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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549
FORM 10-K

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

For the Fiscal Year Ended: December 31, 1999

OR

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

Commission File Number: 000-25867

DIRECT FOCUS, 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.)

2200 NE 65TH AVENUE, VANCOUVER, WA
(Address of principal executive offices)

98661
(Zip Code)

Registrant's telephone number, including area code: 360-694-7722

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act: COMMON STOCK,
WITHOUT PAR VALUE

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

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

The aggregate market value of the voting stock held by non-affiliates
of the Registrant is \$247,324,553 as of February 29, 2000 based upon the last
sales price as reported by the Nasdaq National Market System.

The number of shares outstanding of the Registrant's Common Stock as of
February 29, 2000 was 10,519,565 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 2000 Annual Meeting of
Stockholders.

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DIRECT FOCUS, INC.
1999 FORM 10-K ANNUAL REPORT
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PART I

ITEM 1. BUSINESS

FORWARD LOOKING STATEMENTS

Statements in this Form 10-K that Direct Focus, Inc. considers to be forward-looking are denoted with an asterisk ("*"), and the following cautionary language applies to all such statements, as well as any other statements in this Form 10-K that the reader may consider to be forward-looking. 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;
- Anticipated earnings;
- New product introductions; and
- Future capital expenditures.

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

- Our reliance on a limited product line;
- Market acceptance of our existing and future products;
- Growth management challenges;
- Our limited experience in marketing Nautilus Sleep Systems;
- A decline in consumer spending due to unfavorable economic conditions;
- Government regulatory action;
- Our ability to effectively identify and negotiate any future strategic acquisitions, as well as to integrate any acquired businesses into our operations; and
- Unpredictable events and circumstances relating to international operations, including our use of foreign manufacturers.

We describe certain of these and other key risk factors elsewhere in this Form 10-K. Readers are further cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this Form 10-K. 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.

INTRODUCTION

Direct Focus, Inc. is a direct marketing company that develops and markets premium quality, premium priced, branded consumer products. We market consumer products within our direct marketing segment directly to consumers through a variety of direct marketing channels, including spot television commercials, infomercials, print media, response mailings and the Internet.

Our principal and most successful directly marketed product to date has been our Bowflex line of home fitness equipment, which generated \$100.9 million, or 83.3%, of our net sales in 1999. We also offer a line of premium quality airbed mattresses under the name "Nautilus Sleep Systems," which we test marketed throughout 1999 and began directly marketing on a nationwide basis late in the fourth quarter of 1999.

Another significant component of our operations is our Nautilus segment, which encompasses products and operations outside of our direct marketing segment. Products within our Nautilus segment include Nautilus commercial fitness equipment and Nautilus consumer fitness equipment and accessories, both of which we added in January 1999 as part of our acquisition of Nautilus International, Inc. We anticipate further leveraging our Nautilus brand name through expanded marketing of new Nautilus home gyms and a new line of Nautilus free weight home gym equipment which we recently introduced, as well as any other Nautilus-branded home exercise products we may introduce in 2000.* We market and sell our Nautilus commercial fitness equipment domestically through a direct sales force and internationally through independent sales representatives. We market our other Nautilus consumer products domestically through non-exclusive independent sales representatives. We believe we have effectively integrated the Nautilus commercial business into our operations and stabilized its financial performance, as evidenced by its profitability during the second half of 1999.*

For a discussion of financial information about our two business segments, direct marketing and Nautilus, see Note 14 of the Notes to Consolidated Financial Statements.

Direct Focus was incorporated in California in 1986 and became a Washington corporation in 1993. Our principal executive offices are located at 2200 NE 65th Avenue, Vancouver, Washington 98661, and our telephone number is (360) 694-7722. We maintain our corporate web site at www.directfocusinc.com. None of the information on this web site or our other web sites is part of this Form 10-K.

As used in this Form 10-K, the terms "we," "our," "us," "Direct Focus" and "the Company" refer to Direct Focus, Inc. and its subsidiaries. The names Bowflex-Registered Trademark-, Nautilus-Registered Trademark-, Bowflex Power-Pro-Registered Trademark-, Motivator-Registered Trademark-, Versatrainer-Registered Trademark-, Power Rod-Registered Trademark-, Direct Focus-Registered Trademark-, Instant Comfort-Registered Trademark- and Nautilus Sleep Systems-Registered Trademark- are registered trademarks of Direct Focus, Inc.

DIRECT MARKETING

We directly market our Bowflex home fitness equipment and Nautilus Sleep Systems principally through 30- and 60-second, or "spot," television commercials, television infomercials, the Internet, response mailings and print media. To date, we have been highly successful with what we refer to as a "two-step" marketing approach. In general, our two-step approach focuses first on spot commercials, which we air to generate consumer interest in our products and requests for product information. The second step focuses on converting inquiries into sales, which we accomplish through a combination of response mailings and outbound telemarketing. We supplement our two-step approach with infomercials, which generally are designed to provide potential customers with sufficient product information to stimulate an immediate purchase.

ADVERTISING

SPOT COMMERCIALS AND INFOMERCIALS. Spot television commercials are a key element of the marketing strategy for all of our directly marketed consumer products. For directly marketed products that may require further explanation and demonstration, television infomercials are an important additional marketing tool. We have developed a variety of spot commercials and infomercials for our Bowflex product line and several commercials and marketing videos for our Nautilus Sleep Systems product line. We expect to use spot commercials and, where appropriate, infomercials to market any Nautilus consumer products that we determine are appropriate for direct marketing.

When we begin marketing a new product, we typically test and refine our marketing concepts and selling practices while advertising the product in spot television commercials. Production costs for these commercials can range from \$50,000 to \$150,000. Based on market research and viewer response to our spot commercials, we may produce additional spot commercials and, if appropriate for the product, an infomercial. Production costs for infomercials can range from \$150,000 to \$500,000, depending on the scope of the project. Generally, we attempt to film several infomercial and commercial concepts at the same time in order to maximize production efficiencies. From this footage we can then develop several varieties of spot commercials and infomercials and introduce and refine them over time. We typically generate our own scripts for spot commercials and hire outside writers to assist with infomercial scripts. We also typically contract with outside production companies to produce spot commercials and infomercials.

Once produced, we test spot commercials and infomercials on a variety of cable television networks that have a history of generating favorable responses for our existing products. Our initial objective is to determine the product's marketing appeal and what, if any, creative or product modifications may be appropriate. If these initial tests are successful, we then air the spot commercials and infomercials on an accelerating schedule on additional cable networks.

MEDIA BUYING. An important component of our direct marketing success is our ability to purchase quality media time at an affordable price. The cost of airing spot commercials and infomercials varies significantly, depending on the network, time slot and, for spot commercials, programming. Each spot commercial typically costs between \$50 and \$5,000 to air, and each infomercial typically costs between \$2,500 and \$40,000 to air. We currently purchase the majority of our media time on cable networks, through which we reach more than 70 million homes.

We track the success of each of our spot commercials and infomercials by determining how many viewers respond to each airing of a spot commercial or infomercial. We accumulate this information in a database that we use to evaluate the cost-effectiveness of available media time. In addition, we believe the database enables us to predict with reasonable accuracy how many product sales and inquiries will result from each spot commercial and infomercial that we air.* We also believe we can effectively track changing viewer patterns and adjust our advertising accordingly.*

We do not currently purchase media time under long-term contracts. Instead, we book most of our spot commercial time on a quarterly basis and most of our infomercial time on a monthly or quarterly basis, as networks make time available. Networks typically allow us to cancel booked time with two weeks' advance notice, which enables us to adjust our advertising schedule if our statistical tracking indicates that a particular network or time slot is no longer cost effective. Generally, we can increase or decrease the frequency of our spot commercial and infomercial airings at almost any time.

INTERNET. Our e-commerce sales have grown from 0% in the fourth quarter of 1998 to 12.3% of direct sales in the fourth quarter of 1999, and we expect the Internet to become an increasingly important part of our direct marketing strategy.* For example, we are now promoting our web sites in spot commercials and infomercials in an effort to further stimulate electronic product inquiries and e-commerce transactions. We do not presently advertise our products on third-party web sites, but may do so in the future.*

Our experience indicates that Internet-based inquiries are more likely to be converted into sales than inquiries generated by other media forms, such as television or print media. Consequently, we believe that consumers who visit our web sites are more inclined to purchase our products than are the consumers we target through other media.*

We currently operate two direct marketing-oriented web sites. The first, www.bowflex.com, focuses on our Bowflex line of home exercise equipment. The second, www.nautilusleepsystems.com, focuses on our Nautilus Sleep Systems. In an effort to expand and enhance our web presence, we added dedicated web site development and management personnel. Our immediate Internet-related goals include improving the capabilities at our Bowflex web site and Nautilus Sleep Systems web site. In 1998, we used our web sites to generate interest in our products, but limited the information we provided to potential customers in an effort to induce them to initiate a telephone inquiry. In 1999, we believe we achieved a balance between our goals of finalizing sales and capturing consumer information by strategically designing our web pages and carefully analyzing web page hits, conversion rates, average sales prices and inquiry counts.*

PRINT MEDIA. We have advertised directly marketed products in health and fitness-related consumer magazines and, to a limited extent, in entertainment, leisure and specialty magazines. We recently determined that television advertising and the Internet generate more immediate consumer responses at a lower cost per inquiry and therefore have reduced the print media advertising expenditures for our directly marketed products. We will evaluate print media advertising expenditures for other directly marketed products on a case-by-case basis.

CONVERSION OF INQUIRIES INTO SALES

CUSTOMER SERVICE CALL CENTER AND ORDER PROCESSING. We operate our own customer service call center in Vancouver, Washington, which operates 16 hours per day and receives and processes all infomercial-generated and customer service-related inquiries regarding our Bowflex products and Nautilus Sleep Systems. We have developed a skill-based call routing system that automatically routes each incoming call to the most highly qualified inside sales agent or customer service representative available. The appropriate representative then answers product questions, pro-actively educates the potential customer about the benefits of our product line, promotes financing through our private label credit card, and typically upsells the benefits of higher priced models in our product line. This sophisticated system allows us to better utilize our agents, prioritize call types and improve customer service.

