly upon the obsolescence or invalidity of any form previously delivered by such Non-U.S. Lender. Each Non-U.S. Lender shall promptly notify Borrower at any time it determines that such Lender is no longer in a position to provide any previously delivered certificate to Borrower (or any other form of certification adopted by the U.S. taxing authorities for such purpose).

(e) The agreements in this Section 3.2 shall survive the termination of the Loan Documents and the payment of the Loans and all other amounts payable hereunder.

Section 3.3. Funding Losses. Borrower agrees to indemnify each Lender, promptly after receipt of a written request therefor, and to hold each Lender harmless from, any loss or expense that such Lender may sustain or incur as a consequence of (a) default by Borrower in making a borrowing of, conversion into or continuation of Eurodollar Loans after Borrower has given a notice requesting the same in accordance with the provisions of this Agreement, (b) default by Borrower in making any prepayment of or conversion from Eurodollar Loans after Borrower has given a notice thereof in accordance with the provisions of this Agreement, (c) the making of a prepayment of a Eurodollar Loan on a day that is not the last day of an Interest Period applicable thereto, (d) the making of a prepayment of a Swing Loan on a day that is not the Swing Loan Maturity Date applicable thereto, or (e) any conversion of a Eurodollar Loan to a Base Rate Loan on a day that is not the last day of an Interest Period applicable thereto. Such indemnification shall be in an amount equal to the excess, if any, of (i) the amount of interest that would have accrued on the amounts so prepaid, or not so borrowed, converted or continued, for the period from the date of such prepayment or of such failure to borrow, convert or continue to the last day of such Interest Period (or, in the case of a failure to borrow, convert or continue, the Interest Period that would have commenced on the date of such failure) or the applicable Swing Loan Maturity Date in each case at the applicable rate of interest for such Loans provided for herein over (ii) the amount of interest (as reasonably determined by such Lender) that would have accrued to such Lender on such amount by placing such amount on deposit for a comparable period with leading banks in the appropriate London interbank market, along with any administration fee charged by such Lender. A certificate as to any amounts payable pursuant to this Section 3.3 submitted to Borrower (with a copy to Agent) by any Lender shall be conclusive absent manifest error. The obligations of Borrower pursuant to this Section 3.3 shall survive the termination of this Agreement and the payment of the Loans and all other amounts payable hereunder.

Section 3.4. Change of Lending Office. Each Lender agrees that, upon the occurrence of any event giving rise to the operation of Section 3.1 or 3.2(a) hereof with respect to such Lender, it will, if requested by Borrower, use reasonable efforts (subject to overall policy considerations of such Lender) to designate another lending office (or an affiliate of such Lender, if practical for such Lender) for any Loans affected by such event with the object of avoiding the consequences of such event; provided, that such designation is made on terms that, in the sole judgment of such Lender, cause such Lender and its lending office(s) to suffer no economic, legal or regulatory disadvantage; and provided, further, that nothing in this Section shall affect or postpone any of the obligations of Borrower or the rights of any Lender pursuant to Section 3.1 or 3.2(a) hereof.

Section 3.5. Eurodollar Rate Lending Unlawful; Inability to Determine Rate.

(a) If any Lender shall determine (which determination shall, upon notice thereof to Borrower and Agent, be conclusive and binding on Borrower) that, after the Closing Date, (i) the introduction of or any change in or in the interpretation of any law makes it unlawful, or (ii) any Governmental Authority asserts that it is unlawful, for such Lender to make or continue any Loan as, or to convert (if permitted pursuant to this Agreement) any Loan into, a Eurodollar Loan, the obligations of such Lender to make, continue or convert any such Eurodollar Loan shall, upon such determination, be suspended until such Lender shall notify Agent that the circumstances causing such suspension no longer exist, and all outstanding Eurodollar Loans payable to such Lender shall automatically convert into a Base Rate Loan at the end of the then current Interest Periods with respect thereto or sooner, if required by law or such assertion.

(b) If Agent or the Required Lenders determine that for any reason adequate and reasonable means do not exist for determining the Eurodollar Rate for any requested Interest Period with respect to a proposed Eurodollar Loan, or that the Eurodollar Rate for any requested Interest Period with respect to a proposed Eurodollar Loan does not adequately and fairly reflect the cost to the Lenders of funding such Loan, Agent will promptly so notify Borrower and each Lender. Thereafter, the obligation of the Lenders to make or maintain such Eurodollar Loan shall be suspended until Agent (upon the instruction of the Required Lenders) revokes such notice. Upon receipt of such notice, Borrower may revoke any pending request for a borrowing of, conversion to or continuation of such Eurodollar Loan or, failing that, will be deemed to have converted such request into a request for a borrowing of a Base Rate Loan in the amount specified therein.

ARTICLE IV. CONDITIONS PRECEDENT

Section 4.1. Conditions to Each Credit Event. The obligation of the Lenders, the Fronting Lender and the Swing Line Lender to participate in any Credit Event shall be conditioned, in the case of each Credit Event, upon the following:

(a) all conditions precedent as listed in Section 4.2 hereof required to be satisfied prior to the first Credit Event shall have been satisfied prior to or as of the first Credit Event;

(b) Borrower shall have submitted a Notice of Loan (or with respect to a Letter of Credit, complied with the provisions of Section 2.2(b)(ii) hereof) and otherwise complied with Section 2.5 hereof;

(c) no Default or Event of Default shall then exist or immediately after such Credit Event would exist; and

(d) each of the representations and warranties contained in Article VI hereof shall be true in all material respects as if made on and as of the date of such Credit Event, except to the extent that any thereof expressly relate to an earlier date

Each request by Borrower for a Credit Event shall be deemed to be a representation and warranty by Borrower as of the date of such request as to the satisfaction of the conditions precedent specified in subsections (c) and (d) above.

Section 4.2. Conditions to the First Credit Event. Borrower shall cause the following conditions to be satisfied on or prior to the Closing Date. The obligation of the Lenders, the Fronting Lender and the Swing Line Lender to participate in the first Credit Event is subject to Borrower satisfying each of the following conditions prior to or concurrently with such Credit Event:

(a) Notes. Borrower shall have executed and delivered to Agent for (i) each Lender requesting a Revolving Credit Note, such Lender's Revolving Credit Note, and (ii) the Swing Line Lender the Swing Line Note, if requested by the Swing Line Lender.

(b) Guaranties of Payment. Each Guarantor of Payment shall have executed and delivered to Agent a Guaranty of Payment.

(c) Springing Security Documents. Borrower and each Guarantor of Payment shall have executed and delivered to Agent, for the benefit of the Lenders, a Security Agreement, a Pledge Agreement (with respect to the Pledged Securities) and Control Agreements (with respect to the deposit and securities accounts set forth in Schedule 6.19 hereto).

(d) Officer's Certificate, Resolutions, Organizational Documents. Each Credit Party shall have delivered to Agent an officer's certificate (or comparable domestic or foreign documents) certifying the names of the officers of such Credit Party authorized to sign the Loan Documents, together with the true signatures of such officers and certified copies of (i) the resolutions of the board of directors (or comparable domestic or foreign documents) of such Credit Party evidencing approval of the execution and delivery of the Loan Documents and the execution of other Related Writings to which such Credit Party is a party, and (ii) the Organizational Documents of such Credit Party.

(e) Good Standing and Full Force and Effect Certificates. Borrower shall have delivered to Agent a good standing certificate or full force and effect certificate, as the case may be, for each Credit Party, issued on or about the Closing Date by the Secretary of State in the state or states where such Credit Party is incorporated or formed or qualified as a foreign entity.

(f) Legal Opinion. Borrower shall have delivered to Agent an opinion of counsel for each Credit Party, in form and substance satisfactory to Agent and the Lenders.

(g) Borrower Investment Policy. Borrower shall have delivered to Agent a copy of the Borrower Investment Policy as in effect on the Closing Date.

(h) Agent Fee Letter, Closing Fee Letter and Other Fees. Borrower shall have (i) executed and delivered to Agent the Agent Fee Letter and paid to Agent, for its sole account, the fees stated therein to be due, (ii) executed and delivered to Agent the Closing Fee Letter and paid to Agent, for the benefit of the Lenders, the fees stated therein to be due, and (iii) paid all legal fees and expenses of Agent in connection with the preparation and negotiation of the Loan Documents.

(i) Lien Searches. With respect to the property owned or leased by Borrower and each Guarantor of Payment and any other property securing the Obligations, Borrower shall have caused to be delivered to Agent (i) the results of Uniform Commercial Code lien searches, satisfactory to Agent and the Lenders, (ii) the results of federal and state tax lien and judicial lien searches, satisfactory to Agent and the Lenders, and (iii) Uniform Commercial Code termination statements reflecting termination of all U.C.C. Financing Statements previously filed by any Person and not expressly permitted pursuant to Section 5.9 hereof.

(j) Existing Credit Agreements. Borrower shall have terminated (A) the facility evidenced by the promissory note payable to U.S. Bank National Association, and (B) the Demand Master Promissory Note between Borrower and KeyBank National Association, dated as of August 18, 2005; which terminations shall be deemed to have occurred upon payment in full of all of the Indebtedness outstanding thereunder and termination of the commitments (if any) established therein.

(k) Closing Certificate. Borrower shall have delivered to Agent and the Lenders an officer's certificate certifying that, as of the Closing Date, (i) all conditions precedent set forth in this Article IV have been satisfied, (ii) no Default or Event of Default exists nor immediately after the first Credit Event will exist, and (iii) each of the representations and warranties contained in Article VI hereof are true and correct as of the Closing Date.

(l) Letter of Direction. Borrower shall have delivered to Agent a letter of direction authorizing Agent, on behalf of the Lenders, to disburse the proceeds of the Loans, which includes the transfer of funds under this Agreement and wire instructions setting forth the locations to which such funds shall be sent.

(m) No Material Adverse Change. No material adverse change, in the opinion of Agent, shall have occurred in the financial condition, operations or prospects of the Companies since June 30, 2005.

(n) Miscellaneous. Borrower shall have provided to Agent and the Lenders such other items and shall have satisfied such other conditions as may be reasonably required by Agent or the Lenders.

Section 4.3. Post-Closing Conditions.

(a) Landlords' Waivers. Within forty-five (45) days after the Closing Date (unless a longer period is agreed to in writing by Agent), Borrower shall have delivered Landlords' Waivers to Agent, for the benefit of the Lenders, each in form and substance reasonably satisfactory to Agent, for the locations of Borrower at Portland, Oregon and Bolingbroke, Illinois.

(b) Stock Certificates and Stock Powers. Within thirty (30) days after the Closing Date (unless a longer period is agreed to in writing by Agent), Borrower shall have delivered to Agent, for the benefit of the Lenders, the stock certificates representing the Pledged Securities and corresponding stock transfer powers.

(c) UCC Termination Statements. Within thirty (30) days after the Closing Date (unless a longer period is agreed to in writing by Agent), Borrower shall have delivered to Agent evidence, in form and substance satisfactory to Agent, reflecting the termination of all U.C.C. Financing Statements previsouly filed by U.S. Bank National Association and Bank One, N.A. (n.k.a. JPMorgan Chase Bank, N.A.) with respect to any of the Companies.

ARTICLE V. COVENANTS

Section 5.1. Insurance. Each Company shall (a) maintain insurance to such extent and against such hazards and liabilities as is commonly maintained by Persons similarly situated; and (b) within ten days of any Lender's written request, furnish to such Lender such information about such Company's insurance as that Lender may from time to time reasonably request, which information shall be prepared in form and detail satisfactory to such Lender and certified by a Financial Officer of such Company.

Section 5.2. Money Obligations. Each Company shall pay in full (a) prior in each case to the date when penalties would attach, all taxes, assessments and governmental charges and levies (except only those so long as and to the extent that the same shall be contested in good faith by appropriate and timely proceedings and for which adequate provisions have been established in accordance with GAAP) for which it may be or become liable or to which any or all of its properties may be or become subject; (b) all of its material wage obligations to its employees in compliance with the Fair Labor Standards Act (29 U.S.C. §§ 206-207) or any comparable provisions; and (c) all of its other material obligations calling for the payment of money (except only those so long as and to the extent that the same shall be contested in good faith and for which adequate provisions have been established in accordance with GAAP) before such payment becomes overdue.

Section 5.3. Financial Statements and Information.

(a) Quarterly Financials. Borrower shall deliver to Agent and the Lenders, within forty-five (45) days after the end of each of the first three quarter-annual periods of each fiscal year of Borrower, balance sheets of the Companies as of the end of such period and statements of income (loss), stockholders' equity and cash flow for the quarter and fiscal year to date periods, all prepared on a Consolidated and consolidating basis, in accordance with GAAP, and in form and detail satisfactory to Agent and the Lenders and certified by a Financial Officer of Borrower as fairly presenting the financial condition, results of operations, and cash flows of the Companies in accordance with GAAP, subject to normal year-end audit adjustments and the absence of footnotes.

(b) Annual Audit Report. Borrower shall deliver to Agent and the Lenders, within ninety (90) days after the end of each fiscal year of Borrower, an annual audit report of the Companies for that year prepared on a Consolidated and consolidating basis, in accordance with GAAP, and in form and detail satisfactory to Agent and the Lenders and certified by an independent public accountant satisfactory to Agent, which report shall include balance sheets and statements of income (loss), stockholders' equity and cash-flow for that period.

(c) Compliance Certificate. Borrower shall deliver to Agent and the Lenders, concurrently with the delivery of the financial statements set forth in subsections (a) and (b) above, a Compliance Certificate.

(d) Shareholder and SEC Documents. Borrower shall notify Agent and the Lenders, as soon as practicable, of the availability of all notices, reports, definitive proxy or other statements and other documents sent by Borrower to its shareholders, to the holders of any of its debentures or bonds or the trustee of any indenture securing the same or pursuant to which they are issued, or sent by Borrower (in final form) to the SEC; provided, however, that such notification shall not be necessary to the extent Borrower provides for automatic notices to be sent to Agent through the SEC website (or similar service) with respect to any notices, reports or other statements filed on such website.

(e) Financial Information of Companies. Borrower shall deliver to Agent and the Lenders, within ten days of the written request of Agent or any Lender, such other information about the financial condition, properties and operations of any Company as Agent or such Lender may from time to time reasonably request, which information shall be submitted in form and detail satisfactory to Agent or such Lender and certified by a Financial Officer of the Company or Companies in question.

Section 5.4. Financial Records. Each Company shall at all times maintain true and complete records and books of account, including, without limiting the generality of the foregoing, appropriate provisions for possible losses and liabilities, all in accordance with GAAP, and at all reasonable times (during normal business hours and upon notice to such

Company) permit Agent or any Lender, or any representative of Agent or such Lender, to examine such Company's books and records and to make excerpts therefrom and transcripts thereof.

Section 5.5. Franchises; Change in Business.

(a) Each Company (other than a Dormant Subsidiary) shall preserve and maintain at all times its existence, and its rights and franchises necessary for its business, except as otherwise permitted pursuant to Section 5.12 hereof.

(b) No Company shall engage in any business if, as a result thereof, the general nature of the business of the Companies taken as a whole would be substantially changed from a Related Business.

Section 5.6. ERISA, Pension and Benefit Plan Compliance. No Company shall incur any material accumulated funding deficiency within the meaning of ERISA, or any material liability to the PBGC, established thereunder in connection with any ERISA Plan. Borrower shall furnish to the Lenders (a) as soon as possible and in any event within thirty (30) days after any Company knows or has reason to know that any Reportable Event with respect to any ERISA Plan has occurred, a statement of a Financial Officer of such Company, setting forth details as to such Reportable Event and the action that such Company proposes to take with respect thereto, together with a copy of the notice of such Reportable Event given to the PBGC if a copy of such notice is available to such Company, and (b) promptly after receipt thereof a copy of any notice such Company, or any member of the Controlled Group may receive from the PBGC or the Internal Revenue Service with respect to any ERISA Plan administered by such Company; provided, that this latter clause shall not apply to notices of general application promulgated by the PBGC or the Internal Revenue Service. Borrower shall promptly notify the Lenders of any material taxes assessed, proposed to be assessed or that Borrower has reason to believe may be assessed against a Company by the Internal Revenue Service with respect to any ERISA Plan. As used in this Section 5.6, "material" means the measure of a matter of significance that shall be determined as being an amount equal to five percent (5%) of Consolidated Net Worth. As soon as practicable, and in any event within twenty (20) days, after any Company shall become aware that an ERISA Event shall have occurred, such Company shall provide Agent with notice of such ERISA Event with a certificate by a Financial Officer of such Company setting forth the details of the event and the action such Company or another Controlled Group member proposes to take with respect thereto. Borrower shall, at the request of Agent or any Lender, deliver or cause to be delivered to Agent or such Lender, as the case may be, true and correct copies of any documents relating to the ERISA Plan of any Company.

Section 5.7. Financial Covenants.

(a) Leverage Ratio. The Companies shall not suffer or permit at any time the Leverage Ratio to exceed 3.25 to 1.00.

(b) Fixed Charge Coverage Ratio. The Companies shall not suffer or permit at any time the Fixed Charge Coverage Ratio to be less than 1.20 to 1.00.

Section 5.8. Borrowing. No Company shall create, incur or have outstanding any Indebtedness of any kind; provided that this Section 5.8 shall not apply to the following:

(a) the Loans, the Letters of Credit and any other Indebtedness under this Agreement;

(b) any loans granted to or Capitalized Lease Obligations entered into by any Company for the purchase or lease of fixed assets (and refinancings of such loans or Capitalized Lease Obligations), which loans and Capitalized Lease Obligations shall only be secured by the fixed assets being purchased or leased, so long as the aggregate principal amount of all such loans and Capitalized Lease Obligations for all Companies shall not exceed Ten Million Dollars ($10,000,000) at any time outstanding;

(c) the Indebtedness existing on the Closing Date, in addition to the other Indebtedness permitted to be incurred pursuant to this Section 5.8, as set forth in Schedule 5.8 hereto (and any extension, renewal or refinancing thereof so long as the principal amount thereof shall not be increased after the Closing Date);

(d) loans to a Company from a Company so long as each such Company is a Credit Party;

(e) Indebtedness under any Hedge Agreement, so long as such Hedge Agreement shall have been entered into in the ordinary course of business and not for speculative purposes;

(f) Permitted Foreign Subsidiary Loans and Investments; and

(g) other unsecured Indebtedness, in addition to the Indebtedness listed above, so long as no Default or Event of Default shall then exist or immediately thereafter shall begin to exist.

Section 5.9. Liens. No Company shall create, assume or suffer to exist (upon the happening of a contingency or otherwise) any Lien upon any of its property or assets, whether now owned or hereafter acquired; provided that this Section 5.9 shall not apply to the following:

(a) Liens for taxes not yet due or that are being actively contested in good faith by appropriate proceedings and for which adequate reserves shall have been established in accordance with GAAP;

(b) other statutory (including landlord Liens), carrier, warehouse, or maritime Liens incidental to the conduct of its business or the ownership of its property and assets that (i) were not incurred in connection with the borrowing of money or the obtaining of advances or credit, and (ii) do not in the aggregate materially detract from the value of its property or assets or materially impair the use thereof in the operation of its business;

(c) Liens on property or assets of a Subsidiary to secure obligations of such Subsidiary to a Credit Party;

(d) purchase money Liens on fixed assets securing the loans and Capitalized Lease Obligations pursuant to Section 5.8 (b) hereof, provided that such Lien is limited to the purchase price and only attaches to the property being acquired;

(e) the Liens existing on the Closing Date as set forth in Schedule 5.9 hereto and replacements, extensions, renewals, refundings or refinancings thereof, but only to the extent that the principal amount of debt secured thereby shall not be increased;

(f) easements, covenants, license agreements, or other minor defects or irregularities in title or possession of real property not interfering in any material respect with the use of such property in the business of any Company;

(g) Liens on assets of a Company located at a leased facility that have become a fixture to such real property and thus subject to a Lien by the mortgagor of or grantor of a deed of trust on such real property; or

(h) any Lien granted to Agent, for the benefit of the Lenders.

No Company shall enter into any contract or agreement (other than a contract or agreement entered into in connection with the purchase or lease of fixed assets that prohibits Liens on such fixed assets) that would prohibit Agent or the Lenders from acquiring a security interest, mortgage or other Lien on, or a collateral assignment of, any of the property or assets of such Company.

Section 5.10. Regulations T, U and X. No Company shall take any action that would result in any non-compliance of the Loans or Letters of Credit with Regulations T, U or X, or any other applicable regulation, of the Board of Governors of the Federal Reserve System.

Section 5.11. Investments, Loans and Guaranties. No Company shall (a) create, acquire or hold any Subsidiary, (b) make or hold any investment in any stocks, bonds or securities of any kind, (c) be or become a party to any joint venture or other partnership, (d) make or keep outstanding any advance or loan to any Person, or (e) be or become a Guarantor of any kind (other than a Guarantor of Payment under the Loan Documents); provided that this Section 5.11 shall not apply to the following:

(i) any endorsement of a check or other medium of payment for deposit or collection through normal banking channels or similar transaction in the normal course of business;

(ii) any investment in direct obligations of the United States of America or in certificates of deposit issued by a member bank (having capital resources in excess of One Hundred Million Dollars ($100,000,000)) of the Federal Reserve System;

(iii) any investment made in accordance with the Borrower Investment Policy;

(iv) the holding of each of the Subsidiaries listed on Schedule 6.1 hereto, and the creation, acquisition and holding of, and any investment in, any new Subsidiary after the Closing Date so long as such new Subsidiary shall have been created, acquired or held, and investments made, in accordance with the terms and conditions of this Agreement and such Subsidiary shall, if required pursuant to Section 5.20 hereof, promptly become a Guarantor of Payment;

(v) loans to a Company from a Company so long as each such Company is a Credit Party;

(vi) any Permitted Foreign Subsidiary Loans and Investments or Permitted Investment, so long as no Default or Event of Default shall then exist or would result therefrom;

(vii) the holding of any stock or equity interest that has been acquired pursuant to an Acquisition permitted by Section 5.13 hereof; or

(viii) guaranties or indemnifications with respect to leases and purchase money secured financing extended by third parties for the lease or purchase by customers of the Companies' inventory so long as the aggregate amount all such guaranties and indemnifications under this provision are included in the calculation of Consolidated Funded Indebtedness.

Section 5.12. Merger and Sale of Assets. No Company shall merge, amalgamate or consolidate with any other Person, or sell, lease or transfer or otherwise dispose of any assets to any Person other than in the ordinary course of business, except that, if no Default or Event of Default shall then exist or immediately thereafter shall begin to exist:

(a) any Domestic Subsidiary may merge with (i) Borrower (provided that Borrower shall be the continuing or surviving Person) or (ii) any one or more Guarantors of Payment;

(b) any Domestic Subsidiary may sell, lease, transfer or otherwise dispose of any of its assets to (i) Borrower or (ii) any Guarantor of Payment;

(c) any Foreign Subsidiary may merge or amalgamate with (i) a Credit Party (provided that such Credit Party shall be the continuing or surviving Person), and (ii) a Company that is not a Credit Party;

(d) any Foreign Subsidiary may sell, lease, transfer or otherwise dispose of any of its assets to a Company;

(e) any Company may sell, lease, transfer or otherwise dispose of any assets that are obsolete, out of style or no longer useful in such Company's business; and

(f) Acquisitions may be effected in accordance with the provisions of Section 5.13 hereof.

Section 5.13. Acquisitions. No Company shall effect an Acquisition; provided, however, that a Credit Party may effect an Acquisition so long as:

(a) in the case of a merger, amalgamation or other combination including Borrower, Borrower shall be the surviving entity;

(b) in the case of a merger, amalgamation or other combination including a Credit Party (other than Borrower), a Credit Party shall be the surviving entity;

(c) the business to be acquired shall be principally in any Related Businesses;

(d) no Default or Event of Default shall exist prior to or after giving effect to such Acquisition;

(e) Borrower shall have provided to Agent and the Lenders, at least ten (10) days prior to such Acquisition, historical financial statements of the target entity as provided by the target entity and a pro forma financial statement of the Companies accompanied by a certificate of a Financial Officer of Borrower showing pro forma compliance with Sections 5.7 and 5.13(h) hereof, both before and after the proposed Acquisition; provided, however, that, if the Acquisition price (in cash, securities, debt assumption, or other consideration) does not exceed Twenty-Five Million Dollars ($25,000,000), such financial statements and pro formas may be provided not later than thirty (30) days after consummation of the Acquisition;

(f) such Acquisition is not actively opposed by the board of directors (or similar governing body) of the selling Persons or the Persons whose equity interests are to be acquired; and

(g) the aggregate Consideration paid by the Companies for all Acquisitions (i) shall not exceed the aggregate amount of One Hundred Million Dollars ($100,000,000) during any fiscal year of Borrower, and (ii) shall not exceed the aggregate amount of Two Hundred Fifty Million Dollars ($250,000,000) during the Commitment Period; provided, however, that such limits shall exclude any Consideration paid for Acquisitions completed prior to the Closing Date.

Section 5.14. Notice. Borrower shall cause a Financial Officer of Borrower to promptly notify Agent and the Lenders, in writing, whenever a Default or Event of Default may occur hereunder or any representation or warranty made in Article VI hereof or elsewhere in this Agreement or in any Related Writing may for any reason cease in any material respect to be true and complete.

Section 5.15. Restricted Payments No Company shall make or commit itself to make any Restricted Payment at any time, except that Borrower may make scheduled interest payments on Subordinated Indebtedness so long as no Default or Event of Default shall then exist or immediately thereafter shall begin to exist.

Section 5.16. Environmental Compliance. Each Company shall comply in all material respects with any and all Environmental Laws including, without limitation, all Environmental Laws in jurisdictions in which such Company owns or operates a facility or site, arranges for disposal or treatment of hazardous substances, solid waste or other wastes, accepts for transport any hazardous substances, solid waste or other wastes or holds any interest in real property or otherwise. Borrower shall furnish to the Lenders, promptly after receipt thereof, a copy of any notice such Company may receive from any Governmental Authority or private Person, or otherwise, that any material litigation or proceeding pertaining to any environmental, health or safety matter has been filed or is threatened against such Company, any real property in which such Company holds any interest or any past or present operation of such Company. No Company shall allow any material release or disposal of hazardous waste, solid waste or other wastes on, under or to any real property in which any Company holds any ownership interest or performs any of its operations, in violation of any Environmental Law. As used in this Section 5.16, "litigation or proceeding" means any demand, claim, notice, suit, suit in equity action, administrative action, investigation or inquiry whether brought by any Governmental Authority, private Person or otherwise. Borrower shall defend, indemnify and hold Agent and the Lenders harmless against all costs, expenses, claims, damages, penalties and liabilities of every kind or nature whatsoever (including attorneys' fees) arising out of or resulting from the noncompliance of any Company with any Environmental Law. Such indemnification shall survive any termination of this Agreement.

Section 5.17. Affiliate Transactions. No Company shall, directly or indirectly, enter into or permit to exist any transaction (including, without limitation, the purchase, sale, lease or exchange of any property or the rendering of any service) with any Affiliate (other than a Company that is a Credit Party or a Foreign Subsidiary) on terms that shall be less favorable to such Company than those that might be obtained at the time in a transaction with a non-Affiliate; provided, however, that the foregoing shall not prohibit the payment of customary and reasonable compensation to directors who are not employees of a Company or an Affiliate.

Section 5.18. Use of Proceeds. Borrower's use of the proceeds of the Loans shall be solely for working capital and other general corporate purposes (including Acquisitions) of the Companies.

Section 5.19. Corporate Names. No Company shall change its corporate name or its state, province or other jurisdiction of organization, unless, in each case, Borrower shall have provided Agent and the Lenders with at least thirty (30) days prior written notice thereof.