We employ two large telemarketing companies to receive and process information requests generated by our spot television advertising 24 hours per day. These companies also serve as overflow agents for our call center during peak times. The telemarketing agents for these companies collect only names, addresses and other basic information from callers and do not sell or promote our products. Consequently, we do not need to train these telemarketing agents.

RESPONSE MAILINGS. We forward a "fulfillment kit" in response to each inquiry regarding our directly marketed products. Each kit contains detailed literature that describes the product line and available accessories, a marketing video that demonstrates and highlights the key features of our premium product in the line, and additional information about how to purchase the product. If a potential customer does not respond within a certain time period, we proceed with additional follow-up mailings that convey a different marketing message and typically offer certain inducements to encourage a sale. The specific marketing message and offer at each stage will vary on a case-by-case basis, based on what our statistical tracking indicates is most likely to trigger a sale.

CONSUMER FINANCE PROGRAMS. We believe that convenient consumer financing is an important tool in our direct marketing sales efforts and induces many of our customers to make purchases when they otherwise would not. Currently, we offer "zero-down" financing to approved customers on all sales of

our Bowflex Products and Nautilus Sleep Systems. We arrange this financing through a consumer credit company pursuant to a non-recourse consumer financing agreement. Under this arrangement, our customer service agents can obtain financing approval in a few minutes over the telephone and, if a customer is approved, immediately ship product without the need for cumbersome paperwork. The consumer finance company pays us promptly after submission of the required documentation and subsequently sends to each approved customer a Direct Focus private label credit card that can be used for future purchases of our products. During 1999, approximately 34.4% of our net sales were financed in this manner, and we believe this program will continue to be an effective marketing tool.*

NAUTILUS SALES AND MARKETING

We market and sell our Nautilus commercial fitness equipment domestically through a direct sales force and internationally through independent sales representatives. We market and sell our Nautilus fitness accessories and consumer fitness equipment through non-exclusive independent sales representatives.

DIRECT SALES FORCE

We have hired a new management team to oversee and revitalize the sales and marketing operations of our Nautilus business. Each member of the management team has significant industry experience and a history of sales and marketing success. Our commercial direct sales force will focus on strengthening the market position of our existing Nautilus product line, which we sell principally to health clubs, large hotels, assisted living facilities and the government. Additionally as we broaden our product line, our direct sales force will target new market segments and, if successful, broaden our customer base.* Internationally, we market and sell our Nautilus commercial fitness products through a worldwide network of independent distributors.

OTHER SELLING AND MARKETING CHANNELS

We have implemented additional sales and marketing strategies for our Nautilus commercial equipment. These strategies include the following:

- We offer innovative financing, such as private label leasing that allows pre-approved commercial customers to lease fitness equipment;
- We implemented a targeted mailing program directed at our commercial customers; and
- We expanded the Nautilus trade-in program to induce existing commercial customers to upgrade their equipment.

PRODUCTS

BOWFLEX HOME FITNESS EQUIPMENT

We introduced the first Bowflex home exercise machine in 1986, and since then have implemented several improvements to its design and functionality. We now offer three different Bowflex machines and eight different models. The key feature of each Bowflex machine is our patented "Power Rod" resistance technology. Each Power Rod is made of a solid polymer material that provides lineal progressive resistance in both the concentric and eccentric movements of an exercise. When combined with a bilateral cable pulley system, the machines provide excellent range and direction of motion for a

large variety of strength-building exercises.

We currently offer the following Bowflex machines:

- The Power Pro, introduced in 1993, is our best selling product, accounting for 95.8% of our Bowflex net sales in 1999. The Power Pro is available in four different models: the basic Power Pro, the XT, the XTL and the XTLU. Each model offers over 60 different strength building exercises in one compact, foldable and portable design and comes with a 210-pound resistance pack that can be upgraded to 410 pounds. We have also incorporated an aerobic rowing exercise feature into the Power Pro. Prices currently range from \$999 to \$1,597, depending on the model and add-on features.
- The Motivator, introduced in 1996, is our entry-level strength training line. It is available in three different models: the basic Motivator, the XT and the XTL. Each model offers over 40 different strength building exercises in one compact, foldable design and comes standard with a 210-pound resistance pack that can be upgraded to 410 pounds. Prices currently range from \$699 to \$1,049, depending on the model and add-on features.
- The Versatrainer by Bowflex, introduced in 1988, is specifically designed to accommodate wheelchair-bound users. The Versatrainer's key advantage is that it permits users to exercise while remaining in their wheelchair, which offers enhanced independence and esteem. The Versatrainer can be found in many major rehabilitation hospitals, universities and institutions. The Versatrainer is currently priced at \$1,699.

NAUTILUS COMMERCIAL FITNESS EQUIPMENT AND NAUTILUS FITNESS PRODUCTS

We currently offer the following Nautilus strength training equipment for the commercial market:

- The Nautilus 2ST line of commercial strength equipment offers 27 high quality, technologically advanced strength building machines, each of which is specially designed to focus on a particular strength building exercise, such as leg presses, bench presses, super pullovers, hip abductors and adductors and leg curls. The key component of each Nautilus 2ST machine is either its "cam" or a four-bar linkage mechanism, which builds and releases resistance as a user moves through an exercise. The resistance is at its minimum during the initial and final stages of an exercise, and at its maximum in the middle of an exercise. Each Nautilus machine includes a cam or four-bar linkage mechanism that is designed to accommodate and maximize the benefits associated with the motion required for that machine.
- In 1999, we introduced a line of Nautilus free weight equipment with new innovations in design and engineering intended to help club owners better serve their customers. The product line offers a sleeker look, tougher components and increased versatility. This new free weight gear can be coupled with the Nautilus 2ST circuit to give facility managers a complete strength gym to serve all fitness tastes.

Our Nautilus business also distributes a line of quality consumer fitness accessories. For example, we offer a full line of fitness accessories, such as weight belts, jump ropes and

ankle weights, which we market to specialty fitness retailers and the sporting goods industry. The current line includes over 50 products, which we selected after conducting a rigorous evaluation of sales potential, fitness trends and functionality. We began offering two new Nautilus home gyms, the Strength Station and an adjustable bench with chrome dumbbells, in late 1999. In addition, we introduced a twelve piece line of quality strength equipment, which included Nautilus free weight home gyms and Nautilus selectorized weight stack home gyms at the 2000 Super Show(R), a fitness industry trade show. We intend to continue building and developing our Nautilus consumer fitness business and expand our offering of Nautilus brand consumer fitness products, as appropriate, in 2000.*

NAUTILUS SLEEP SYSTEMS

In late 1998, we began test marketing a line of premium air sleep systems under the brand name "Instant Comfort," which we have since renamed the "Nautilus Sleep Systems." The key feature of each Nautilus Sleep System is its variable firmness support chamber, an air chamber within each airbed that can be electronically adjusted to regulate firmness. All queen and larger airbeds in our Signature, Premier and Ultimate Premier Series are equipped with dual air chambers that enable users to maintain different firmness settings on each side of the bed. We believe that variable firmness and other comfort-oriented features of our Nautilus Sleep Systems favorably differentiate them from conventional innerspring mattresses.

We currently offer four models of our Nautilus Sleep System:

- The Ultimate Premier Series is our top-of-the-line Nautilus Sleep System. It features dual patent pending interlocking variable support chambers that permit users to maintain separate firmness settings on each side of the airbed. The interlocking chambers regulate airflow and pressure to more effectively maintain support when a user changes position. The Ultimate Premier Series comes with a removable wool blend and silk blend pillow top sleeping surface, which permits users to easily convert to a "tight top" surface when they desire extra firmness. The Ultimate Premier Series also has an upgraded comfort layer of visco-elastic foam that conforms to a user's body. The Ultimate Premier Series is available in seven sizes and currently ranges in price from \$1,199.99 for a twin to \$1,799.99 for a California king, excluding foundation.
- The Premier Series features dual patent pending interlocking variable support chambers that permit users to maintain separate firmness settings on each side of the airbed. The interlocking chambers regulate airflow and pressure to more effectively maintain support when a user changes position. The Premier Series comes with a removable wool blend pillow top sleeping surface, which permits users to easily convert to a "tight top" surface when they desire extra firmness. The Premier Series is available in seven sizes and currently ranges in price from \$699.99 for a twin to \$1,299.99 for a California king, excluding foundation.
- The Signature Series is designed to appeal to consumers who desire the flexibility of dual variable firmness support chambers, but at a more affordable price. Our customers can choose between a tight top and a pillow top sleeping surface over a one and one-half inch convoluted foam comfort layer. The Signature Series is available in seven sizes and currently ranges in price from \$399.99 for a twin to \$999.99 for a California king, excluding foundation.

- The Basic Series is our entry-level Nautilus Sleep System, which features a single, head-to-toe variable firmness support chamber and a traditional tight top sleeping surface over a one and one-half inch thick convoluted foam comfort layer. The Basic Series is available in five sizes and currently ranges in price from \$249.99 for a twin to \$699.99 for a California king, excluding foundation.

We offer foundations that are specifically designed to support and enhance the performance of our Nautilus Sleep Systems. We advise consumers to use our foundations because conventional box springs tend to sag and wear over time, causing an airbed to eventually mirror the worn box spring. We believe the majority of our Nautilus Sleep System customers will order a complete sleep system, which includes both a mattress and a foundation.* Our foundations currently range in price from \$199 for a twin to \$399 for a California king.

NEW PRODUCT DEVELOPMENT AND INNOVATION

DIRECT MARKETING PRODUCTS

We develop direct marketing products either from internally generated ideas or, as with its Bowflex technology, by acquiring or licensing patented technology from outside inventors and then enhancing the technology. During the evaluation phase of product development, we evaluate the suitability of the product for direct marketing, whether the product can be developed and manufactured in acceptable quantities and at an acceptable cost, and whether it can be sold at a price that satisfies our profitability goals. More specifically, we look for high-quality consumer products that:

- Have patented or patentable features*;
- Will have a retail price between \$500 and \$2,500*;
- Can be marketed as a line of products with materially different features that facilitate upselling*; and
- Have the potential for mass consumer appeal, particularly among members of the "baby-boom" generation, who are accustomed to watching television and now have significant disposable income.*

In addition, because of our relatively high retail price target, we typically require that a product have a potential television advertising life cycle of at least five years and the possibility of an extended life cycle in retail stores.*

Once we determine that a product may satisfy our criteria, we further assess the product's direct marketing potential by continuing to research the product and its probable market and by conducting blind product and focus group studies. If we develop the product internally, or if we acquire or license the rights to the product, we will then proceed to develop and test a direct marketing campaign for the product. In most cases, our direct marketing campaigns will emphasize the use of spot commercials and television infomercials, which we supplement with print media advertisements, written materials, marketing videos and our web sites.*

Our growth strategy and financial performance depend in part on our ability to develop or acquire the rights to, and then directly market, new consumer products. Our net sales and profitability would be harmed if we are unable to develop or acquire the rights to premium quality, premium priced consumer products that satisfy our direct marketing criteria. In addition, any new products that we directly market

may not generate sufficient net sales or profits to justify their development or acquisition costs.

NAUTILUS COMMERCIAL FITNESS PRODUCTS

Our Nautilus commercial product development group develops and refines our commercial fitness products. The group's members gather and evaluate ideas from various areas, including existing and potential customers, sales and marketing, manufacturing, engineering and finance, and then determine which ideas will be incorporated into existing products or will serve as the basis for new products. Based on these ideas, the group designs new or enhanced products, develops prototypes, tests and modifies products, develops a manufacturing plan, and finally brings products to market. The group evaluates, designs and develops each new or enhanced product, taking into consideration our marketing requirements, target price points, target gross margin requirements and manufacturing constraints. In addition, each new or enhanced product must maintain the Nautilus standard of quality and reputation for excellence. We incorporate principles of physiology, anatomy and biomechanics into all of our Nautilus machines in order to match the movements of the human body throughout an exercise. Our key objective is to produce products that minimize the stress on users' skeletal systems and connective tissues and maximize the safety and efficiency of each workout.

NAUTILUS CONSUMER FITNESS PRODUCTS

We have developed a line of Nautilus consumer strength training fitness equipment and hand-held fitness accessories. Current products include free weight home gym equipment, selectorized weight stack home gyms and a variety of hand held fitness accessories, such as jump ropes, hand weights and other similar devices. We are currently evaluating design and feature concepts for a new line of aerobic Nautilus consumer products, such as stationary bicycles, treadmills, and stair machines. If we elect to proceed with one or more of these products, we intend to assess price points, develop a prototype and determine the most appropriate manufacturing plan.* We do not anticipate introducing any such aerobic products before 2001.*

MANUFACTURING AND DISTRIBUTION

BOWFLEX PRODUCTS AND NAUTILUS SLEEP SYSTEMS

Our primary manufacturing and distribution objectives for our Bowflex products and Nautilus Sleep Systems are to maintain product quality, reduce and control costs, maximize production flexibility and improve delivery speed. We use a computerized inventory management system to forecast our manufacturing requirements. In general, we attempt to use outside suppliers to manufacture a majority of our raw materials and finished parts. We select these suppliers based upon their production quality, cost and flexibility. Whenever possible and in order to improve flexibility, we will attempt to use at least two suppliers to manufacture each product component. We currently use overseas suppliers to manufacture approximately 65% of our Bowflex components, although we produce the main component of our Bowflex products, the Power Rods, exclusively in the United States. We intend to continue to use outside suppliers that meet our manufacturing criteria. All components of our Nautilus Sleep Systems are currently manufactured domestically, but in the second half of fiscal year 2000, we plan on manufacturing some components overseas.

We inspect, package and ship our products from our Washington, Virginia and Nevada facilities. We rely primarily on UPS to deliver our Bowflex and our Nautilus Sleep Systems products.

NAUTILUS COMMERCIAL FITNESS EQUIPMENT, CONSUMER FITNESS EQUIPMENT AND ACCESSORIES

Our Nautilus manufacturing 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 Nautilus products and offer our commercial customers the opportunity to order certain color variations. We currently distribute Nautilus commercial fitness equipment from our Virginia warehouse facilities directly to customers primarily through our own truck fleet. This method of distribution allows us to effectively control the set-up and inspection of equipment at the end-user's facilities. We outsource the manufacturing of Nautilus consumer fitness equipment and fitness accessories to outside foreign manufacturers. We currently distribute our Nautilus fitness accessories from our Nevada facilities.

INDUSTRY OVERVIEW

FITNESS EQUIPMENT

We market our Bowflex home fitness equipment principally in the United States, which we believe is a large and growing market. According to the Sporting Goods Manufacturers' Association, United States consumers spent roughly \$5.5 billion on home exercise equipment in 1998, which represented an 5.8% increase from roughly \$5.2 billion in 1997.

We market our Nautilus commercial fitness equipment throughout the world, including the United States, Europe, the United Kingdom, Asia, the Middle-East, Latin America and Africa. Within these markets, we target the following commercial customers, among others:

-	-	Health clubs and gyms	-	Corporate fitness centers
-	-	Rehabilitation clinics	-	Colleges and universities
-	-	The military	-	Governmental agencies
-	-	Hospitals	-	YMCA's and YWCA's
-	-	Hotels and motels	-	Professional sports teams

According to the Sporting Goods Manufacturers' Association, which has only tracked the commercial market since 1996, aggregate sales of fitness equipment to commercial purchasers in the United States rose from \$450 million in 1996 to \$500 million in 1997 and \$575 million in 1998, a 15% increase from 1997 to 1998.

MATTRESSES

The United States mattress market is large and dominated by four major manufacturers whose primary focus is the conventional innerspring mattress. According to the International Sleep Products Association, United States consumers purchased approximately 36.3 million mattress and foundation units in 1998, generating approximately \$3.9 billion in wholesale sales. We believe this equates to over \$7.0 billion in retail sales. The International Sleep Products Association (ISPA) estimates that innerspring mattresses accounted for approximately 90% of total domestic mattress sales in 1998. The ISPA also believes that less than 7% of all mattress sales are made through direct marketing channels. According to the ISPA, the bedding industry has enjoyed years of uninterrupted growth. In 1998, queen-sized mattresses became the largest selling segment while king-sized mattresses picked up market share as well.

COMPETITION

BOWFLEX HOME FITNESS EQUIPMENT

The market for our Bowflex products is highly competitive. Our competitors frequently introduce new and/or improved products, often accompanied by major advertising and promotional programs. We believe the principal competitive factors affecting this portion of our business are price, quality, brand name recognition, product innovation and customer service.

We compete directly with a large number of companies that manufacture, market and distribute home fitness equipment, and with the many health clubs that offer exercise and recreational facilities. We also compete indirectly with outdoor fitness, sporting goods and other recreational products. Our principal direct competitors include ICON Health & Fitness, Inc. (through its Health Rider, NordicTrak, Image, Proform, Weider and Weslo brands), Schwinn Fitness, Precor and Total Gym.

We believe our Bowflex line of home exercise equipment is competitive within the market for home fitness equipment and that our direct marketing activities are effective in distinguishing our products from the competition. In addition, we believe we can capitalize on the well-known Nautilus brand name by directly marketing existing Nautilus consumer products and developing and introducing new products.* However, some of our competitors have significantly greater financial and marketing resources, which may give them and their products an advantage in the marketplace.

NAUTILUS COMMERCIAL FITNESS EQUIPMENT

The market for commercial fitness equipment is highly competitive. Our Nautilus products compete against the products of numerous other commercial fitness equipment companies, including Life Fitness, Cybex and Precor. Many of our competitors have greater financial and marketing resources, significantly more experience in the commercial fitness equipment industry, and more extensive experience manufacturing their products. We believe the key competitive factors in this industry include price, product quality and durability, diversity of features, financing options and warranties. Many commercial customers are also interested in product-specific training programs that educate them regarding how to safely maximize the benefits of a workout and achieve specific fitness objectives. In addition, certain commercial customers, such as hotels and corporate fitness centers, have limited floor space to devote to fitness equipment. These customers tend to favor multi-function machines that require less floor space.

Our Nautilus commercial fitness products carry a premium price, however we believe their reputation for quality and durability appeals to a significant portion of the market that strives for long-term product value. In addition, our principal line of Nautilus commercial fitness equipment, the Nautilus 2ST, possesses unique features that appeal to the commercial market, such as low friction working parts, one-pound incremental weight stacks and hydraulic seat adjustments. We also offer training programs that are responsive to marketplace demands.

NAUTILUS SLEEP SYSTEMS

The mattress industry is also highly competitive, as evidenced by the wide range of products available to consumers, such as innerspring mattresses, waterbeds, futons and other air-supported mattresses. According to the International Sleep Products Association, conventional innerspring mattresses presently account for at least 90% of all domestic mattress sales, with waterbeds, futons and other types of mattresses making up the remainder of the market. We believe market participants

compete primarily on the basis of price, product quality and durability, brand name recognition, innovative features, warranties and return policies.

We believe our most significant competition is the conventional mattress industry, which is dominated by four large, well-recognized manufacturers: Sealy (which also owns the Stearns & Foster brand name), Serta, Simmons and Spring Air. Although we believe our Nautilus Sleep Systems offer consumers an appealing alternative to conventional mattresses, many of these conventional manufacturers, including Sealy, Serta, Simmons and Spring Air, possess significantly greater financial, marketing and manufacturing resources and better brand name recognition.