Section 5.20. Subsidiary Guaranties, Springing Security Documents and Pledge of Stock or Other Ownership Interest.

(a) Guaranties and Springing Security Documents. Each Domestic Subsidiary (that is not Dashamerica, Inc. or a Dormant Subsidiary) created, acquired or held subsequent to the Closing Date, shall, within thirty (30) days after the date such Domestic Subsidiary is created or acquired, or within thirty (30) days after the end of the fiscal quarter in which a Dormant Subsidiary becomes a non-Dormant Subsidiary, execute and deliver to Agent, for the benefit of the Lenders, a Guaranty of Payment of all of the Obligations and Springing Security Documents

(as required on the Closing Date with respect to Companies that were Guarantors on the Closing Date) along with any such other supporting documentation, corporate governance and authorization documents, and an opinion of counsel as may be deemed necessary or advisable by Agent, such documentation to be in form and substance acceptable to Agent; provided, however, that the Springing Security Documents shall be subject to Section 2.12 hereof.

(b) Pledge of Stock. With respect to the creation or acquisition, after the Closing Date, of a first-tier Foreign Subsidiary of Borrower or a Guarantor of Payment, Borrower shall deliver to Agent, for the benefit of the Lenders, subject to Section 2.12 hereof, all of the share certificates (or other evidence of equity) owned by a Credit Party pursuant to the terms of a Pledge Agreement executed by the appropriate Credit Party; provided, however, that no Company shall be required to pledge more than sixty-five percent (65%) of the outstanding shares or other ownership interest of any Foreign Subsidiary.

(c) Perfection or Registration of Interest in Foreign Shares. With respect to any foreign shares pledged to Agent, for the benefit of the Lenders, on or after the Triggering Event Date, Agent shall at all times, in the discretion of Agent or the Required Lenders, have the right to perfect, at Borrower's cost, payable upon request therefor (including, without limitation, any foreign counsel, or foreign notary, filing, registration or similar, fees, costs or expenses), its security interest in such shares in the respective foreign jurisdiction.

Section 5.21. Restrictive Agreements. Except as set forth in this Agreement, Borrower shall not, and shall not permit any of its Subsidiaries to, directly or indirectly, create or otherwise cause or suffer to exist or become effective any encumbrance or restriction on the ability of any Subsidiary to (a) make, directly or indirectly, any Capital Distribution to Borrower, (b) make, directly or indirectly, loans or advances or capital contributions to Borrower or (c) transfer, directly or indirectly, any of the properties or assets of such Subsidiary to Borrower; except for such encumbrances or restrictions existing under or by reason of (i) applicable law, (ii) customary non-assignment provisions in leases or other agreements entered in the ordinary course of business and consistent with past practices, or (iii) customary restrictions in security agreements or mortgages securing Indebtedness or capital leases, of a Company to the extent such restrictions shall only restrict the transfer of the property subject to such security agreement, mortgage or lease.

Section 5.22. Other Covenants. In the event that any Company shall be a party to any Material Indebtedness Agreement, wherein the covenants contained therein shall be more restrictive than the covenants set forth herein, then the Companies shall be bound hereunder by such more restrictive covenants with the same force and effect as if such covenants were written herein.

Section 5.23. Guaranty Under Material Indebtedness Agreement. No Company shall be or become a Guarantor of the Indebtedness incurred pursuant to any Material Indebtedness Agreement unless such Company shall also be a Guarantor of Payment under this Agreement prior to or concurrently therewith.

Section 5.24. Right to Take Additional Collateral. In addition to any other right that Agent and the Lenders may have pursuant to this Agreement or otherwise, upon written request of Agent whenever made after the Triggering Event Date, Borrower shall, and shall cause each Guarantor of Payment to, grant to Agent, for the benefit of the Lenders, as additional security for the Secured Obligations, a first (except as to fixed assets subject to a capitalized lease or purchase money security interest) security interest in or Lien on any real or personal property of Borrower and each Guarantor of Payment in which Agent does not have a first priority security interest Lien, subject only to Liens permitted under Section 5.9 hereof. Borrower agrees that, within thirty (30) days after such written request, Borrower shall secure all of the Secured Obligations by delivering to Agent, for the benefit of the Lenders, such Springing Security Documents or other documents, instruments or agreements as Agent may reasonably require. Borrower shall pay all recordation, legal and other expenses in connection therewith.

Section 5.25. Amendment of Organizational Documents. No Company shall amend its Organizational Documents to change its name or state, province or other jurisdiction of organization, or otherwise amend its Organizational Documents in any manner adverse to Lenders, without the prior written consent of Agent.

ARTICLE VI. REPRESENTATIONS AND WARRANTIES

Section 6.1. Corporate Existence; Subsidiaries; Foreign Qualification. Each Company is duly organized, validly existing, and in good standing under the laws of its state or jurisdiction of incorporation or organization and is duly qualified and authorized to do business and is in good standing as a foreign entity in the jurisdictions set forth opposite its name on Schedule 6.1 hereto, which are all of the states or jurisdictions where the character of its property or its business activities makes such qualification necessary, except where a failure to qualify will not result in a Material Adverse Effect. Each Foreign Subsidiary is validly existing under the laws of its jurisdiction of organization. Schedule 6.1 hereto sets forth, as of the Closing Date, each Subsidiary of Borrower (and whether such Subsidiary is a Dormant Subsidiary), its state of formation, its relationship to Borrower, including the percentage of each class of stock or membership interests owned by a Company, each Person that owns the stock or other equity interest of each Company, the location of its chief executive office and its principal place of business.

Section 6.2. Corporate Authority. Each Credit Party has the right and power and is duly authorized and empowered to enter into, execute and deliver the Loan Documents to which it is a party and to perform and observe the provisions of the Loan Documents. The Loan Documents to which each Credit Party is a party have been duly authorized and approved by such Credit Party's board of directors or other governing body, as applicable, and are the valid and binding obligations of such Credit Party, enforceable against such Credit Party in accordance with their respective terms. The execution, delivery and performance of the Loan Documents will not conflict with, result in a breach in any of the provisions of, constitute a default under, or result in the creation of a Lien (other than Liens permitted under Section 5.9 hereof) upon any assets or property of any Company under the provisions of, such Company's Organizational Documents or any material agreement.

Section 6.3. Compliance with Laws and Contracts. Each Company:

(a) holds permits, certificates, licenses, orders, registrations, franchises, authorizations, and other approvals from any Governmental Authority necessary for the conduct of its business and is in compliance with all applicable laws relating thereto, the lack of which has or could have a Material Adverse Effect;

(b) is in compliance with all material federal, state, local, or foreign applicable statutes, rules, regulations, and orders including, without limitation, those relating to environmental protection, occupational safety and health, and equal employment practices; and

(c) is not in violation of or in default under any agreement to which it is a party or by which its assets are subject or bound, the effect of which has or could have a Material Adverse Effect.

Section 6.4. Litigation and Administrative Proceedings. Except as disclosed on Schedule 6.4 hereto, there are (a) no material lawsuits, actions, investigations, or other proceedings pending or threatened against any Company, or in respect of which any Company may have any liability, in any court or before any Governmental Authority, arbitration board, or other tribunal, (b) no orders, writs, injunctions, judgments, or decrees of any court or government agency or instrumentality to which any Company is a party or by which the property or assets of any Company are bound, and (c) no material grievances, disputes, or controversies outstanding with any union or other organization of the employees of any Company, or threats of work stoppage, strike, or pending demands for collective bargaining.

Section 6.5. Title to Assets. Each Company has good title to and ownership of all material property it purports to own, which property is free and clear of all Liens, except those permitted under Section 5.9 hereof.

Section 6.6. Liens and Security Interests. On and after the Closing Date, except for Liens permitted pursuant to Section 5.9 hereof, (a) there is and will be no U.C.C. Financing Statement or similar notice of Lien outstanding covering any personal property of any Company; (b) there is and will be no mortgage outstanding covering any real property of any Company; and (c) no real or personal property of any Company is subject to any security interest or Lien of any kind. No Company has entered into any contract or agreement (other than a contract or agreement entered into in connection with the purchase or lease of fixed assets that prohibits Liens on such fixed assets) that exists on or after the Closing Date that would prohibit Agent or the Lenders from acquiring a Lien on, or a collateral assignment of, any of the property or assets of any Company.

Section 6.7. Tax Returns. All federal, state and local tax returns and other reports required by law to be filed in respect of the income, business, properties and employees of each Company have been filed and all taxes, assessments, fees and other governmental charges that are due and payable have been paid, except as otherwise permitted herein except any of the foregoing which are disputed in good faith and for which the Company maintains adequate reserves under GAAP. The provision for taxes on the books of each Company is adequate for all years not closed by applicable statutes and for the current fiscal year.

Section 6.8. Environmental Laws. Each Company is in material compliance with all Environmental Laws, including, without limitation, all Environmental Laws in all jurisdictions in which any Company owns or operates, or has owned or operated, a facility or site, arranges or has arranged for disposal or treatment of hazardous substances, solid waste or other wastes, accepts or has accepted for transport any hazardous substances, solid waste or other wastes or holds or has held any interest in real property. No litigation or other material proceeding arising under, relating to or in connection with any Environmental Law is pending or, to the best knowledge of each Responsible Officer of the relevant Company, threatened, against any Company, any real property in which any Company holds or has held an interest or any past or present operation of any Company. No release, threatened release or disposal of hazardous waste, solid waste or other wastes is occurring, or has occurred (other than those that are currently being cleaned up in accordance with Environmental Laws), on, under or to any real property in which any Company holds any interest or performs any of its operations, in violation of any Environmental Law. As used in this Section 6.8, "litigation or proceeding" means any demand, claim, notice, suit, suit in equity, action, administrative action, investigation or inquiry whether brought by any Governmental Authority or private Person, or otherwise.

Section 6.9. Locations. As of the Closing Date, the Companies have places of business or maintain their accounts, inventory and equipment, other than inventory and equipment that is in transit or in temporary storage, at the locations set forth on Schedule 6.9 hereto, and each Company's chief executive office is set forth on Schedule 6.9 hereto. Schedule 6.9 further specifies whether each location, as of the Closing Date, (a) is owned by the Companies, or (b) is leased by a Company from a third party. As of the Closing Date, Schedule 6.9 correctly identifies the name and address of each third party location where assets of the Companies are located.

Section 6.10. Continued Business. There exists no actual, pending, or, to Borrower's knowledge, any threatened termination, cancellation or limitation of, or any modification or change in the business relationship of any Company and any customer or supplier, or any group of customers or suppliers, whose purchases or supplies, individually or in the aggregate, are material to the business of any Company, and there exists no present condition or state of facts or circumstances that would have a Material Adverse Effect or prevent a Company from conducting such business or the transactions contemplated by this Agreement in substantially the same manner in which it was previously conducted.

Section 6.11. Employee Benefits Plans. Schedule 6.11 hereto identifies each ERISA Plan as of the Closing Date. No ERISA Event has occurred or is expected to occur with respect to an ERISA Plan. Full payment has been made of all amounts that a Controlled Group member is required, under applicable law or under the governing documents, to have paid as a contribution to or a benefit under each ERISA Plan. The liability of each Controlled Group member with respect to each ERISA Plan has been fully funded based upon reasonable and proper actuarial assumptions, has been fully insured, or has been fully reserved for on its financial statements. No changes have occurred or are expected to occur that would cause a

material increase in the cost of providing benefits under the ERISA Plan (other than increases in the number of Company employees, revision of the scope of health care plans, and deductibles, franchises, and co-pay clauses thereunder, or increases in costs imposed by plan providers or administrators). With respect to each ERISA Plan that is intended to be qualified under Code Section 401(a), (a) the ERISA Plan and any associated trust operationally comply with the material applicable requirements of Code Section 401(a); (b) the ERISA Plan and any associated trust have been amended to comply with all such material requirements as currently in effect, other than those requirements for which a retroactive amendment can be made within the "remedial amendment period" available under Code Section 401(b) (as extended under Treasury Regulations and other Treasury pronouncements upon which taxpayers may rely); (c) the ERISA Plan and any associated trust have received a favorable determination letter from the Internal Revenue Service stating that the ERISA Plan qualifies under Code Section 401(a), that the associated trust qualifies under Code Section 501(a) and, if applicable, that any cash or deferred arrangement under the ERISA Plan qualifies under Code Section 401(k), unless the ERISA Plan was first adopted at a time for which the above-described "remedial amendment period" has not yet expired; (d) the ERISA Plan currently satisfies the requirements of Code Section 410(b), subject to any retroactive amendment that may be made within the above-described "remedial amendment period"; and (e) no contribution made to the ERISA Plan is subject to an excise tax under Code Section 4972. With respect to any Pension Plan, the "accumulated benefit obligation" of Controlled Group members with respect to the Pension Plan (as determined in accordance with Statement of Accounting Standards No. 87, "Employers' Accounting for Pensions") does not exceed the fair market value of Pension Plan assets. As used in this Section 6.11, "material" means the measure of a matter of significance that shall be determined as being an amount equal to five percent (5%) of Consolidated Net Worth.

Section 6.12. Consents or Approvals. No consent, approval or authorization of, or filing, registration or qualification with, any Governmental Authority or any other Person is required to be obtained or completed by any Company in connection with the execution, delivery or performance of any of the Loan Documents, that has not already been obtained or completed.

Section 6.13. Solvency. Borrower has received consideration that is the reasonable equivalent value of the obligations and liabilities that Borrower has incurred to Agent and the Lenders. Borrower is not insolvent as defined in any applicable state, federal or relevant foreign statute, nor will Borrower be rendered insolvent by the execution and delivery of the Loan Documents to Agent and the Lenders. Borrower is not engaged or about to engage in any business or transaction for which the assets retained by it are or will be an unreasonably small amount of capital, taking into consideration the obligations to Agent and the Lenders incurred hereunder. Borrower does not intend to, nor does it believe that it will, incur debts beyond its ability to pay such debts as they mature.