Moreover, several manufacturers currently offer beds with firmness technology similar to our Nautilus Sleep Systems. We believe the largest manufacturer in this niche market is Select Comfort, Inc. Select Comfort offers its airbeds at company-owned retail stores throughout the United States and engages in a significant amount of direct marketing, including infomercials, targeted mailings, print, radio and television advertising. Select Comfort has an established brand name and has greater financial, marketing and manufacturing resources. Select Comfort also has significantly greater experience in marketing and distributing airbeds. Despite these advantages, we believe the market for airbeds is large enough for both companies to be successful.* In addition, we believe our Nautilus Sleep Systems possess features that will enable us to effectively compete against Select Comfort and other airbed companies.*

We believe our success in the mattress business depends in part on convincing consumers that variable firmness control and other features of our sleep system favorably differentiate our products from those of our competitors.* We also believe our experience with direct marketing will enable us to successfully convey this message.* However, the intense competition in the mattress industry, both from conventional mattress manufacturers and Select Comfort, may adversely affect our efforts to market and sell our airbeds and, consequently, may adversely affect our financial performance.

INTELLECTUAL PROPERTY

Protecting our intellectual property is an important factor in maintaining our competitive position in the fitness and mattress industries. If we do not, or are unable to, adequately protect our intellectual property, our sales and profitability could be adversely affected. Accordingly, we have taken the following protective measures:

- We hold 17 United States patents and have applied for three additional United States patents with respect to our Nautilus products;
- We hold four patents relating to our Bowflex home fitness equipment;
- We have applied for one patent relating to our Nautilus Sleep Systems;
- We have obtained United States trademark protection for various names associated with our products, including "Bowflex," "Nautilus," "Power Rod," "Bowflex Power Pro," "Motivator" and "Versatrainer";
- We have applied for United States trademark protection for the names "Direct Focus," "Instant Comfort" and various other names and slogans associated with our products;
- We have registered the name "Bowflex" in Canada and the European Community, and have registered or applied to register the "Nautilus" trademark in approximately 30 foreign countries;
- We have obtained trademark protection for the "look" of our Bowflex Power Rods; and
- We hold eight United States copyright registrations relating to our Nautilus products.

Notwithstanding these measures, our efforts to protect our proprietary rights may be inadequate, and applicable laws provide only limited protection. For example, of our four Bowflex patents, the most important covers our Power Rods, and this patent expires on April 27, 2004. The other three patents expire on February 16, 2005, April 14, 2007, and January 4, 2010. In addition, we may not be able to successfully prevent others from claiming that we have violated their proprietary rights. We could incur substantial costs in defending against such claims, even if they are invalid, and we could become subject to judgments requiring us to pay substantial damages.

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

ENVIRONMENTAL REGULATION

Environmental regulations most significantly affect our Nautilus facilities in Independence, Virginia. The Virginia Department of Environmental Quality has issued an air permit for several point sources at this facility. The sources include boilers, flash ovens and high solids paint booths. The permit imposes operation limits based on the length of time each piece of equipment is operated each day, and we operate the plant within these limits. The town of Independence, Virginia has issued an industrial user's wastewater permit that governs our discharge of on-site generated wastewater and storm water. In addition to the foregoing, in early 1999, we completed a Phase I Environmental Site Assessment and a limited Phase II Soil Analysis Assessment at our Nautilus facilities in Independence, Virginia. No significant deficiencies or violations were noted. We do not believe that continued compliance with federal, state and local environmental laws will have a material effect upon our capital expenditures, earnings or competitive position.*

EMPLOYEES

As of December 31, 1999, we employed 378 full-time employees, including 3 executive officers and 58 part-time employees. None of our employees is subject to any collective bargaining agreement.

ITEM 2. PROPERTIES

Our corporate headquarters and our principal warehouse facilities occupy approximately 74,000 square feet in Vancouver, Washington. We also use these facilities to house our customer call center and to assemble and distribute our Bowflex products for the Northwestern part of the United States. We lease these properties pursuant to operating leases that expire at various times, from May 30, 2000, to April 30, 2002. The aggregate base rent is approximately \$28,379 per month and some of the leases are subject to annual adjustments based upon changes in the consumer price index, but no adjustment may exceed 6.0% in any calendar year.

We house our Nautilus commercial operations and our East Coast distribution center for our Bowflex products in Independence, Virginia. The 54 acres of commercial real property include the following facilities:

- A 124,000 square foot building devoted to fabrication, finishing, assembly, plastics, upholstery, warehousing and shipping;
- A 100,000 square foot building devoted to fabrication and warehousing;
- A 27,105 square foot building that houses our Nautilus engineering, prototyping and

- customer service operations; and
- A 9,187 square foot building that houses our Nautilus administrative operations.

We recently added a distribution center in Las Vegas, Nevada. We distribute Bowflex equipment, Nautilus Sleep Systems and Nautilus fitness products from this 53,657 square foot facility. The term of the lease is from December 1, 1999, to November 30, 2002. The aggregate base rent is approximately \$12,878 per month for the first twelve months, and is subject to an annual cost of living increase of 3.5%.

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

As of March 22, 2000, there were no material, pending legal proceedings to which we or our subsidiaries were a party. From time to time, we become involved in ordinary, routine or regulatory legal proceedings incidental to our business.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our shareholders during the quarter ended December 31, 1999.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

MARKET PRICE OF OUR COMMON STOCK

Since May 4, 1999, our common stock has been listed for trading exclusively on The Nasdaq National Market System under the symbol DFXI. Prior to such date, our common stock was listed for trading exclusively on the Toronto Stock Exchange in the Province of Ontario, Canada, under the symbol DFX. The following table summarizes the high and low sales prices for our common stock as reported on the Toronto Stock Exchange and The Nasdaq National Market System, as applicable, for the two years in the period ended December 31, 1999. The prices below in Canadian dollars are listed in the currency they were quoted in until May 4, 1999 and are translated into United States dollars based on the currency exchange rate in effect on the date of each high and low quarterly price:

	CANADIAN DOLLARS		UNITED STATES DOLLARS	
	HIGH	LOW	HIGH	LOW
1998				
Quarter 1.....	\$ 10.05	\$ 3.50	\$ 7.07	\$ 2.45
Quarter 2.....	15.00	10.00	10.48	7.05
Quarter 3.....	18.00	11.80	12.09	7.67
Quarter 4.....	\$ 23.00	\$ 10.50	\$ 14.95	\$ 6.80
1999				
Quarter 1.....	\$ 28.00	\$ 18.55	\$ 18.39	\$ 12.09

Quarter 2.....	N/A	N/A	26.00	16.25
Quarter 3.....	N/A	N/A	21.00	15.00
Quarter 4.....	N/A	N/A	\$ 29.00	\$ 18.25

As of February 29, 2000, 10,519,565 shares of our common stock were issued and outstanding and held of record by 81 shareholders.

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. Our credit lines do not restrict the payment of dividends. To date, we have never declared or paid any cash dividends on our common stock and do not presently intend to declare any cash dividends in the near future.* Instead, we intend to retain and direct any future earnings to fund our anticipated expansion and growth.*

USE OF PROCEEDS

We received approximately \$17,938,000 in net proceeds from the sale of 975,000 shares of common stock in our May 1999 initial U.S. public offering, which includes proceeds from the overallotment option exercised by the managing underwriters. During 1999, we applied \$3.7 million of the net proceeds toward stock repurchases and \$1.3 million toward computer and related technology upgrades. We also used approximately \$5.0 million of the net proceeds for working capital purposes, including increased direct marketing expenditures and increases in inventory and accounts receivable balances due to the growth of our business. We have invested all unexpended net proceeds in an interest bearing depository account with Bank of America, pending anticipated application of proceeds in fiscal 2000 toward such purposes as further stock repurchases, the purchase of a distribution center in Las Vegas, Nevada, the purchase of a building in Vancouver, Washington to consolidate our Washington operations, and any of the other purposes described in our registration statement on Form S-1.*

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data presented below for each year in the five-year period ended December 31, 1999 have been derived from our audited financial statements. 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."

IN THOUSANDS (EXCEPT PER SHARE AMOUNTS)	1995	1996	1997	1998	1999
STATEMENT OF OPERATIONS DATA					
Net Sales	\$4,772	\$8,517	\$19,886	\$57,297	\$121,019
Cost of sales	1,616	2,603	5,114	12,442	34,423
Gross profit	3,156	5,914	14,772	44,855	86,596
Operating expenses:					
Selling and marketing	2,644	4,712	9,600	22,643	44,630
General and administrative	370	473	975	1,701	4,237
Royalties	201	269	581	1,623	2,897
Litigation settlement	-	-	-	-	4,000
Total operating expenses	3,215	5,454	11,156	25,967	55,764
Operating income (loss)	(59)	460	3,616	18,888	30,832
Other income (expense)					
Interest income	26	37	119	527	1,003
Other-net	(20)	(53)	(88)	(222)	3
Total other income (expense)	6	(16)	31	305	1,006
Income (loss) before income taxes	(53)	444	3,647	19,193	31,838
Income tax expense (benefit)	(68)	(249)	1,226	6,708	11,495
Net income	\$ 15	\$ 693	\$2,421	\$12,485	\$20,343
Basic earnings per share(1)	\$ 0.00	\$ 0.08	\$ 0.27	\$ 1.34	\$ 2.00
Diluted earnings per share(1)	\$ 0.00	\$ 0.08	\$ 0.25	\$ 1.28	\$ 1.95
Basic shares outstanding	8,132	8,558	8,987	9,337	10,166
Diluted shares outstanding	8,132	8,943	9,511	9,726	10,425
BALANCE SHEET DATA					
Cash and cash equivalents	\$756	\$1,154	\$4,790	\$18,911	\$35,703
Working Capital	1,063	1,973	4,100	15,682	38,209
Total assets	2,150	3,515	7,922	24,373	67,310
Current liabilities	858	1,281	3,330	6,655	14,091
Total stockholders' equity	\$1,274	\$2,220	\$4,592	\$17,651	\$53,031

(1) Basic earnings per share have been computed by dividing net income by the weighted average number of shares of common stock outstanding during each period. Diluted earnings per share have been computed by dividing net income by the weighted average number of shares of common stock and common stock equivalents, such as stock options, outstanding during each period.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

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 experiencing rapid growth and, in particular, rapidly growing companies that operate in evolving markets. We may not be able to successfully address these risks and difficulties. Although we have experienced net sales growth in recent years, our net sales growth may not continue, and we cannot assure you of any future growth or profitability.

The following table presents certain financial data as a percentage of total revenues:

	Year Ended December 31,		
	1997	1998	1999
STATEMENT OF OPERATIONS DATA			
Net sales.....	100.0%	100.0%	100.0%
Cost of sales.....	25.7	21.7	28.4
Gross profit.....	74.3	78.3	71.6
Operating expenses			
Selling and marketing.....	48.3	39.5	36.9
General and administrative.....	4.9	3.0	3.5
Royalties.....	2.9	2.8	2.4
Litigation settlement.....	-	-	3.3
Total operating expenses.....	56.1	45.3	46.1
Operating income.....	18.2	33.0	25.5
Other income.....	0.2	0.5	0.8
Income before income taxes.....	18.4	33.5	26.3
Income tax expense.....	6.2	11.7	9.5
Net income.....	12.2%	21.8%	16.8%

COMPARISON OF THE YEARS ENDING DECEMBER 31, 1999, AND DECEMBER 31, 1998

NET SALES

Net sales grew by 111.2% to \$121.0 million in 1999 from \$57.3 million in 1998. Sales within our direct marketing business increased by 77.8% over prior year levels and accounted for \$101.9 million, or 84.2%, of our aggregate net sales in 1999. One product, our Bowflex Power Pro, generated 79.9% of our aggregate net sales in 1999, compared to 93.3% in 1998. The principal reason for this decrease was the addition of our Nautilus business. Net sales within our Nautilus business generated \$19.1 million of our aggregate net sales and accounted for 33.4% of the aggregate increase.

Sales growth in 1999 primarily resulted from expanded direct marketing of our Bowflex products and the addition of our Nautilus business. Within our direct marketing business, with respect to both our Bowflex products and our Nautilus Sleep Systems, we intend to further expand our use of spot television commercials and infomercials during 2000 by increasing our presence in existing television markets and

entering new television markets.* We intend to increase Nautilus sales by developing new products and expanding our direct sales efforts both domestically and internationally.*

Notwithstanding our product diversification efforts, we anticipate that sales of our Bowflex Power Pro will continue to account for a substantial portion of our net sales for the foreseeable future.* Any significant diminished consumer interest in this product line would sharply reduce our net sales and profitability. In addition, the success of each of our products depends substantially on how consumers decide to spend their money. Unfavorable economic conditions may depress consumer spending, especially for premium priced products like ours.

Except for the fourth quarter, fiscal 1999 sales of our Bowflex products appear to have been consistent with historic trends. As in prior years, first and third quarter sales of our Bowflex products were strong, while the second quarter reflected seasonal weakness. Our direct marketing business is largely dependent upon national cable television advertising, and we are finding that second quarter influences on television viewership, such as the broadcast of national network season finales and seasonal weather factors, are causing our spot television commercials on national cable television to be marginally less effective than in other periods of the year.* During the fourth quarter of 1999, we experienced unusually strong consumer demand compared to the third quarter for our Bowflex products, which we believe is a trend that will not continue for the fourth quarter in future periods.*

Sales within our Nautilus business were, and we believe will continue to be, strongest in the third and fourth quarters.* We believe the principal reason for this trend is the commercial fitness industry's preparation for the impact of New Year fitness resolutions and seasonal weather factors in the fourth quarter, and retail fitness store purchases of fitness equipment in preparation for the Christmas buying season and New Year fitness resolutions in the third and fourth quarters.*

GROSS PROFIT

Gross profit grew 92.9% to \$86.6 million in 1999, from \$44.9 million in 1998. Our gross profit margin decreased 6.7% to 71.6% in 1999, from 78.3% in 1998. The decrease in gross profit margin was mainly attributable to our Nautilus operations, which had a gross profit margin in 1999 of 38.5%.

We expect a lower percentage gross profit margin contribution from our Nautilus Sleep Systems as we continue our direct marketing campaign for this product.* At least initially, we expect the domestic production and relatively lower sales volume of our Nautilus Sleep Systems will result in lower gross profit margins than our Bowflex products.* Similar to our Bowflex products, with the anticipated future higher sales volume of Nautilus Sleep Systems, we expect to take advantage of overseas production to strengthen the margins for these products.*

OPERATING EXPENSES

SELLING AND MARKETING

Selling and marketing expenses grew to \$44.6 million in 1999 from \$22.6 million in 1998, an increase of 97.3%. This increase in selling and marketing expenses resulted primarily from the continued expansion of our Bowflex direct marketing campaign and variable costs associated with our sales growth. The addition of our Nautilus business accounted for \$5.1 million of the increase.

As a percentage of net sales, selling and marketing expenses decreased by 2.6% in 1999 to 36.9%, compared to 39.5% in 1998. Selling and marketing expenses within our direct marketing business

were \$39.5 million, a 0.7% decrease as a percentage of net sales compared to 1998. Selling and marketing expenses within our Nautilus business traditionally have been a lower percentage of net sales than we have experienced in direct marketing. In real dollar terms, we expect our aggregate selling and marketing expenses will continue to increase, but not materially as a percentage of net sales,* as we:

- Continue to expand our Bowflex direct marketing campaign;*
- Continue rolling out the direct marketing campaign for our Nautilus Sleep Systems;*
- Continue integrating the marketing and distribution infrastructure for our Nautilus line of commercial fitness equipment;* and
- Begin marketing new home fitness equipment products and fitness accessories under the Nautilus brand name.*

GENERAL AND ADMINISTRATIVE

General and administrative expenses grew to \$4.2 million in 1999 from \$1.7 in 1998, an increase of 147.1%. Our direct marketing business accounted for \$1.3 million of the increase in general and administrative expenses, due primarily to increased staffing levels in our accounting and information systems departments necessitated by our continued growth and the implementation of our new information system. Nautilus operations accounted for the remaining increase of \$1.2 million. As a percentage of net sales, general and administrative expenses increased to 3.5% in 1999 from 3.0% in 1998. We believe our general and administrative expenses, in real dollar terms and as a percentage of net sales, will increase in future periods as we continue to integrate the Nautilus business into our operations and expand our administrative staff and other resources to manage anticipated growth.*

ROYALTY

Royalty expense grew to \$2.9 million in 1999 from \$1.6 million in 1998, an increase of 81.3%. The increase in our royalty expense is attributable to increased sales of our Bowflex products in 1999. Our royalty expenses will increase if sales of our Bowflex products continue to increase.*

OTHER INCOME

In 1999, other income increased to \$1.0 million from \$0.3 million in 1998. The \$0.7 million increase resulted primarily from interest income generated by higher cash investments accumulated from a combination of results from operations and our public offering completed during the second quarter of 1999.

INCOME TAX EXPENSE

Income tax expense increased by \$4.8 million in 1999 compared to 1998. We expect our income tax expense to increase in line with increases of our income before taxes.* Our effective tax rate increased by 1.2% to 36.1% due to state tax liability. We believe this higher rate is indicative of our future effective tax rate.*

NET INCOME

For the reasons discussed above, net income increased 62.4% to \$20.3 million in 1999 compared to \$12.5 million in 1998.

COMPARISON OF YEARS ENDING DECEMBER 31, 1998, AND DECEMBER 31, 1997

NET SALES

Net sales grew by 187.9% to \$57.3 million in 1998, from \$19.9 million in 1997. Sales of our Bowflex Power Pro grew by 199.0% and accounted for 93.3% of our aggregate net sales in 1998. Sales of our Bowflex Motivator increased by 73.0% and sales of our Bowflex accessories increased by 148.0% in 1998, and accounted for 1.8% and 4.5% of our aggregate net sales, respectively. We introduced and began test marketing our airbeds in late 1998, but this product did not materially contribute to our net sales in 1998.

Our sales growth in 1998 primarily resulted from expanded direct marketing of our Bowflex products. In 1998, we increased our advertising expenditures by 196.1%, focusing principally on expanded broadcasts of our Bowflex spot television commercials and television infomercials. Both of these direct marketing techniques generated strong sales in 1998.

GROSS PROFIT

Our gross profit grew 203.4% to \$44.9 million in 1998, from \$14.8 million in 1997. Our gross profit as a percentage of net sales increased by 4.0% to 78.3% in fiscal 1998, from 74.3% in 1997. We believe that our improved percentage gross profit in 1998 resulted primarily from a March 1998 increase in the shipping charge for our Bowflex products, as well as reduced component costs for our Bowflex products and improved labor and overhead efficiencies. We benefited from reduced component costs principally through volume discounts. Our improved labor and overhead efficiencies resulted primarily from improved manufacturing methods and the implementation of a second work shift.

OPERATING EXPENSES

SELLING AND MARKETING

Selling and marketing expenses grew to \$22.6 million in 1998 from \$9.6 million in 1997, an increase of 135.4%. This increase in selling and marketing expenses resulted primarily from the expansion of our Bowflex direct marketing campaign and variable costs associated with our sales growth.

As a percentage of net sales, selling and marketing expenses decreased to 39.5% in 1998 from 48.3% in 1997. This decrease in selling and marketing expenses as a percentage of net sales reflects the improved efficiency of our Bowflex direct marketing campaign. As we refined our spot commercial and infomercial advertising policies and our customer response techniques, we were able to stimulate sales growth at a more rapid rate than the growth in our selling and marketing expenses.