Section 6.14. Financial Statements. The audited Consolidated financial statements of Borrower for the fiscal year ended December 31, 2004 and the unaudited Consolidated financial statements of Borrower for the fiscal quarter ended June 30, 2005, furnished to Agent and the Lenders, are true and complete, have been prepared in accordance with GAAP, and fairly present the financial condition of the Companies as of the dates of such financial statements and the results of their operations for the periods then ending. Since the dates of such statements, there has been no material adverse change in any Company's financial condition, properties or business or any change in any Company's accounting procedures.

Section 6.15. Regulations. No Company 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" (within the meaning of Regulation U of the Board of Governors of the Federal Reserve System of the United States of America). Neither the granting of any Loan (or any conversion thereof) or Letter of Credit nor the use of the proceeds of any Loan or Letter of Credit will violate, or be inconsistent with, the provisions of Regulation T, U or X or any other Regulation of such Board of Governors.

Section 6.16. Material Agreements. Except as disclosed on Schedule 6.16 hereto, as of the Closing Date, no Company is a party to any (a) debt instrument (excluding the Loan Documents); (b) lease (capital, operating or otherwise), whether as lessee or lessor thereunder; (c) contract, commitment, agreement, or other arrangement involving the purchase or sale of any inventory other than guaranties or indemnifications described in Section 5.11(viii) hereof by it, or the license of any right to or by it; (d) contract, commitment, agreement, or other arrangement with any of its "Affiliates" (as such term is defined in the Securities Exchange Act of 1934, as amended) other than a Company or pertaining to director compensation; (e) management or employment contract or contract for personal services with any of its Affiliates that is not otherwise terminable at will or on less than ninety-one (91) days' notice without liability; (f) collective bargaining agreement; or (g) other contract, agreement, understanding, or arrangement with a third party; that, as to subsections (a) through (g), above, if violated, breached, or terminated for any reason, would have or would be reasonably expected to have a Material Adverse Effect.

Section 6.17. Intellectual Property. Other than as disclosed on Schedule 6.17 hereto, each Company owns or has the right to use all of the material patents, patent applications, industrial designs, designs, trademarks, service marks, copyrights and licenses, and rights with respect to the foregoing, necessary for the conduct of its business, and none of the Responsible Officers of any Company are aware of any material claim by any other party which, if true, would terminate such Company's rights with respect thereto.

Section 6.18. Insurance. Each Company maintains with financially sound and reputable insurers insurance with coverage and limits as required by law and as is customary with Persons engaged in the same businesses as the Companies. Schedule 6.18 hereto sets forth all insurance carried by Borrowers and its Domestic Subsidiaries on the Closing Date, setting forth in detail the amount and type of such insurance. Upon request, Borrower shall provide Agent and the Lenders with such additional information as Agent or the Lenders may from time to time reasonably request.

Section 6.19. Deposit and Securities Accounts. Schedule 6.19 hereto lists all banks and other financial institutions at which any Company maintains deposit or other accounts as of the Closing Date, and Schedule 6.19 hereto correctly identifies the name, address and telephone number of each depository, the name in which the account is held, a description of the purpose of the account, and the complete account number therefor.

Section 6.20. Accurate and Complete Statements. Neither the Loan Documents nor any written statement made by any Company in connection with any of the Loan Documents contains any untrue statement of a material fact or omits a material fact necessary to make the statements contained therein or in the Loan Documents not misleading. After due inquiry by Borrower, there is no known fact that any Company has not disclosed to Agent and the Lenders that has or is likely to have a Material Adverse Effect.

Section 6.21. Investment Company; Holding Company. No Company is an "investment company" or a company "controlled" by an "investment company" within the meaning of the Investment Company Act of 1940, as amended.

Section 6.22. Defaults. No Default or Event of Default exists hereunder, nor will any begin to exist immediately after the execution and delivery hereof.

ARTICLE VII. EVENTS OF DEFAULT

Each of the following shall constitute an Event of Default hereunder:

Section 7.1. Payments. If (a) the interest on any Loan or any facility or other fee shall not be paid in full when due and payable or within five days thereafter, or (b) the principal of any Loan or any obligation under any Letter of Credit shall not be paid in full when due and payable.

Section 7.2. Special Covenants. If any Company shall fail or omit to perform and observe Section 5.7, 5.8, 5.9, 5.11, 5.12, 5.13, 5.15, 5.22 or 5.23 hereof.

Section 7.3. Other Covenants. If any Company shall fail or omit to perform and observe any agreement or other provision (other than those referred to in Section 7.1 or 7.2 hereof) contained or referred to in this Agreement or any Related Writing that is on such Company's part to be complied with, and that Default shall not have been fully corrected within thirty (30) days after the earlier of (a) any Financial Officer of such Company becomes aware of the occurrence thereof, or (b) the giving of written notice thereof to Borrower by Agent or the Required Lenders that the specified Default is to be remedied.

Section 7.4. Representations and Warranties. If any material representation, warranty or statement made in or pursuant to this Agreement or any Related Writing or any other material information furnished by any Company to Agent or the Lenders or any thereof or any other holder of any Note, shall be false or erroneous.

Section 7.5. Cross Default. If any Company shall default in any payment due and owing under any Material Indebtedness Agreement beyond any period of grace provided with respect thereto or in the performance or observance of any other agreement, term or condition contained in any agreement under which such obligation is created, if the effect of such default is to allow the acceleration of the maturity of such Indebtedness or to permit the holder thereof to cause such Indebtedness to become due prior to its stated maturity.

Section 7.6. ERISA Default. The occurrence of one or more ERISA Events that (a) has a Material Adverse Effect equal to five percent (5%) of Consolidated Net Worth, or (b) results in a Lien on any of the assets of any Company.

Section 7.7. Change in Control. If any Change in Control shall occur.

Section 7.8. Money Judgment. A final judgment or order for the payment of money shall be rendered against any Company by a court of competent jurisdiction, that remains unpaid or unstayed and undischarged for a period (during which execution shall not be effectively stayed) of thirty (30) days after the date on which the right to appeal has expired, provided that the aggregate of all such judgments for all such Companies shall exceed Five Hundred Thousand Dollars ($500,000).

Section 7.9. Material Adverse Change. There shall have occurred any condition or event that Agent or the Required Lenders determine has or is reasonably likely to have a Material Adverse Effect.

Section 7.10. Security. If any Lien granted in any Loan Document in favor of Agent, for the benefit of the Lenders, shall be determined to be void, voidable or invalid, or does not otherwise have the priority contemplated (whether perfected or not) by this Agreement or the Springing Security Documents and Borrower has failed to promptly execute appropriate documents to correct such matters.

Section 7.11. Validity of Loan Documents. (a) Any material provision, in the sole opinion of Agent, of any Loan Document shall at any time for any reason cease to be valid, binding and enforceable against any Credit Party; (b) the validity, binding effect or enforceability of any Loan Document against any Credit Party shall be contested by any Credit Party; (c) any Credit Party shall deny that it has any or further liability or obligation under any Loan Document; or (d) any Loan Document shall be terminated, invalidated or set aside, or be declared ineffective or inoperative or in any way cease to give or provide to Agent and the Lenders the benefits purported to be created thereby.

Section 7.12. Solvency. If any Company (other than a Dormant Subsidiary) shall (a) except as permitted pursuant to Section 5.12 hereof, discontinue business, (b) generally not pay its debts as such debts become due, (c) make a general assignment for the benefit of creditors, (d) apply for or consent to the appointment of an interim receiver, a receiver, a receiver and manager, an administrator, sequestrator, monitor, a custodian, a trustee, an interim trustee or liquidator of all or a substantial part of its assets or of such Company, (e) be adjudicated a debtor or insolvent or have entered against it an order for relief under Title 11 of the United States Code, or under any other bankruptcy insolvency, liquidation, winding-up, corporate or similar statute or law, foreign, federal state or provincial, in any applicable jurisdiction, now or hereafter existing, as any of the foregoing may be amended from time to time, or other applicable statute for jurisdictions outside of the United States, as the case may be, which adjudication or entry is not stayed or rescinded within thirty (30) days thereafter, (f) file a voluntary petition in bankruptcy, or file a proposal or notice of intention to file a proposal or have an involuntary

proceeding filed against it and the same shall continue undismissed for a period of thirty (30) days from commencement of such proceeding or case, or file a petition or an answer or an application or a proposal seeking reorganization or an arrangement with creditors or seeking to take advantage of any other law (whether federal, provincial or state, or, if applicable, other jurisdiction) relating to relief of debtors, or admit (by answer, by default or otherwise) the material allegations of a petition filed against it in any bankruptcy, reorganization, insolvency or other proceeding (whether federal, provincial or state, or, if applicable, other jurisdiction) relating to relief of debtors, (g) suffer or permit to continue unstayed and in effect for thirty (30) consecutive days any judgment, decree or order entered by a court of competent jurisdiction, that approves a petition or an application or a proposal seeking its reorganization or appoints an interim receiver, a receiver and manager, an administrator, custodian, trustee, interim trustee or liquidator of all or a substantial part of its assets or of such Company, (h) have an administrative receiver appointed over the whole or substantially the whole of its assets or of such Company, whose appointment is not rescinded within thirty (30) days thereafter, (i) take, or omit to take, any action in order thereby to effect any of the foregoing have assets the value of which is less than its liabilities (taking into account prospective and contingent liabilities), or (j) have a moratorium declared in respect of any of its Indebtedness, or any analogous procedure or step is taken in any jurisdiction, which is not rescinded within thirty (30) days thereafter.

ARTICLE VIII. REMEDIES UPON DEFAULT

Notwithstanding any contrary provision or inference herein or elsewhere:

Section 8.1. Optional Defaults. If any Event of Default referred to in Section 7.1, 7.2, 7.3, 7.4, 7.5, 7.6, 7.7, 7.8, 7.9, 7.10 or 7.11 hereof shall occur, Agent may, with the consent of the Required Lenders, and shall, at the written request of the Required Lenders, give written notice to Borrower to:

(a) terminate the Commitment, if not previously terminated, and, immediately upon such election, the obligations of the Lenders, and each thereof, to make any further Loan and the obligation of the Fronting Lender to issue any Letter of Credit immediately shall be terminated; and/or

(b) accelerate the maturity of all of the Obligations (if the Obligations are not already due and payable), whereupon all of the Obligations shall become and thereafter be immediately due and payable in full without any presentment or demand and without any further or other notice of any kind, all of which are hereby waived by Borrower.

Section 8.2. Automatic Defaults. If any Event of Default referred to in Section 7.12 hereof shall occur:

(a) all of the Commitment shall automatically and immediately terminate, if not previously terminated, and no Lender thereafter shall be under any obligation to grant any further Loan, nor shall the Fronting Lender be obligated to issue any Letter of Credit; and

(b) the principal of and interest then outstanding on all of the Loans, and all of the other Obligations, shall thereupon become and thereafter be immediately due and payable in full (if the Obligations are not already due and payable), all without any presentment, demand or notice of any kind, which are hereby waived by Borrower.

Section 8.3. Letters of Credit. If the maturity of the Obligations shall be accelerated pursuant to Section 8.1 or 8.2 hereof, Borrower shall immediately deposit with Agent, as security for the obligations of Borrower and any Guarantor of Payment to reimburse Agent and the Lenders for any then outstanding Letters of Credit, cash equal to the sum of the aggregate undrawn balance of any then outstanding Letters of Credit. Agent and the Lenders are hereby authorized, at their option, to deduct any and all such amounts from any deposit balances then owing by any Lender (or any affiliate of such Lender, wherever located) to or for the credit or account of any Credit Party, as security for the obligations of Borrower and any Guarantor of Payment to reimburse Agent and the Lenders for any then outstanding Letters of Credit.

Section 8.4. Offsets. If there shall occur or exist any Event of Default referred to in Section 7.12 hereof or if the maturity of the Obligations is accelerated pursuant to Section 8.1 or 8.2 hereof, each Lender shall have the right at any time to set off against, and to appropriate and apply toward the payment of, any and all of the Obligations then owing by Borrower or a Guarantor of Payment to such Lender (including, without limitation, any participation purchased or to be purchased pursuant to Section 2.2(b), 2.2(c) or 8.5 hereof), whether or not the same shall then have matured, any and all deposit (general or special) balances and all other indebtedness then held or owing by such Lender (including, without limitation, by branches and agencies or any affiliate of such Lender, wherever located) to or for the credit or account of Borrower or any Guarantor of Payment, all without notice to or demand upon Borrower or any other Person, all such notices and demands being hereby expressly waived by Borrower.

Section 8.5. Equalization Provision. Each Lender agrees with the other Lenders that if it, at any time, shall obtain any Advantage over the other Lenders or any thereof in respect of the Obligations (except as to Swing Loans and Letters of Credit prior to Agent's giving of notice to participate and except under Article III hereof), it shall purchase from the other Lenders, for cash and at par, such additional participation in the Obligations as shall be necessary to nullify the Advantage. If any such Advantage resulting in the purchase of an additional participation as aforesaid shall be recovered in whole or in part from the Lender receiving the Advantage, each such purchase shall be rescinded, and the purchase price restored (but without interest unless the Lender receiving the Advantage is required to pay interest on the Advantage to the Person recovering the Advantage from such Lender) ratably to the extent of the recovery. Each Lender further agrees with the other Lenders that if it at any time shall receive any payment for or on behalf of Borrower on any indebtedness owing by Borrower to that Lender pursuant to this Agreement (whether by voluntary payment, by realization upon security, by reason of offset of any deposit or other indebtedness, by counterclaim or cross-action, by the enforcement of any right under any Loan Document, or otherwise), it will apply such payment first to any and all Obligations owing by Borrower to that Lender (including, without limitation, any participation purchased or to be purchased pursuant to this Section 8.5 or any other Section of this Agreement). Each Credit Party agrees that any Lender so purchasing a participation from the other Lenders or any thereof pursuant to this Section 8.5 may exercise all of its rights of payment (including the right of set-off) with respect to such participation as fully as if such Lender were a direct creditor of such Credit Party in the amount of such participation.