GENERAL AND ADMINISTRATIVE

General and administrative expenses grew to \$1.7 million in 1998 from \$975,000 in 1997, an increase of 74.3%. This increase in general and administrative expenses was due primarily to increased staffing and infrastructure expenses necessary to support our continued growth. As a percentage of net sales, general and administrative expenses decreased to 3.0% in 1998 from 4.9% in 1997. The decline in general and administrative expenses as a percentage of our net sales resulted primarily from our substantial increase in net sales.

ROYALTY

Royalty expense grew to \$1.6 million in 1998 from \$581,000 in 1997, an increase of 175.4%. The increase in our royalty expenses is attributable to the increased sales of our Bowflex products in 1998. Our royalty expenses will increase if sales of our Bowflex products continue to increase.

OTHER INCOME

In 1998, other income increased to \$305,000 from \$31,000 in 1997. The \$274,000 increase resulted primarily from interest income generated by our cash investments, which was partially offset by a \$135,000 increase in our state business tax expense.

INCOME TAX EXPENSE

Income tax expense increased by \$5.5 million in 1998 because of the growth in our income before taxes. We expect our income tax expense to increase in line with increases in our income before taxes.

NET INCOME

For the reasons discussed above, net income grew to \$12.5 million in 1998 from \$2.4 million in 1997, an increase of 420.8%.

QUARTERLY RESULTS OF OPERATIONS

The following table presents our operating results for each of the eight quarters in the period ended December 31, 1999. 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, consisting only of normal recurring adjustments, have been included to present fairly the unaudited quarterly results when read together with our audited financial statements and the related notes. These operating results are not necessarily indicative of the results of any future period.

SELECTED QUARTERLY INFORMATION

	QUARTER ENDED (IN THOUSANDS, EXCEPT PER SHARE)			
	MARCH 31 -----	JUNE 30 -----	SEPTEMBER 30 -----	DECEMBER 31 -----
Fiscal 1999:				
Net sales	26,113	25,244	31,773	37,889
Gross profit	18,723	17,882	22,982	27,008
Operating income	6,907	1,999 (1)	8,099	13,827
Net income	4,479	1,399 (1)	5,495	8,969
Earnings per share				
Basic	.47	.14 (1)	.52	.86
Diluted	.45	.13 (1)	.51	.84
Fiscal 1998:				
Net sales	11,051	12,236	15,200	18,809
Gross profit	8,497	9,584	11,766	15,007
Operating income	3,852	3,014	4,370	7,653
Net income	2,571	1,982	2,910	5,023
Earnings per share				
Basic	.28	.21	.31	.54
Diluted	.27	.20	.30	.52

(1) Includes a \$4 million litigation settlement expense. Net income and earnings per share amounts also reflect \$1.4 million of income tax benefit related to the litigation settlement.

LIQUIDITY AND CAPITAL RESOURCES

Historically, we have financed our growth primarily from cash generated by our operating activities. During 1999, our operating activities generated \$20.8 million in net cash, which contributed to an aggregate \$35.7 million in cash and cash equivalents on hand as of December 31, 1999. We used \$16.6 million in cash to fund the Nautilus acquisition in January 1999. Our public offering on May 5, 1999 generated \$15.1 million in cash and the underwriters' exercise of their over-allotment option on June 10, 1999 generated an additional \$2.8 million in cash, bringing the total net offering proceeds to \$17.9 million. Through a stock repurchase program, we bought back \$3.7 million in common stock on the open market. These activities contributed to a \$16.8 million, or 88.9% increase in our cash and cash equivalents during 1999.

We anticipate our working capital requirements will increase as a result of increased inventory and accounts receivable related to our Nautilus operations.* We also expect to increase our cash expenditures on spot commercials and infomercials as we continue to expand the direct marketing campaigns for our Bowflex products and Nautilus Sleep Systems.*

We maintain a \$5.0 million line of credit with Bank of America. The line of credit is secured by our general assets and contains certain financial covenants. As of the date of these financial statements, we are in compliance with all material covenants applicable to the line of credit and there is no outstanding balance under the line.

We believe our existing cash balances, combined with our line of credit, will be sufficient to meet our capital requirements for at least the next twelve months.*

INFLATION AND PRICE INCREASES

Although we cannot accurately anticipate the effect of inflation on our operations, we do not believe that inflation has had or is likely in the foreseeable future to materially adversely affect our results of operations, cash flows or our financial position.* However, increases in inflation over historical levels or uncertainty in the general economy could decrease discretionary consumer spending for products like ours. We have not raised the prices on our Bowflex products since 1997. Consequently, none of our revenue growth is attributable to price increases.

YEAR 2000

We did not experience any material year 2000 problems with respect to our products, information systems, suppliers or resellers. To help ensure a smooth transition into 2000, we did the following:

- Upgraded all computer hardware and equipment determined to have potential Year 2000 problems;
- Stockpiled certain inventory components;
- Acquired and prepared to use back-up power generators;
- Developed manual workarounds for all critical automated processes;
- Downloaded and printed critical data and reports by December 30, 1999;
- Created specific plans of action for dealing with critical non-compliant suppliers and resellers; and
- Executed critical operations, such as payroll, prior to December 31, 1999.

We estimate that, as of December 31, 1999, the cost of remediating and/or replacing our internal systems was approximately \$1.3 million. We funded this effort through normal working capital.

Because we experienced no major Year 2000-related issues internally or externally over the Year 2000 transition, we do not currently believe that we will incur material costs or experience material disruptions in our business associated with the year 2000. However, there can be no assurance that our computer systems or those of our suppliers do not contain undetected errors or defects associated with Year 2000 date functions. These could give rise to increased customer satisfaction costs related to Year 2000 and to litigation over Year 2000 compliance issues.

RECENT ACCOUNTING PRONOUNCEMENT

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133, "ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES" ("SFAS 133"). SFAS 133 establishes accounting and reporting standards for all derivative instruments. SFAS 133, as amended, is effective for fiscal years beginning after June 15, 2000. We do not currently have any derivative instruments and, accordingly, do not expect the adoption of SFAS 133 to have an impact on our financial position, results of operations, or cash flows.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

No disclosure is required under this item.

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY FINANCIAL DATA

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INDEPENDENT AUDITORS' REPORT

Board of Directors and Stockholders
of Direct Focus, Inc.:

We have audited the accompanying consolidated balance sheets of Direct Focus, Inc. and subsidiaries as of December 31, 1998 and 1999 and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1999. Our audits also included the financial statement schedule at Item 14. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 Direct Focus, Inc. and subsidiaries at December 31, 1998 and 1999 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

DELOITTE & TOUCHE LLP

Portland, Oregon
February 21, 2000

DIRECT FOCUS, INC.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 1998 AND 1999

	December 31, 1998	December 31, 1999
	-----	-----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 18,910,675	\$ 35,703,457
Trade receivables (less allowance for doubtful accounts of: 1998, \$40,000 and 1999, \$304,727)	218,207	4,744,213
Inventories	2,614,673	9,167,554
Prepaid expenses and other current assets	378,409	1,863,951
Current deferred tax asset	215,737	820,789
	-----	-----
Total current assets	22,337,701	52,299,964
	-----	-----
PROPERTY, PLANT AND EQUIPMENT (less accumulated Depreciation of: 1998, \$438,790 and 1999, \$1,100,255)	1,842,712	10,644,838
	-----	-----
OTHER ASSETS (less accumulated amortization of: 1998, \$49,967 and 1999, \$272,183)	192,859	4,364,963
	-----	-----
TOTAL ASSETS	\$ 24,373,272	\$ 67,309,765
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	\$ 3,602,074	\$ 5,871,369
Accrued liabilities	1,851,253	4,051,540
Income taxes payable	504,775	2,177,236
Royalty payable to stockholders	548,211	893,563
Customer deposits	148,937	1,097,748
	-----	-----
Total current liabilities	6,655,250	14,091,456
	-----	-----
LONG-TERM DEFERRED TAX LIABILITY	66,880	187,484
	-----	-----
COMMITMENTS AND CONTINGENCIES (Note 7)	-	-
STOCKHOLDERS' EQUITY:		
Common stock - authorized, 50,000,000 shares of no par value; Outstanding, 1998: 9,448,523 shares, 1999: 10,444,148 shares	3,565,628	18,602,420
Retained earnings	14,085,514	34,428,405
	-----	-----
Total stockholders' equity	17,651,142	53,030,825
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 24,373,272	\$ 67,309,765
	=====	=====

See notes to consolidated financial statements.

DIRECT FOCUS, INC.
CONSOLIDATED STATEMENTS OF INCOME
THREE YEARS ENDED DECEMBER 31, 1999

	1997	1998	1999
	-----	-----	-----
NET SALES	\$ 19,886,354	\$ 57,296,880	\$121,018,477
COST OF SALES	5,113,980	12,442,307	34,422,577
	-----	-----	-----
Gross profit	14,772,374	44,854,573	86,595,900
	-----	-----	-----
EXPENSES:			
Selling and marketing	9,600,076	22,642,885	44,629,825
General and administrative	974,887	1,700,956	4,236,804
Royalties	580,677	1,622,726	2,897,278
Litigation settlement	-	-	4,000,000
	-----	-----	-----
Total operating expenses	11,155,640	25,966,567	55,763,907
	-----	-----	-----
INCOME FROM OPERATIONS	3,616,734	18,888,006	30,831,993
	-----	-----	-----
OTHER INCOME (EXPENSE):			
Interest income	118,541	526,961	1,003,586
Other - net	(88,041)	(221,889)	2,737
	-----	-----	-----
Total other income - net	30,500	305,072	1,006,323
	-----	-----	-----
INCOME BEFORE INCOME TAXES	3,647,234	19,193,078	31,838,316
INCOME TAX EXPENSE	1,226,068	6,707,584	11,495,425
	-----	-----	-----
NET INCOME	\$ 2,421,166	\$ 12,485,494	\$ 20,342,891
	=====	=====	=====
BASIC EARNINGS PER SHARE	\$.27	\$ 1.34	\$ 2.00
	=====	=====	=====
DILUTED EARNINGS PER SHARE	\$.25	\$ 1.28	\$ 1.95
	=====	=====	=====
Basic shares outstanding	8,986,655	9,336,525	10,165,617
Diluted shares outstanding	9,510,868	9,725,958	10,425,208

See notes to consolidated financial statements.