Section 8.6. Other Remedies. The remedies in this Article VIII are in addition to, not in limitation of, any other right, power, privilege, or remedy, either in law, in equity, or otherwise, to which the Lenders may be entitled. Agent shall exercise the rights under this Article VIII and all other collection efforts on behalf of the Lenders and no Lender shall act independently with respect thereto, except as otherwise specifically set forth in this Agreement.

ARTICLE IX. THE AGENT

The Lenders authorize KeyBank National Association and KeyBank National Association hereby agrees to act as agent for the Lenders in respect of this Agreement upon the terms and conditions set forth elsewhere in this Agreement, and upon the following terms and conditions:

Section 9.1. Appointment and Authorization. Each Lender hereby irrevocably appoints and authorizes Agent to take such action as agent on its behalf and to exercise such powers hereunder as are delegated to Agent by the terms hereof, together with such powers as are reasonably incidental thereto. Neither Agent nor any of its affiliates, directors, officers, attorneys or employees shall (a) be liable to the Lenders for any action taken or omitted to be taken by it or them hereunder or in connection herewith, except for its or their own gross negligence or willful misconduct (as determined by a court of competent jurisdiction), or be responsible in any manner to any of the Lenders for the effectiveness, enforceability, genuineness, validity or due execution of this Agreement or any other Loan Documents, (b) be under any obligation to any Lender to ascertain or to inquire as to the performance or observance of any of the terms, covenants or conditions hereof or thereof on the part of Borrower or any other Company, or the financial condition of Borrower or any other Company, or (c) be liable to any of the Companies for consequential damages resulting from any breach of contract, tort or other wrong in connection with the negotiation, documentation, administration or collection of the Loans or Letters of Credit or any of the Loan Documents.

Section 9.2. Note Holders. Agent may treat the payee of any Note as the holder thereof (or, if there is no Note, the holder of the interest as reflected on the books and records of Agent) until written notice of transfer shall have been filed with Agent, signed by such payee and in form satisfactory to Agent.

Section 9.3. Consultation With Counsel. Agent may consult with legal counsel selected by Agent and shall not be liable to the Lenders for any action taken or suffered in good faith by Agent in accordance with the opinion of such counsel.

Section 9.4. Documents. Agent shall not be under any duty to examine into or pass upon the validity, effectiveness, genuineness or value of any Loan Document or any other Related Writing furnished pursuant hereto or in connection herewith or the value of any collateral obtained hereunder, and Agent shall be entitled to assume that the same are valid, effective and genuine and what they purport to be.

Section 9.5. Agent and Affiliates. KeyBank National Association ("KeyBank") and its affiliates may make loans to, issue letters of credit for the account of, accept deposits from, acquire equity interests in and generally engage in any kind of banking, trust, financial advisory, underwriting or other business with the Companies and Affiliates as though KeyBank were not Agent hereunder and without notice to or consent of any Lender. Each Lender acknowledges that, pursuant to such activities, KeyBank or its affiliates may receive information regarding any Company or any Affiliate (including information that may be subject to confidentiality obligations in favor of such Company or such Affiliate) and acknowledge that Agent shall be under no obligation to provide such information to other Lenders. With respect to Loans and Letters of Credit (if any), KeyBank and its affiliates shall have the same rights and powers under this Agreement as any other Lender and may exercise the same as though KeyBank were not Agent, and the terms "Lender" and "Lenders" include KeyBank and its affiliates, to the extent applicable, in their individual capacities.

Section 9.6. Knowledge of Default. It is expressly understood and agreed that Agent shall be entitled to assume that no Default or Event of Default has occurred, unless Agent has been notified by a Lender in writing that such Lender believes that a Default or Event of Default has occurred and is continuing and specifying the nature thereof or has been notified by Borrower pursuant to Section 5.14 hereof.

Section 9.7. Action by Agent. Subject to the other terms and conditions hereof, so long as Agent shall be entitled, pursuant to Section 9.6 hereof, to assume that no Default or Event of Default shall have occurred and be continuing, Agent shall be entitled to use its discretion with respect to exercising or refraining from exercising any rights that may be vested in it by, or with respect to taking or refraining from taking any action or actions that it may be able to take under or in respect of, this Agreement. Agent shall incur no liability under or in respect of this Agreement by acting upon any notice, certificate, warranty or other paper or instrument believed by it to be genuine or authentic or to be signed by the proper party or parties, or with respect to anything that it may do or refrain from doing in the reasonable exercise of its judgment, or that may seem to it to be necessary or desirable in the premises.

Section 9.8. Release of a Guarantor of Payment. In the event of a merger, sale of assets or other transaction permitted pursuant to Section 5.12 hereof and so long as there is no Event of Default existing, Agent, at the request and expense of Borrower, is hereby authorized by the Lenders to release, in connection therewith one or more Guarantors of Payment or pledge of pledged securities, and any Springing Security Documents, as appropriate, upon the written request of Borrower.

Section 9.9. Notice of Default. In the event that Agent shall have acquired actual knowledge of any Default or Event of Default, Agent shall promptly notify the Lenders and shall take such action and assert such rights under this Agreement as the Required Lenders shall direct and Agent shall inform the other Lenders in writing of the action taken. Agent may take such action and assert such rights as it deems to be advisable, in its discretion, for the protection of the interests of the holders of the Obligations.

Section 9.10. Delegation of Duties. Agent may execute any of its duties under this Agreement or any other Loan Document by or through agents, employees or attorneys-in-fact and shall be entitled to advice of counsel and other consultants or experts concerning all matters pertaining to such duties. Agent shall not be responsible for the negligence or misconduct of any agent or attorney-in-fact that it selects in the absence of gross negligence or willful misconduct, as determined by a court of competent jurisdiction.

Section 9.11. Indemnification of Agent. The Lenders agree to indemnify Agent (to the extent not reimbursed by Borrower) ratably, according to their respective Commitment Percentages, from and against any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses (including attorneys' fees) or disbursements of any kind or nature whatsoever that may be imposed on, incurred by or asserted against Agent in its capacity as agent in any way relating to or arising out of this Agreement or any Loan Document or any action taken or omitted by Agent with respect to this Agreement or any Loan Document, provided that no Lender shall be liable for any portion of such liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses (including attorneys' fees) or disbursements resulting from Agent's gross negligence or willful misconduct as determined by a court of competent jurisdiction, or from any action taken or omitted by Agent in any capacity other than as agent under this Agreement or any other Loan Document. No action taken in accordance with the directions of the Required Lenders shall be deemed to constitute gross negligence or willful misconduct for purposes of this Section 9.11. The undertaking in this Section 9.11 shall survive repayment of the Loans, cancellation of the Notes, if any, expiration or termination of the Letters of Credit, any foreclosure under, or modification, release or discharge of, any or all of the Springing Security Documents, termination of this Agreement and the resignation or replacement of the agent.

Section 9.12. Successor Agent. Agent may resign as agent hereunder by giving not fewer than thirty (30) days prior written notice to Borrower and the Lenders. If Agent shall resign under this Agreement, then either (a) the Required Lenders shall appoint from among the Lenders a successor agent for the Lenders (with the consent of Borrower so long as an Event of Default has not occurred and which consent shall not be unreasonably withheld), or (b) if a successor agent shall not be so appointed and approved within the thirty (30) day period following Agent's notice to the Lenders of its resignation, then Agent shall appoint a successor agent that shall serve as agent until such time as the Required Lenders appoint a successor agent. Upon its appointment, such successor agent shall succeed to the rights, powers and duties as agent, and the term "Agent" shall mean such successor effective upon its appointment, and the former agent's rights, powers and duties as agent shall be terminated without any other or further act or deed on the part of such former agent or any of the parties to this Agreement.

Section 9.13. Other Agents. As used in this Agreement, the term "Agent" shall only include Agent. The Syndication Agent shall not have any rights, obligations or responsibilities hereunder in such capacity.

ARTICLE X. MISCELLANEOUS

Section 10.1. Lenders' Independent Investigation. Each Lender, by its signature to this Agreement, acknowledges and agrees that Agent has made no representation or warranty, express or implied, with respect to the creditworthiness, financial condition, or any other condition of any Company or with respect to the statements contained in any information memorandum furnished in connection herewith or in any other oral or written communication between Agent and such Lender. Each Lender represents that it has made and shall continue to make its own independent investigation of the creditworthiness, financial condition and affairs of the Companies in connection with the extension of credit hereunder, and agrees that Agent has no duty or responsibility, either initially or on a continuing basis, to provide any Lender with any credit or other information with respect thereto (other than such notices as may be expressly required to be given by Agent to the Lenders hereunder), whether coming into its possession before the first Credit Event hereunder or at any time or times thereafter. Each Lender further represents that it has reviewed each of the Loan Documents.

Section 10.2. No Waiver; Cumulative Remedies. No omission or course of dealing on the part of Agent, any Lender or the holder of any Note (or, if there is no Note, the holder of the interest as reflected on the books and records of Agent) in exercising any right, power or remedy hereunder or under any of the Loan Documents shall operate as a waiver thereof; nor shall any single or partial exercise of any such right, power or remedy preclude any other or further exercise thereof or the exercise of any other right, power or remedy hereunder or under any of the Loan Documents. The remedies herein provided are cumulative and in addition to any other rights, powers or privileges held by operation of law, by contract or otherwise.

Section 10.3. Amendments, Waivers and Consents.

(a) General Rule. No amendment, modification, termination, or waiver of any provision of any Loan Document nor consent to any variance therefrom, shall be effective unless the same shall be in writing and signed by the Required Lenders and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given.

(b) Exceptions to the General Rule. Anything herein to the contrary notwithstanding, unanimous consent of the Lenders shall be required with respect to (i) any increase in the Commitment hereunder, (ii) the extension of maturity of the Loans, the payment date of interest or scheduled principal thereunder, or the payment date of facility or other fees payable hereunder, (iii) any reduction in the rate basis of interest on the Loans (provided that the institution of the Default Rate and a subsequent removal of the Default Rate shall not constitute a decrease in interest rate pursuant to this Section 10.3), or in any amount of interest or scheduled principal due on any Loan, or the payment of facility or other fees hereunder or any change in the manner of pro rata application of any payments made by Borrower to the Lenders hereunder, (iv) any change in any percentage voting requirement, voting rights, or the Required Lenders definition in this Agreement, (v) the release of any Guarantor of Payment or any material amount of collateral, except as specifically permitted hereunder, or (vi) any amendment to this Section 10.3 or Section 8.5 hereof.

(c) Generally. Notice of amendments or consents ratified by the Lenders hereunder shall be forwarded by Agent to all of the Lenders. Each Lender or other holder of a Note (or interest in any Loan) shall be bound by any amendment, waiver or consent obtained as authorized by this Section 10.3, regardless of its failure to agree thereto.

Section 10.4. Notices. All notices, requests, demands and other communications provided for hereunder shall be in writing and, if to Borrower, mailed or delivered to it, addressed to it at the address specified on the signature pages of this Agreement, if to Agent or a Lender, mailed or delivered to it, addressed to the address of Agent or such Lender specified on the signature pages of this Agreement, or, as to each party, at such other address as shall be designated by such party in a written notice to each of the other parties. All notices, statements, requests, demands and other communications provided for hereunder shall be given by overnight delivery or first class mail with postage prepaid by registered or certified mail, addressed as aforesaid, or sent by facsimile with telephonic confirmation of receipt, except that all notices hereunder shall not be effective until received.

Section 10.5. Costs, Expenses and Taxes. Borrower agrees to pay on demand all costs and expenses of Agent and all Related Expenses, including, but not limited to, (a) syndication, administration, travel and out-of-pocket expenses, including but not limited to attorneys' fees and expenses, of Agent in connection with the preparation, negotiation and closing of the Loan Documents and the administration of the Loan Documents, the collection and disbursement of all funds hereunder and the other instruments and documents to be delivered hereunder, (b) extraordinary expenses of Agent in connection with the administration of the Loan Documents and the other instruments and documents to be delivered hereunder, and (c) the reasonable fees and out-of-pocket expenses of special counsel for Agent, with respect to the foregoing, and of local counsel, if any, who may be retained by said special counsel with respect thereto. Borrower also agrees to pay on demand all costs and expenses of Agent and the Lenders, including reasonable attorneys' fees and expenses, in connection with the restructuring or enforcement of the Obligations, this Agreement or any Related Writing. In addition, Borrower shall pay any and all stamp, transfer, documentary and other taxes, assessments, charges and fees payable or determined to be payable in connection with the execution and delivery of the Loan Documents, and the other instruments and documents to be delivered hereunder, and agrees to hold Agent and each Lender harmless from and against any and all liabilities with respect to or resulting from any delay in paying or failure to pay such taxes or fees.

Section 10.6. Indemnification. Borrower agrees to defend, indemnify and hold harmless Agent and the Lenders (and their respective affiliates, officers, directors, attorneys, agents and employees) from and against any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses (including attorneys' fees) or disbursements of any kind or nature whatsoever that may be imposed on, incurred by or asserted against Agent or any Lender in connection with any investigative, administrative or judicial proceeding (whether or not such Lender or Agent shall be designated a party thereto) or any other claim by any Person relating to or arising out of any Loan Document or any actual or proposed use of proceeds of the Loans or any of the Obligations, or any activities of any Company or its Affiliates; provided that no Lender nor Agent shall have the right to be indemnified under this Section 10.6 for its own gross negligence or willful misconduct as determined by a court of competent jurisdiction. All obligations provided for in this Section 10.6 shall survive any termination of this Agreement.

Section 10.7. Obligations Several; No Fiduciary Obligations. The obligations of the Lenders hereunder are several and not joint. Nothing contained in this Agreement and no action taken by Agent or the Lenders pursuant hereto shall be deemed to constitute Agent or the Lenders a partnership, association, joint venture or other entity. No default by any Lender hereunder shall excuse the other Lenders from any obligation under this Agreement; but no Lender shall have or acquire any additional obligation of any kind by reason of such default. The relationship between Borrower and the Lenders with respect to the Loan Documents and the Related Writings is and shall be solely that of debtor and creditors, respectively, and neither Agent nor any Lender shall have any fiduciary obligation toward any Credit Party with respect to any such documents or the transactions contemplated thereby.

Section 10.8. Execution in Counterparts. This Agreement may be executed in any number of counterparts and by different parties hereto in separate counterparts and by facsimile signature, each of which counterparts when so executed and delivered shall be deemed to be an original and all of which taken together shall constitute but one and the same agreement.

Section 10.9. Binding Effect; Borrower's Assignment. This Agreement shall become effective when it shall have been executed by Borrower, Agent and each Lender and thereafter shall be binding upon and inure to the benefit of Borrower, Agent and each of the Lenders and their respective successors and assigns, except that Borrower shall not have the right to assign its rights hereunder or any interest herein without the prior written consent of Agent and all of the Lenders.

Section 10.10. Lender Assignments.

(a) Assignments of Commitments. Each Lender shall have the right at any time or times to assign to an Eligible Transferee (other than to a Lender that shall not be in compliance with this Agreement), without recourse, all or a percentage of all of the following: (i) such Lender's Commitment, (ii) all Loans made by that Lender, (iii) such Lender's Notes, and (iv) such Lender's interest in any Letter of Credit or Swing Loan, and any participation purchased pursuant to Section 2.2(b), 2.2(c) or 8.5 hereof.

(b) Prior Consent. No assignment may be consummated pursuant to this Section 10.10 without the prior written consent of Borrower and Agent (other than an assignment by any Lender to any affiliate of such Lender which affiliate is an Eligible Transferee and either wholly-owned by a Lender or is wholly-owned by a Person that wholly owns, either directly or indirectly, such Lender, or to another Lender, and which would not result in a withholding tax with respect to any payment made with respect to the Obligations or require Borrower to make any payment under Article III hereof, or result in any illegality as contemplated in Section 3.5(a) hereof), which consent of Borrower and Agent shall not be unreasonably withheld; provided, however, that Borrower's consent shall not be required if, at the time of the proposed assignment, any Default or Event of Default shall then exist. Anything herein to the contrary notwithstanding, any Lender may at any time make a collateral assignment of all or any portion of its rights under the Loan Documents to a Federal Reserve Bank, and no such assignment shall release such assigning Lender from its obligations hereunder.

(c) Minimum Amount. Each such assignment shall be in a minimum amount of the lesser of Five Million Dollars ($5,000,000) of the assignor's Commitment and interest herein or the entire amount of the assignor's Commitment and interest herein.

(d) Assignment Fee. Unless the assignment shall be to an affiliate of the assignor or the assignment shall be due to merger of the assignor or for regulatory purposes, either the assignor or the assignee shall remit to Agent, for its own account, an administrative fee of Three Thousand Five Hundred Dollars ($3,500).

(e) Assignment Agreement. Unless the assignment shall be due to merger of the assignor or a collateral assignment for regulatory purposes, the assignor shall (i) cause the assignee to execute and deliver to Borrower and Agent an Assignment Agreement, and (ii) execute and deliver, or cause the assignee to execute and deliver, as the case may be, to Agent such additional amendments, assurances and other writings as Agent may reasonably require.

(f) Non-U.S. Assignee. If the assignment is to be made to an assignee that is organized under the laws of any jurisdiction other than the United States or any state thereof, the assignor Lender shall cause such assignee, at least five Business Days prior to the effective date of such assignment, (i) to represent to the assignor Lender (for the benefit of the assignor Lender, Agent and Borrower) that under applicable law and treaties no taxes will be required to be withheld by Agent, Borrower or the assignor with respect to any payments to be made to such assignee in respect of the Loans hereunder, (ii) to furnish to the assignor Lender (and, in the case of any assignee registered in the Register (as defined below), Agent and Borrower) either U.S. Internal Revenue Service Form W-8ECI or U.S. Internal Revenue Service Form W-8BEN, as applicable (wherein such assignee claims entitlement to complete exemption from U.S. federal withholding tax on all payments hereunder), and (iii) to agree (for the benefit of the assignor, Agent and Borrower) to provide to the assignor Lender (and, in the case of any assignee registered in the Register, to Agent and Borrower) a new Form W-8ECI or Form W-8BEN, as applicable, upon the expiration or obsolescence of any previously delivered form, and to provide comparable statements in accordance with applicable U.S. laws and regulations and amendments duly executed and completed by such assignee, and to comply from time to time with all applicable U.S. laws and regulations with regard to such withholding tax exemption.

(g) Deliveries by Borrower. Upon satisfaction of all applicable requirements specified in subsections (a) through (f) above, Borrower shall execute and deliver (i) to Agent, the assignor and the assignee, any consent or release (of all or a portion of the obligations of the assignor) that is reasonably required to be delivered by Borrower in connection with the Assignment Agreement, and (ii) to the assignee, if requested, and the assignor, if applicable, an appropriate Note or Notes. After delivery of the new Note or Notes, the assignor's Note or Notes, if any, being replaced shall be returned to Borrower marked "replaced".

(h) Effect of Assignment. Upon satisfaction of all applicable requirements set forth in subsections (a) through (g) above, and any other condition contained in this Section 10.10,

(i) the assignee shall become and thereafter be deemed to be a "Lender" for the purposes of this Agreement, (ii) the assignor shall be released from its obligations hereunder to the extent that its interest has been assigned, (iii) in the event that the assignor's entire interest has been assigned, the assignor shall cease to be and thereafter shall no longer be deemed to be a "Lender" and (iv) the signature pages hereto and Schedule 1 hereto shall be automatically amended, without further action, to reflect the result of any such assignment.

(i) Agent to Maintain Register. Agent shall maintain at the address for notices referred to in Section 10.4 hereof a copy of each Assignment Agreement delivered to it and a register (the "Register") for the recordation of the names and addresses of the Lenders and the Commitment of, and principal amount of the Loans owing to, each Lender from time to time. The entries in the Register shall be conclusive, in the absence of manifest error, and Borrower, Agent and the Lenders may treat each Person whose name is recorded in the Register as the owner of the Loan recorded therein for all purposes of this Agreement. The Register shall be available for inspection by Borrower or any Lender at any reasonable time and from time to time upon reasonable prior notice.

Section 10.11. Sale of Participations. Any Lender may, in the ordinary course of its commercial banking business and in accordance with applicable law, at any time sell participations to one or more Eligible Transferees (each a "Participant") in all or a portion of its rights or obligations under this Agreement and the other Loan Documents (including, without limitation, all or a portion of the Commitment and the Loans and participations owing to it and the Note, if any, held by it); provided, that:

(a) any such Lender's obligations under this Agreement and the other Loan Documents shall remain unchanged;

(b) such Lender shall remain solely responsible to the other parties hereto for the performance of such obligations;

(c) the parties hereto shall continue to deal solely and directly with such Lender in connection with such Lender's rights and obligations under this Agreement and each of the other Loan Documents;

(d) such Participant shall be bound by the provisions of Section 8.5 hereof, and the Lender selling such participation shall obtain from such Participant a written confirmation of its agreement to be so bound; and

(e) no Participant (unless such Participant is itself a Lender) shall be entitled to require such Lender to take or refrain from taking action under this Agreement or under any other Loan Document, except that such Lender may agree with such Participant that such Lender will not, without such Participant's consent, take action of the type described as follows:

(i) increase the portion of the participation amount of any Participant over the amount thereof then in effect, or extend the Commitment Period, without the written consent of each Participant affected thereby; or

(ii) reduce the principal amount of or extend the time for any payment of principal of any Loan, or reduce the rate of interest or extend the time for payment of interest on any Loan, or reduce the facility fee, without the written consent of each Participant affected thereby.

Borrower agrees that any Lender that sells participations pursuant to this Section 10.11 shall still be entitled to the benefits of Article III hereof, notwithstanding any such transfer; provided, however, that the obligations of Borrower shall not increase as a result of such transfer and Borrower shall have no obligation to any Participant.

Section 10.12. Patriot Act Notice. Each Lender and Agent (for itself and not on behalf of any other party) hereby notifies the Credit Parties that, pursuant to the requirements of the Patriot Act, such Lender and Agent are required to obtain, verify and record information that identifies the Credit Parties, which information includes the name and address of the Credit Parties and other information that will allow such Lender or Agent, as applicable, to identify the Credit Parties in accordance with the Patriot Act. Borrower shall provide, to the extent commercially reasonable, such information and take such actions as are reasonably requested by Agent or a Lender in order to assist Agent or such Lender in maintaining compliance with the Patriot Act.

Section 10.13. Severability of Provisions; Captions; Attachments. Any provision of this Agreement that shall be prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof or affecting the validity or enforceability of such provision in any other jurisdiction. The several captions to Sections and subsections herein are inserted for convenience only and shall be ignored in interpreting the provisions of this Agreement. Each schedule or exhibit attached to this Agreement shall be incorporated herein and shall be deemed to be a part hereof.

Section 10.14. Investment Purpose. Each of the Lenders represents and warrants to Borrower that it is entering into this Agreement with the present intention of acquiring any Note issued pursuant hereto (or, if there is no Note, the interest as reflected on the books and records of Agent) for investment purposes only and not for the purpose of distribution or resale, it being understood, however, that each Lender shall at all times retain full control over the disposition of its assets.

Section 10.15. Entire Agreement. This Agreement, any Note and any other Loan Document or other agreement, document or instrument attached hereto or executed on or as of the Closing Date integrate all of the terms and conditions mentioned herein or incidental hereto and supersede all oral representations and negotiations and prior writings with respect to the subject matter hereof.

Section 10.16. Legal Representation of Parties. The Loan Documents were negotiated by the parties with the benefit of legal representation and any rule of construction or interpretation otherwise requiring this Agreement or any other Loan Document to be construed or interpreted against any party shall not apply to any construction or interpretation hereof or thereof.

Section 10.17. Governing Law; Submission to Jurisdiction.

(a) Governing Law. This Agreement, each of the Notes and any Related Writing shall be governed by and construed in accordance with the laws of the State of Ohio and the respective rights and obligations of Borrower, Agent, and the Lenders shall be governed by Ohio law, without regard to principles of conflicts of laws.

(b) Submission to Jurisdiction. Borrower hereby irrevocably submits to the exclusive jurisdiction (assuming jurisdiction is available) of any Washington state or federal court sitting in Seattle, Washington, over any action or proceeding arising out of or relating to this Agreement, the Obligations or any Related Writing, and Borrower hereby irrevocably agrees that all claims in respect of such action or proceeding may be heard and determined in such Washington state or federal court. Borrower, on behalf of itself and its Subsidiaries, hereby irrevocably waives, to the fullest extent permitted by law, any objection it may now or hereafter have to the laying of venue in any action or proceeding in any such court as well as any right it may now or hereafter have to remove such action or proceeding, once commenced, to another court on the grounds of FORUM NON CONVENIENS or otherwise. Borrower agrees that a final, nonappealable judgment in any such action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law.

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Section 10.18. Jury Trial Waiver. TO THE EXTENT PERMITTED BY LAW, BORROWER, AGENT AND EACH LENDER WAIVE ANY RIGHT TO HAVE A JURY PARTICIPATE IN RESOLVING ANY DISPUTE, WHETHER SOUNDING IN CONTRACT, TORT OR OTHERWISE, AMONG BORROWER, AGENT AND THE LENDERS, OR ANY THEREOF, ARISING OUT OF, IN CONNECTION WITH, RELATED TO, OR INCIDENTAL TO THE RELATIONSHIP ESTABLISHED AMONG THEM IN CONNECTION WITH THIS AGREEMENT OR ANY NOTE OR OTHER INSTRUMENT, DOCUMENT OR AGREEMENT EXECUTED OR DELIVERED IN CONNECTION HEREWITH OR THE TRANSACTIONS RELATED THERETO.

IN WITNESS WHEREOF, the parties have executed and delivered this Credit Agreement as of the date first set forth above.

Address: 16400 SE Nautilus Drive
Vancouver, Washington 98683
Attention: James Tener

NAUTILUS, INC.

By: /s/ William D. Meadowcroft
William D. Meadowcroft
Secretary – Treasurer

Address: 127 Public Square
Cleveland, Ohio 44114-1306
Attention: Institutional Banking

KEYBANK NATIONAL ASSOCIATION,
as Agent and as a Lender

By: /s/ Jeffrey R. Dincher
Name: Jeffrey R. Dincher
Title: Assistant Vice President

Address: 555 S.W. Oak Street
Portland, Oregon 97204
Attention: Scott J. Bell

U.S. BANK NATIONAL ASSOCIATION,
as Syndication Agent and as a Lender

By: /s/ Scott J. Bell
Name: Scott J. Bell
Title: Senior Vice President

Exhibit 10.22

EMPLOYMENT AGREEMENT

This Employment Agreement (this "Agreement") is entered into as of June 30, 2005, by and between Nautilus, Inc., a Washington corporation (the "Company" or "Employer"), and Juergen Eckmann ("Employee"). In consideration of the premises and the mutual covenants and agreements hereinafter set forth, the Company and Employee hereby agree as follows:

1. Employment. Employee is being hired as Vice President and Chief of Staff, Apparel Division. Employee shall (a) devote his professional entire time, attention, and energies to his position, (b) use his best efforts to promote the interests of Employer; (c) perform faithfully and efficiently his responsibilities and duties, and (d) refrain from any endeavor outside of his employment which interferes with his ability to perform his obligations hereunder. Employee shall report to the President, Apparel Division, and/or such other persons as may be designated by Employer, and perform his job duties subject to his general supervision, orders, advice and direction. Employee shall perform the duties normally associated with the position and/or such duties as delegated and assigned by the Company. The Company retains the sole discretion to change Employee's position and/or duties as it deems appropriate.