DIRECT FOCUS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY
FOR THE THREE YEARS ENDED DECEMBER 31, 1999

	COMMON STOCK		RETAINED EARNINGS (ACCUM. DEF.)	TOTAL
	SHARES	AMOUNT		
BALANCES, JANUARY 1, 1997	8,921,541	\$3,040,425	\$ (821,146)	\$2,219,279
Options exercised	129,887	15,586	-	15,586
Stock repurchased	(46,100)	(98,120)	-	(98,120)
Tax benefit of exercise of nonqualified options	-	34,281	-	34,281
Net income	-	-	2,421,166	2,421,166
BALANCES, DECEMBER 31, 1997	9,005,328	\$2,992,172	\$1,600,020	\$4,592,192
Options exercised	443,195	134,004	-	134,004
Tax benefit of exercise of nonqualified options	-	439,452	-	439,452
Net income	-	-	12,485,494	12,485,494
BALANCES, DECEMBER 31, 1998	9,448,523	\$3,565,628	\$14,085,514	\$17,651,142
Public offering	975,000	17,937,691	-	17,937,691
Options exercised	231,825	300,482	-	300,482
Stock repurchased	(211,200)	(3,698,793)	-	(3,698,793)
Tax benefit of exercise of nonqualified options	-	497,412	-	497,412
Net income	-	-	20,342,891	20,342,891
BALANCES, DECEMBER 31, 1999	10,444,148	\$18,602,420	\$34,428,405	\$53,030,825

See notes to consolidated financial statements

DIRECT FOCUS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE YEARS ENDED DECEMBER 31, 1999

	1997	1998	1999
	-----	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 2,421,166	\$ 12,485,494	\$ 20,342,891
Adjustments to reconcile net income to net cash Provided by operating activities:			
Depreciation and amortization	96,133	301,913	1,183,412
Loss on equipment disposal	-	-	1,262
Deferred income taxes	140,659	99,484	(484,448)
Changes in:			
Trade receivables	(29,128)	41,336	(1,519,116)
Inventories	(1,156,643)	(668,900)	(3,448,750)
Prepaid expenses and other current assets	373,807	(166,027)	(1,377,336)
Trade payables	277,909	2,423,819	2,001,235
Income taxes payable	835,409	143,099	2,169,873
Accrued liabilities and royalty payable to Stockholders	944,547	1,099,819	988,414
Customer deposits	25,473	107,084	948,811
	-----	-----	-----
Net cash provided by operating activities	3,929,332	15,867,121	20,806,248
	-----	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to equipment	(278,886)	(1,738,836)	(1,929,137)
Proceeds from sale of property, plant and equip.	-	-	159,238
Additions to other assets	(22,514)	(12,309)	(167,935)
Acquisition cost of Nautilus	-	(120,454)	(16,615,012)
Sale of certificate of deposit	100,000	-	-
	-----	-----	-----
Net cash used in investing activities	(201,400)	(1,871,599)	(18,552,846)
	-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:			
Principal payments under capital lease obligations	(9,113)	(9,167)	-
Proceeds from public offering	-	-	17,937,691
Funds used for stock repurchase	(98,120)	-	(3,698,793)
Proceeds from exercise of stock options, net	15,586	134,004	300,482
	-----	-----	-----
Net cash provided by (used in) financing activities	(91,647)	124,837	14,539,380
	-----	-----	-----
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,636,285	14,120,359	16,792,782

CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,154,031	4,790,316	18,910,675
	-----	-----	-----
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 4,790,316	\$18,910,675	\$35,703,457
	=====	=====	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid for interest	1,381	455	-
Cash paid for income taxes	250,000	6,465,006	9,835,000
SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING TRANSACTIONS:			
Tax benefit of exercise of nonqualified options	34,281	439,452	497,412

See notes to consolidated financial statements

DIRECT FOCUS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
THREE YEARS ENDED DECEMBER 31, 1999

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

Direct Focus Inc. (the "Company," a Washington corporation) is a direct marketing company that develops and markets premium quality, premium priced, branded consumer products. The Company has two operating segments. One is the direct business through which they market consumer products directly through a variety of direct marketing channels, including spot television commercials, infomercials, print media, response mailings, and the Internet. The Company's principal products are the Bowflex line of home fitness equipment and a line of premium quality airbeds (Nautilus Sleep Systems). As a result of the acquisition in January 1999 of Nautilus International, Inc., the Company added a second business segment which comprises a significant component of the Company's operations and includes Nautilus commercial and home fitness equipment.

CONSOLIDATION

The consolidated financial statements of the Company include Direct Focus, Inc., Nautilus HPS, Inc., Nautilus, Inc., DFI Properties, LLC, BFI Advertising, Inc., DFI Sales, Inc., and Nautilus Fitness Products, Inc. All inter-company transactions have been eliminated.

USE OF ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles 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.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, cash deposited with banks and financial institutions and highly liquid debt instruments purchased with maturity dates of three months or less at 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 losses in such accounts.

INVENTORIES

Inventories are stated at the lower of average cost or market.

ADVERTISING

The Company expenses the production costs of advertising the first time the advertising takes place.

PROPERTY, PLANT AND EQUIPMENT

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 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 the three years ended December 31, 1999. 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 asset and its eventual disposition. If these cash flows were less than the carrying amount of the asset, an impairment loss would be recognized to write down the asset to its estimated fair value.

OTHER ASSETS

Other assets consist of acquisition costs, license agreements, patents and trademarks. Amortization is computed using the straight-line method over estimated useful lives of three to twenty years. The trademark associated with the Nautilus acquisition was valued at \$4,349,839 and is being amortized over twenty years.

WARRANTY COSTS

The Company's warranty policy provides for coverage for defects in material and workmanship. Warranty periods on the Company's products range from two to five years on the Bowflex lines of fitness products and twenty years on airbeds. The Nautilus commercial line of fitness products includes a lifetime warranty on the structural frame, welded moving parts and weight stacks, a 120-day warranty on upholstery and padded items, and a one-year warranty on all other parts. A provision for estimated warranty costs of \$70,000 and \$383,356 is included in accrued liabilities at December 31, 1998 and 1999, respectively.

REVENUE RECOGNITION

Revenue from product sales is generally recognized at the time of shipment. Revenue is recognized upon installation for the Nautilus commercial equipment, if the Company's truck fleet is used for delivery of the products. The Company has established reserves for potential sales returns for 1998 and 1999 of \$600,704 and \$786,921, respectively, based upon historical experience.

INCOME TAXES

Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to periods in which the differences are expected to affect taxable income. A valuation allowance is established when necessary to reduce deferred tax assets to the amount more likely than not to be realized. Income tax expense is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

COMPREHENSIVE INCOME

Effective January 1, 1998, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 130, "REPORTING COMPREHENSIVE INCOME," which requires presentation of comprehensive income within an entity's primary financial statements. 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 equaled net income for all periods presented.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount of the Company's cash, trade receivables, trade payables, royalty payables, and accrued liabilities approximates their estimated fair values due to the short-term maturities of those financial instruments.

RECENT ACCOUNTING PRONOUNCEMENT

In June 1999, the FASB issued Statement of Financial Accounting Standards No. 133, "ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES" ("SFAS 133"). SFAS 133 establishes accounting and reporting standards for all derivative instruments. SFAS 133, as amended, is effective for fiscal years beginning after June 15, 2000. We do not currently have any derivative instruments and, accordingly, do not expect the adoption of SFAS 133 to have an impact on our financial position or results of operations.

RECLASSIFICATIONS

Certain amounts from 1997 and 1998 have been reclassified to conform to the 1999 presentation.

2. PUBLIC OFFERING

On May 5, 1999, the Company completed its initial U.S. public offering of common stock listed on the Nasdaq exchange. The initial offering consisted of one million total shares at \$20.50 per share, of which 825,000 shares were offered by the Company, with an additional 175,000 shares offered by selling shareholders. On June 10, 1999, the underwriting group exercised a 150,000 share over-allotment. Total net proceeds realized by Direct Focus, Inc. from the offerings were \$17.9 million. The Company was listed on the Toronto Stock Exchange from January 1993 to May 1999.

3. ACQUISITION OF NAUTILUS

Effective January 4, 1999, the Company acquired substantially all of the net assets of Nautilus International, Inc. ("Nautilus"). Nautilus was a manufacturer and distributor of commercial fitness equipment and, to a limited extent, consumer fitness equipment and accessories. The acquisition has been

accounted for under the purchase method of accounting and, accordingly, the assets acquired, liabilities assumed, and results of operations have been included in the accompanying financial statements since the date of acquisition. The Company paid approximately \$16.7 million, including acquisition costs of approximately \$500,000, for the assets and intellectual property of Nautilus and assumed \$1.8 million of current liabilities.