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

2. Salary. As compensation for services to be rendered hereunder, the Company shall pay Employee an initial annual salary in the gross amount of US$195,000. Said salary will be paid in accordance with the Company's existing payroll policies, and shall be subject to normal and/or authorized deductions and withholdings. In addition, the Company will pay to Employee a one time bonus in the amount of $30,000 payable on August 1, 2005, which bonus will vest in 1/12 increments over a 12 month period of time beginning August 1, 2005. Should employee voluntarily resign from the Company prior to August 1, 2006 he will re-pay a pro rata amount of that unvested bonus for any remaining time that he is not employed prior to August 1, 2006.

3. Bonus. Employee will be eligible to receive an annual bonus up to the target range of thirty percent (30%) of Employee's base salary earned in 2005 while employed by the Company and in each year thereafter. Employee will also be eligible for a bonus of an additional 50% above the target range (i.e., a total of 45% of salary earned in 2005) should the Company and individual reach certain additional goals established by the President, Apparel Division and the Board of Directors. The amount of such bonus (if any) is determined at the discretion of the Company and based on the accomplishment of individual and Company objectives. To be eligible to receive this bonus Employee must be employed on the date the bonus is actually paid and no partial or pro-rata bonus will be paid if Employee is not employed on the day the bonus is actually paid.

4. Stock Options. Pursuant to the Company's current 2005 Long Term Incentive Plan (the "Plan"), the Company shall recommend that Employee receive options ("Options") to purchase 16,000 shares of Employer's stock. The terms of any option grant shall be governed by the Plan and a Stock Option Agreement (the "Option Agreement"). Employee acknowledges that any stock options granted do not, and will not, constitute wages or compensation. Unless otherwise provided in the Plan or required by law, the Board of Directors of Employer shall have sole discretion regarding the grant of options, price of options, the vesting schedule and all other terms and conditions of the option grant.

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

6. Health and Welfare Benefits. Employee will remain on the current Dash America benefit plans through December 31, 2005 on the same basis as he is currently eligible and as those benefits are currently in place. Effective January 1, 2006, the Employee shall be eligible to receive employee benefits, if any, generally provided to employees at the same level as Employee. Such benefits may be amended or discontinued by Employer at any time and on the same basis as the Employer does for employees at the same level as Employee.

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

(a) Cause. As used in this Agreement, Cause means (i) Employee's indictment or conviction in a court of law for any crime or offense that in Employer's reasonable judgment makes Employee unfit for continued employment, prevents Employee from performing Employee's duties or other obligations or adversely affects the reputation of Employer; (ii) dishonesty by Employee related to his employment; (iii) violation of a key Employer policy or this Agreement by Employee (including, but not limited to, acts of harassment or discrimination, use of unlawful drugs or drunkenness on Employer's premises during normal work hours); (iv) insubordination (i.e. conduct such as refusal to follow direct orders of the President or other individuals(s) to whom Employee reports; (v) dereliction of duty by Employee (e.g., failure to perform minimum duties after warning) and reasonable opportunity to correct; (vi) Employee's competition with Employer, diversion of any corporate opportunity, violation of the Business Protection Agreement, or other similarly serious conflict of interest or self-dealing incurring to Employee's direct or indirect benefit and Employer's detriment; (vii) intentional or grossly negligent conduct by Employee that is significantly injurious to Employer or its affiliates; (viii) Employee's failure to meet the minimum goals of his position if such are provided in

writing to Employee, and as such goals may be amended from time to time; and (ix) Employee's death or disability (i.e., Employee's inability to perform the essential job functions of the position with or without a reasonable accommodation).

(b) At-Will. At-will termination shall mean a termination by the Company where it does not seek to establish Cause. If the Company exercises its right to terminate Employee without Cause, it shall provide the Employee with 183 days prior written notice of the termination of his employment (Notice of Termination), provided however, that at the Company's sole discretion, it may immediately relieve Employee from all duties and responsibilities during the Notice Period. After receiving Notice of Termination, the Employee must continue to perform all duties and responsibilities, unless such duties are removed. If the Company exercises its option to relieve Employee of duties after the Company has provided Notice of Termination, then the Company shall continue to provide Employee with the basic benefits generally applicable to the Company's employees and base salary during the Notice Period. If Employee exercises his right to terminate his employment, the Employee agrees to provide the Company with 21 days' prior written notice of the termination of his employment (Notice of Termination). After receiving such Notice from the Employee, the Company retains the right to accept Employee's resignation, and hence, terminate the employment relationship without the need for further payments, at an earlier date than provided in the Employee's Notice of Termination.

8. Severance Upon Termination.

(a) Upon termination of Employee's employment under this Agreement by the Company without Cause, then, in lieu of any further salary, bonus, or other payments for periods subsequent to the Date of Termination, the Company shall pay to the Employee severance equal to six months average monthly annual base salary[1]. Such severance payment shall be made according to the Company's normal payroll process spread out equally over the severance period. Violation of this Agreement or the Business Protection Agreement and/or failure to sign the Release and Waiver Agreement shall immediately relieve the Company from its payment obligation under this paragraph and entitle it to recover any amounts paid under this paragraph. This Section 8 shall be read in conjunction with Section 7(b), and entitles the employee to a maximum of six months salary, benefits, or notice under this Agreement.

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

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

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[1] The average annual monthly base salary shall be calculated using the average of the cash compensation received by Employee in the six months prior to the Date of Termination.

(d) In the event that Employee is discharged without cause as defined herein, Company shall provide the following relocation benefits to Employee: packaging and shipment of household goods from Colorado to Germany, and airfare for Employee and his family from Colorado to Germany.

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

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

11. Release of Claims. As a precondition to receipt of the severance provided in Section 7(b) or 8(a) of this Agreement, Employee acknowledges and understands that he must sign a standard Waiver and Release of Claims Agreement in a form acceptable to the Company and generally then in use for employees who are terminated. Employee understands that he will not be entitled to receive any payments under this Agreement until he executes and delivers the Waiver and Release of Claims Agreement, and the revocation period set forth in the Waiver and Release of Claims Agreement has run.

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

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

To the Company:	Nautilus, Inc. 16400 SE Nautilus Drive Vancouver, WA 98684 Attention: Human Resources
With a Copy to:	Garvey, Schubert & Barer 1191 Second Avenue, 18th Floor Seattle, WA 98101-2939 Attention: Bruce Robertson
To Employee:	Employee: Juergen Eckmann At the last address and fax number Shown on the records of the Company

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

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

15. Entire Agreement. This Agreement, along with the Business Protection Agreement attached as Exhibit A, sets forth the entire agreement of the parties hereto and supersedes any and all prior agreements and understandings concerning Employee's employment by the Company. This Agreement shall replace the Employment Agreement dated August 1, 2004 between Employee and DashAmerica, Inc., which Employment Agreement shall have no further force and effect. This Agreement may be changed only by a written document signed by Employee and the Company.

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

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

18. Vacation Benefit. Employee will be granted 4 weeks vacation upon assuming employment and will be able to carryover from one year to another a maximum of 2 weeks of unused vacation, which will allow Employee to accrue a maximum of 6 weeks vacation. Any accrued but unused vacation will be paid at time of termination.

19. Miscellaneous Benefits. Company will provide appropriate legal advice and support to enable Employee's spouse to be legally employed pursuant to US laws, and will provide professional job search and outplacement assistance in connection with a job search in the Denver/Boulder Colorado area.

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

Employer: NAUTILUS, INC.

By _____ Date _____

Its _____

Employee _____ Date _____

Exhibit 10.28

FIRST AMENDMENT AGREEMENT

This FIRST AMENDMENT AGREEMENT (this "Amendment") is made as of the 10th day of March, 2006 among:

(a) NAUTILUS, INC., a Washington corporation ("Borrower");

(b) the Lenders, as defined in the Credit Agreement, as hereinafter defined;

(c) KEYBANK NATIONAL ASSOCIATION, as lead arranger, sole book runner and administrative agent for the Lenders under the Credit Agreement ("Agent"); and

(d) U.S. BANK NATIONAL ASSOCIATION, as syndication agent under the Credit Agreement.

WHEREAS, Borrower, Lenders and Agent are parties to that certain Credit Agreement, dated as of November 18, 2005, that provides, among other things, for loans and letters of credit aggregating Sixty-Five Million Dollars ($65,000,000), all upon certain terms and conditions (as the same may from time to time be amended, restated or otherwise modified, the "Credit Agreement");

WHEREAS, Borrower has notified Agent and the Lenders that the following subsidiaries have merged with and into Borrower:

-Nautilus Direct, Inc.
-The Nautilus Group Sales Corporation
-DFI Properties, LLC
-BFI Advertising, Inc.
-Nautilus/Schwinn Fitness Group Inc.
-DF Hebb Industries, Inc.
-Stairmaster Health & Fitness Products, Inc.
-Nautilus Human Performance Systems, Inc.

WHEREAS, Borrower, Agent and the Lenders desire to amend the Credit Agreement to modify certain provisions thereof and add certain provisions thereto;

WHEREAS, each capitalized term used herein and defined in the Credit Agreement, but not otherwise defined herein, shall have the meaning given such term in the Credit Agreement; and

WHEREAS, unless otherwise specifically provided herein, the provisions of the Credit Agreement revised herein are amended effective as of the date of this Amendment;

NOW, THEREFORE, in consideration of the premises and of the mutual covenants herein and for other valuable consideration, Borrower, Agent and the Lenders agree as follows:

1. Retroactive Amendment to Definitions. Article I of the Credit Agreement is hereby retroactively amended, effective as of December 31, 2005, to the delete the definitions of "Consolidated Capital Expenditures" and "Triggering Event Date" therefrom and to insert in place thereof, respectively, the following:

"Consolidated Capital Expenditures" shall mean, for any period, the amount of capital expenditures of Borrower, as determined on a Consolidated basis and in accordance with GAAP; provided, however, that, for purposes of calculating the Fixed Charge Coverage Ratio and the related financial covenant set forth in Section 5.7(b) hereof, the following capital expenditures made by Borrower for the purchase of a new chief executive office shall be excluded from the calculation of Consolidated Capital Expenditures: (a) during the period from January 1, 2005 through March 31, 2005, an amount equal to Zero Dollars ($0), (b) during the period from April 1, 2005 through June 30, 2005, an amount equal to Five Million One Hundred Twelve Thousand Seven Hundred Fifty-Three and 15/100 Dollars ($5,112,753.15), (c) during the period from July 1, 2005 through September 31, 2005, an amount equal to Four Million Nine Hundred Two Thousand Three Hundred Ten and 98/100 Dollars ($4,902,310.98), and (d) during the period from October 1, 2005 through December 31, 2005, an amount equal to Three Million Two Hundred Twenty Three Thousand Three Hundred Twenty-Six and 12/100 Dollars ($3,223,326.12).

"Triggering Event Date" shall mean the earlier of (a) the first date that the Leverage Ratio is equal to or greater than 2.00 to 1.00, or (b) the first date that an Event of Default shall occur after March 10, 2006.

2. Amendment to Definitions. Article I of the Credit Agreement is hereby amended to delete the definition of "Restricted Payment" therefrom and to insert in place thereof the following:

"Restricted Payment" shall mean, with respect to any Company, (a) any Capital Distribution, or (b) any amount paid by such Company in repayment, redemption, retirement or repurchase, directly or indirectly, of any Subordinated Indebtedness.

3. Addition to Definitions. Article I of the Credit Agreement is hereby amended to add the following new definition thereto:

"First Amendment Effective Date" shall mean March 10, 2006.

4. Amendment to Default Rate. Section 2.3 of the Credit Agreement is hereby amended to delete subsection (c) therefrom and to insert in place thereof the following:

(c) Default Rate. Anything herein to the contrary notwithstanding, if an Event of Default shall occur, upon the election of the Required Lenders (i) the principal of each Loan and the unpaid interest thereon shall bear interest, until paid, at the Default

Rate, (ii) the fee for the aggregate undrawn amount of all issued and outstanding Letters of Credit shall be increased by two percent (2%) in excess of the rate otherwise applicable thereto, and (iii) in the case of any other amount not paid when due from Borrower hereunder or under any other Loan Document, such amount shall bear interest at the Default Rate; provided that, during an Event of Default under Section 7.1 or 7.12 hereof, the applicable Default Rate shall apply without any election or action on the part of Agent or any Lender.

5. Retroactive Amendment to Post-Closing Items. Section 4.3(a) of the Credit Agreement is hereby retroactively amended, effective as of the Closing Date, to delete the phrase "forty-five (45) days" therefrom and to insert in place thereof the phrase "ninety (90) days".

6. Amendment to Financial Covenants. Section 5.7 of the Credit Agreement is hereby amended to delete subsection (b) therefrom and to insert in place thereof the following:

(b) Fixed Charge Coverage Ratio. The Companies shall not suffer or permit at any time the Fixed Charge Coverage Ratio to be less than (i) on the Closing Date through March 30, 2006, 1.20 to 1.00, (ii) on March 31, 2006 through December 30, 2006, 0.75 to 1.00, and (iii) on December 31, 2006 and thereafter, 1.20 to 1.00.

7. Retroactive Additions to Investments. Section 5.11 of the Credit Agreement is hereby retroactively amended, effective as of the Closing Date, to add the following new subparts (ix) and (x) at the end thereto:

(ix) any Hedge Agreement that may be construed as an investment, so long as such Hedge Agreement shall have been entered into in the ordinary course of business and not for speculative purposes; and

(x) guaranties for leases of real or personal property leased by a Credit Party if such leases are not otherwise prohibited by any Loan Documents

8. Amendment to Restricted Payments. Article V of the Credit Agreement is hereby amended to delete Section 5.15 therefrom and to insert in place thereof the following:

Section 5.15. Restricted Payments. No Company shall make or commit itself to make any Restricted Payment at any time, except that Borrower may make (a) Capital Distributions, and (b) scheduled interest payments on Subordinated Indebtedness, in each case so long as no Default or Event of Default shall then exist or immediately thereafter shall begin to exist; provided, however, that, for the period commencing on January 1, 2006 until such time as the Fixed Charge Coverage Ratio shall be equal to or greater than 1.20 to 1.00, Borrower may only make Capital Distributions for the repurchase of shares in an aggregate amount not to exceed Thirty Million Dollars ($30,000,000).

9. Addition to Compliance with Laws. Section 6.3 of the Credit Agreement is hereby amended to add the following new subsections (d), (e) and (f) at the end thereto:

(d) has ensured that no Person who owns a controlling interest in or otherwise controls a Company is (i) listed on the Specially Designated Nationals and Blocked Person List maintained by the Office of Foreign Assets Control ("OFAC"), Department of the Treasury, or any other similar lists maintained by OFAC pursuant to any authorizing statute, executive order or regulation, or (ii) a Person designated under Section 1(b), (c) or (d) of Executive Order No. 13224 (September 23, 2001), any related enabling legislation or any other similar executive orders;

(e) is in compliance with all applicable Bank Secrecy Act and anti-money laundering laws and regulations; and

(f) is in compliance, in all material respects, with the Patriot Act.

10. Amendment to Locations. Section 6.9 of the Credit Agreement is hereby amended to delete each instance of the phrase "As (or "as", as appropriate) of the Closing Date" therefrom and to insert in place thereof, respectively, the phrase "As (or "as", as appropriate) of the First Amendment Effective Date".

11. Retroactive Amendment to Intellectual Property. Section 6.17 of the Credit Agreement is hereby retroactively amended, effective as of the Closing Date, to delete the phrase "Other than as disclosed on Schedule 6.17 hereto" therefrom and to insert in place thereof the phrase "Other than as disclosed on Schedule 6.4 hereto".

12. Amendment to Schedules. The Credit Agreement is hereby amended to delete Schedule 2 (Guarantors of Payment), Schedule 3 (Pledged Securities), Schedule 6.1 (Corporate Existence), Schedule 6.9 (Locations) therefrom and to insert in place thereof, respectively, a new Schedule 2, Schedule 3, Schedule 6.1 and Schedule 6.9 in the form of Schedule 2, Schedule 3, Schedule 6.1 and Schedule 6.9, as appropriate, attached hereto.

13. Waiver of Specific Defaults. Borrower has notified Agent and the Lenders that Borrower has failed to comply with the financial covenant set forth in Section 5.7(b) (Fixed Charge Coverage Ratio) for the fiscal year of Borrower ending December 31, 2005 (the "Violation"). Borrower has requested that Agent and the Lenders waive the Default and Event of Default that exist under the Credit Agreement by virtue of the Violation. Agent and the Lenders hereby waive the aforesaid Default and Event of Default that exist solely by virtue of the Violation on the condition that, after giving effect to the terms of this Amendment, no Default or Event of Default shall exist under the Credit Agreement or any other Loan Document. This Amendment shall serve as evidence of such waiver. Borrower agrees with Agent and the Lenders that (a) except with respect to the limited waiver granted herein specifically relating to the Violation, Agent and the Lenders shall not be under any obligation to forbear from exercising any of their rights or remedies upon the occurrence of any Default or Event of Default, (b) Borrower shall be in full compliance with the Credit Agreement and the other Loan Documents on and after the date of this Amendment, and (c) Agent and the Lenders have not established any course of dealing with respect to such waiver or otherwise that is inconsistent with the express terms of the Credit Agreement and the other Loan Documents.

14. Closing Items. Concurrently with the execution of this Amendment, Borrower shall:

(a) deliver to Agent, for the benefit of the Lenders, a Guaranty of Payment executed by DashAmerica, Inc., such agreement to be substantially in the form of Exhibit H to the Credit Agreement, along with any corporate governance and authorization documents, in each case as may be deemed reasonably necessary or advisable by Agent;

(b) cause each Guarantor of Payment to execute the attached Acknowledgement and Agreement; and

(c) pay all legal fees and expenses of Agent in connection with this Amendment.

15. Post-Closing Items. Within thirty (30) days after the First Amendment Effective Date (unless a longer period is agreed to in writing by Agent), Borrower shall have delivered to Agent, for the benefit of the Lenders, the stock certificate representing sixty-five percent (65%) of the common stock of Nautilus International Holdings, S.A. and a corresponding stock transfer power, to be executed in blank and held in escrow pursuant to Section 2.12 of the Credit Agreement.

16. Representations and Warranties. Borrower hereby represents and warrants to Agent and the Lenders that (a) Borrower has the legal power and authority to execute and deliver this Amendment; (b) the officers executing this Amendment have been duly authorized to execute and deliver the same and bind Borrower with respect to the provisions hereof; (c) the execution and delivery hereof by Borrower and the performance and observance by Borrower of the provisions hereof do not violate or conflict with the organizational agreements of Borrower or any law applicable to Borrower or result in a breach of any provision of or constitute a default under any other agreement, instrument or document binding upon or enforceable against Borrower; (d) except as waived herein, no Default or Event of Default exists under the Credit Agreement, nor will any occur immediately after the execution and delivery of this Amendment or by the performance or observance of any provision hereof; (e) Borrower is not aware of any claim or offset against, or defense or counterclaim to, Borrower's obligations or liabilities under the Credit Agreement or any Related Writing; and (f) this Amendment constitutes a valid and binding obligation of Borrower in every respect, enforceable in accordance with its terms.

17. References to Credit Agreement. Each reference that is made in the Credit Agreement or any Related Writing shall hereafter be construed as a reference to the Credit Agreement as amended hereby. Except as herein otherwise specifically provided, all terms and provisions of the Credit Agreement are confirmed and ratified and shall remain in full force and effect and be unaffected hereby. This Amendment is a Related Writing.

18. Waiver. Borrower, by signing below, hereby waives and releases Agent and each of the Lenders, and their respective directors, officers, employees, attorneys, affiliates and subsidiaries, from any and all claims, offsets, defenses and counterclaims of which Borrower is aware, such waiver and release being with full knowledge and understanding of the circumstances and effect thereof and after having consulted legal counsel with respect thereto.

19. Counterparts. This Amendment may be executed in any number of counterparts, by different parties hereto in separate counterparts and by facsimile signature, each of which when so executed and delivered shall be deemed to be an original and all of which taken together shall constitute but one and the same agreement.

20. Headings. The headings, captions and arrangements used in this Amendment are for convenience only and shall not affect the interpretation of this Amendment.

21. Severability. Any term or provision of this Amendment held by a court of competent jurisdiction to be invalid or unenforceable shall not impair or invalidate the remainder of this Amendment and the effect thereof shall be confined to the term or provision so held to be invalid or unenforceable.

22. Governing Law. The rights and obligations of all parties hereto shall be governed by the laws of the State of Ohio, without regard to principles of conflicts of laws.

[Remainder of page intentionally left blank.]

JURY TRIAL WAIVER. BORROWER, THE LENDERS AND AGENT, TO THE EXTENT PERMITTED BY LAW, EACH HEREBY WAIVES ANY RIGHT TO HAVE A JURY PARTICIPATE IN RESOLVING ANY DISPUTE, WHETHER SOUNDING IN CONTRACT, TORT OR OTHERWISE, AMONG BORROWER, THE LENDERS AND AGENT, OR ANY THEREOF, ARISING OUT OF, IN CONNECTION WITH, RELATED TO, OR INCIDENTAL TO THE RELATIONSHIP ESTABLISHED AMONG THEM IN CONNECTION WITH THIS AMENDMENT OR ANY NOTE OR OTHER INSTRUMENT, DOCUMENT OR AGREEMENT EXECUTED OR DELIVERED IN CONNECTION HEREWITH OR THE TRANSACTIONS RELATED THERETO.

IN WITNESS WHEREOF, the parties have executed and delivered this Amendment as of the date first set forth above.

NAUTILUS, INC.

By: /s/ William D. Meadowcroft
Name: William D. Meadowcroft
Title: Secretary-Treasurer

KEYBANK NATIONAL ASSOCIATION,
as Agent and as a Lender

By: /s/ Jeffrey R. Dincher
Name: Jeffrey R. Dincher
Title: Assistant Vice President

U.S. BANK NATIONAL ASSOCIATION,
as Syndication Agent and as a Lender

By: /s/ Scott J. Bell
Name: Scott J. Bell
Title: Senior Vice President

ACKNOWLEDGMENT AND AGREEMENT

The undersigned consent and agree to and acknowledge the terms of the foregoing First Amendment Agreement dated as of March 10, 2006. The undersigned further agree that the obligations of the undersigned pursuant to the Guaranty of Payment executed by the undersigned shall remain in full force and effect and be unaffected hereby.

The undersigned hereby waive and release Agent and the Lenders and their respective directors, officers, employees, attorneys, affiliates and subsidiaries from any and all claims, offsets, defenses and counterclaims of which the undersigned are aware, such waiver and release being with full knowledge and understanding of the circumstances and effect thereof and after having consulted legal counsel with respect thereto.

JURY TRIAL WAIVER. THE UNDERSIGNED, TO THE EXTENT PERMITTED BY LAW, HEREBY WAIVE ANY RIGHT TO HAVE A JURY PARTICIPATE IN RESOLVING ANY DISPUTE, WHETHER SOUNDING IN CONTRACT, TORT OR OTHERWISE, AMONG BORROWERS, AGENT, THE LENDERS AND THE UNDERSIGNED, OR ANY THEREOF, ARISING OUT OF, IN CONNECTION WITH, RELATED TO, OR INCIDENTAL TO THE RELATIONSHIP ESTABLISHED AMONG THEM IN CONNECTION WITH THIS AMENDMENT OR ANY NOTE OR OTHER INSTRUMENT, DOCUMENT OR AGREEMENT EXECUTED OR DELIVERED IN CONNECTION HEREWITH OR THE TRANSACTIONS RELATED THERETO.

DFI LEASECO, LLC

By: Nautilus, Inc.
Its: Sole Member

By: /s/ William D. Meadowcroft
Name: William D. Meadowcroft
Title: Secretary-Treasurer

DASHAMERICA, INC.

By: /s/ Wayne M. Bolio
Name: Wayne M. Bolio
Title: Vice President

EXHIBIT 21

SUBSIDIARIES OF NAUTILUS, INC.

Nautilus Direct, Inc., a Washington corporation
Nautilus Human Performance Systems, Inc., a Virginia corporation
The Nautilus Group Sales Corporation, a Washington corporation
DFI Properties, LLC, a Virginia limited liability company
BFI Advertising, Inc., a Washington corporation
DFI Leaseco, LLC, a Washington limited liability company
Nautilus/Schwinn Fitness Group, Inc., a Colorado corporation
DF Hebb Industries, Inc., a Texas corporation
StairMaster Health & Fitness Products, 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
Schwinn UK Ltd., a United Kingdom corporation
Nautilus Fitness Academy UK Ltd., a United Kingdom corporation
Schwinn Fitness Academy 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
Pearl Izumi Europe BV, a Netherlands corporation

EXHIBIT 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statements Nos. 333-126054, 333-46936 and 333-79643 on Form S-8 of our reports dated March 16, 2006 relating to the consolidated financial statements of Nautilus, Inc., and of our report on internal control over financial reporting dated March 16, 2006 (which report expresses an adverse opinion on the effectiveness of the Company's internal control over financial reporting because of material weaknesses) appearing in this Annual Report on Form 10-K of Nautilus, Inc. for the year ended December 31, 2005.

DELOITTE & TOUCHE LLP

Portland, Oregon
March 16, 2006

EXHIBIT 24

POWER OF ATTORNEY

PETER A. ALLEN

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Peter A. Allen, hereby constitutes and appoints Greggory C. Hammann 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, 2005, 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 16th day of March, 2006.

Signature:

/s/ Peter A. Allen

Peter A. Allen

POWER OF ATTORNEY

ROBERT S. FALCONE

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Robert S. Falcone, hereby constitutes and appoints Greggory C. Hammann 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, 2005, 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 16th day of March, 2006.

Signature:

/s/ Robert S. Falcone

Robert S. Falcone

POWER OF ATTORNEY

FREDERICK T. HULL

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Frederick T. Hull, hereby constitutes and appoints Greggory C. Hammann 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, 2005, 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 16th day of March, 2006.

Signature:

/s/ Frederick T. Hull

Frederick T. Hull

POWER OF ATTORNEY

DONALD W. KEEBLE

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Donald W. Keeble, hereby constitutes and appoints Greggory C. Hammann 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, 2005, 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 16th day of March, 2006.

Signature:

/s/ Donald W. Keeble

Donald W. Keeble

POWER OF ATTORNEY

PAUL F. LITTLE

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Paul F. Little, hereby constitutes and appoints Greggory C. Hammann 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, 2005, 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 16th day of March, 2006.

Signature:

/s/ Paul F. Little

Paul F. Little

POWER OF ATTORNEY

DIANE L. NEAL

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Diane L. Neal, hereby constitutes and appoints Greggory C. Hammann 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, 2005, 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 16th day of March, 2006.

Signature:

/s/ Diane L. Neal

Diane L. Neal

POWER OF ATTORNEY

MARVIN G. SIEGERT

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Marvin G. Siegert, hereby constitutes and appoints Greggory C. Hammann 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, 2005, 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 16th day of March, 2006.

Signature:

/s/ Marvin G. Siegert

Marvin G. Siegert

EXHIBIT 31.1

CERTIFICATION

I, Greggory C. Hammann, 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)) 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 16, 2006
Date

By: /s/ Greggory C. Hammann
Greggory C. Hammann, Chief Executive Officer,
President and Chairman of the Board

EXHIBIT 31.2

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)) 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 16, 2006
Date

By: /s/ William D. Meadowcroft
William D. Meadowcroft, Chief Financial Officer
and Secretary

EXHIBIT 32.1

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, 2005 (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 16, 2006
Date

By: /s/ Greggory C. Hammann
Greggory C. Hammann, Chief Executive Officer,
President and Chairman of the Board

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.

EXHIBIT 32.2

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, 2005 (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 16, 2006
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.