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

Cash	\$ 8,512
Trade receivables	3,006,890
Inventories	3,104,131
Prepaid expenses and other current assets	108,206
Furniture and equipment	7,991,685
Other assets	4,349,839
Liabilities assumed	(1,825,285)

Total	\$ 16,743,978
	=====

The unaudited pro forma financial information below for the year ended December 31, 1998 was prepared as if the transaction had occurred on January 1, 1998:

Revenue	\$76,600,696
Net income	\$ 9,868,213
Basic earnings per share	\$ 1.06
Diluted earnings per share	\$ 1.01

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

4. INVENTORIES

Inventories at December 31 consisted of the following:

	1998	1999
	----	----
Finished goods.....	\$1,758,171	\$1,145,848
Work in process.....	-	1,141,803
Parts and components.....	856,502	6,879,903
	-----	-----
	\$2,614,673	\$9,167,554
	=====	=====

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost and depreciated on the straight-line method over the estimated useful lives of the assets. Details of property, plant and equipment are summarized as follows at December 31:

	Estimated Useful Life	1998	1999
Land.....	N/A	\$ -	\$ 140,000
Buildings.....	31.5	-	5,870,592
Computer equipment.....	3 - 5	1,411,523	2,737,488
Production equipment.....	10	410,682	2,481,839
Furniture and fixtures.....	5	459,297	462,174
Automobiles.....	7	-	53,000
		2,281,502	11,745,093
Less accumulated depreciation.....		438,790	1,100,255
Property, plant and equipment, net.....		\$ 1,842,712	\$ 10,644,838

6. ACCRUED LIABILITIES

Accrued liabilities at December 31 consisted of the following:

	1998	1999
Accrued payroll.....	\$ 660,888	\$ 2,318,771
Accrued warranty expense.....	70,000	383,356
Sales return reserve.....	600,704	786,921
Accrued advertising.....	275,298	137,742
Accrued other.....	244,363	424,750
Total.....	\$ 1,851,253	\$ 4,051,540

7. COMMITMENTS AND CONTINGENCIES

LINES OF CREDIT

During 1999, the Company obtained a line of credit for \$5 million with a bank. The line is secured by the Company's general assets, and interest is payable on outstanding borrowings under the line at the bank's prime rate (8.5% at December 31, 1999). There were no outstanding borrowings on the line of credit at December 31, 1999.

OPERATING LEASES

The Company leases its Vancouver, Washington office and warehouse facilities under an operating lease which expires April 30, 2002. The lease commitment is subject to an annual rent adjustment based upon changes in the consumer price index, limited to a 6.0% annual change. The agreement provides for an annual cancellation provision by the Company upon proper notification. Under a separate agreement in 1997, which was amended in 1998, the Company leased additional warehouse facilities. This operating lease expires May 21, 2000.

In December 1999, the Company leased a distribution center in Las Vegas, Nevada to service the Southwestern part of the United States. This operating lease expires November 30, 2002.

Nautilus HPS, Inc. leases trucks and trailers and other equipment used in the Nautilus commercial business. These leases expire over various terms through December 2002.

Rent expense under all leases was \$107,361 in 1997, \$239,197 in 1998, and \$664,922 in 1999.

OBLIGATIONS

Future minimum lease payments under the operating leases during the years ending December 31 are as follows:

2000.....	\$ 609,677
2001.....	427,906
2002.....	245,973

Total minimum lease payments.....	\$1,283,556
	=====

8. STOCK OPTIONS

The Company's stock-based compensation plan was adopted in June 1995. The Company can issue both nonqualified stock options to the Company's officers and directors and qualified options to the Company's employees. The plan was amended in June 1998 so the Company may grant options up to 1,857,961 shares of common stock. At December 31, 1999, 561,215 shares are available for future issuance under the plan. The plan is administered by the Company's Board of Directors which determines the terms and conditions of the various grants awarded under these plans. Stock options granted generally have an exercise price equal to the closing market price of the Company's stock on the date of the grant, and vesting periods vary by option granted, generally no longer than four years.

In October 1995, the Financial Accounting Standards Board issued SFAS No. 123, "ACCOUNTING FOR STOCK-BASED COMPENSATION," which encouraged (but did not require) that stock-based compensation cost be recognized and measured by the fair value of the equity instrument awarded. The Company did not change its method of accounting for its stock-based compensation plans and will continue to apply Accounting Principles Board Opinion No. 25, "ACCOUNTING FOR STOCK-BASED COMPENSATION PLANS ISSUED TO EMPLOYEES," and related interpretations in accounting for these plans. Accordingly, no compensation cost has been recognized for these plans in the financial statements. If compensation cost on stock options granted in 1997, 1998 and 1999 under these plans had been determined based on the fair value of the options consistent with that described in SFAS No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below for the years ended December 31, 1997, 1998 and 1999.

	1997	1998	1999
	-----	-----	-----
Net income, as reported.....	\$2,421,166	\$12,485,494	\$20,342,891
Net income, pro forma.....	2,334,082	12,274,208	19,958,204
Diluted earnings per share, as reported.....	\$ 0.25	\$ 1.28	\$ 1.95
Diluted earnings per share, pro forma.....	\$ 0.25	\$ 1.26	\$ 1.91

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 and the granting of stock compensation awards in future years.

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 grants in 1997, 1998 and 1999, respectively; all options granted will vest as scheduled; no dividend yield for all three years; risk-free interest rate of 5.5%, 5% and 6.4%; expected volatility of 93%, 76% and 60%; and expected lives of five years for all three years.

A summary of the status of the Company's stock option plans as of December 31, 1997, 1998 and 1999, and changes during the years ended on those dates is presented below.

	1997		1998		1999	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year....	646,500	\$0.18	813,113	\$0.47	550,618	\$2.39
Granted.....	386,500	0.96	188,000	5.70	169,680	20.21
Forfeited or cancelled.....	(90,000)	0.98	(7,300)	0.96	(21,334)	10.71
Exercised.....	(129,887)	0.12	(443,195)	0.30	(231,825)	1.30
Outstanding at end of year.....	813,113	\$0.47	550,618	\$2.39	467,139	\$9.03
Options exercisable at end of year.....	504,779		309,199		214,502	

The following table summarizes information about stock options outstanding as of December 31, 1999:

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
\$0.12 - \$0.98	159,451	2.3	\$0.90	138,951	\$0.89
\$4.62 - \$9.75	143,008	3.2	5.23	65,671	4.65
\$18.50 - \$20.69	164,680	4.6	20.20	9,880	19.84
\$0.12 - \$20.69	467,139	3.4	\$9.03	214,502	\$3.39

9. INCOME TAXES

The Company realizes 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 is credited to common stock.

The provision for (benefit from) income taxes consists of the following for the three years ended December 31, 1999:

	1997	1998	1999
Current:			
Federal.....	\$ 1,085,409	\$ 6,608,100	\$11,634,863
State.....	-	-	345,010
Total Current.....	1,085,409	6,608,100	11,979,873
Deferred:			
Federal.....	140,659	99,484	(484,448)
State.....	-	-	-
Total Deferred.....	140,659	99,484	(484,448)
Total Provision.....	\$1,226,068	\$ 6,707,584	\$11,495,425
	=====	=====	=====

The components of the net deferred tax asset/liability at December 31, 1998 and 1999 are as follows:

	1998	1999
Current:		
Assets:		
Accrued vacation.....	\$ 12,468	\$ 124,933
Allowance for doubtful accounts.....	14,000	106,633
Inventory reserve.....	17,500	107,083
Uniform capitalization.....	20,114	43,750
Accrued reserves.....	195,216	442,847
Customer deposits.....	52,128	384,034
Other.....	-	202,205
Liabilities:		
Prepaid advertising.....	(82,984)	(440,476)
Other prepaids.....	(12,705)	(150,220)
Net current deferred tax asset.....	\$ 215,737	\$ 820,789
	=====	=====
Non Current		
Liabilities:		
Other.....	\$ -	\$ (39,908)
Depreciation.....	(66,880)	(147,576)
Net long-term deferred tax liability.....	\$ (66,880)	\$ (187,484)
	=====	=====

A reconciliation of the statutory income tax rate with the company's effective income tax rate is as follows:

	1998	1999
Federal.....	35.00%	35.00%
State.....	-	1.08%
Other.....	(.05%)	0.03%
Total.....	34.95%	36.11%
	=====	=====

10. EARNINGS PER SHARE

The per share amounts are based on the weighted average number of basic and dilutive common equivalent shares assumed to be outstanding during the period of computation. Net income for the calculation of both basic and diluted earnings per share is the same for all periods.

The calculation of weighted average outstanding shares is as follows:

	Average Shares		
	1997	1998	1999
Basic shares outstanding.....	8,986,655	9,336,525	10,165,617
Common stock equivalents.....	524,213	389,433	259,591
Diluted shares outstanding.....	9,510,868	9,725,958	10,425,208

11. STOCK REPURCHASE PROGRAM

In the third quarter, the Board of Directors authorized the expenditures of up to \$8 million to purchase shares of Direct Focus, Inc. common stock in open market transactions until December 31, 1999. During the third quarter, the Company bought back \$3.7 million, or 211,200 common shares in the open market.

12. RELATED-PARTY TRANSACTIONS

The Company incurred royalty expense under an agreement with a stockholder of the Company of \$530,805 in 1997, \$1,603,821 in 1998, and \$2,815,116 in 1999, of which \$548,211 and \$893,563 was payable at December 31, 1998 and 1999, respectively.

The Company incurred investment consulting expense under an agreement with a director of the Company of \$30,000 in 1997, all of which was paid in 1997. This agreement expired in 1997.

13. LITIGATION SETTLEMENT

On July 17, 1999, the Company reached an agreement with a competitor to settle pending litigation. As a result of the settlement, the Company took a one-time, after-tax charge of \$2.6 million in the second quarter. The Company made an \$8 million cash payment to the competitor, of which \$4 million was paid by insurance.

The Company made no admission of guilt in the settlement and continues to believe that the competitor's claims were without merit. However, when the court denied the Company's motions to have the case dismissed before trial, the Company was faced with a lengthy jury trial and the possibility of a large jury verdict, including multiple damages as allowed under federal law. Under those circumstances, the Company determined that it was in the best interest of its shareholders to settle the case on terms that will have no negative long-term impact on the Company.

This settlement does not affect the ongoing direct marketing campaign for the Company's Bowflex home fitness equipment. Additionally, in the normal course of business, the Company is a party to various other legal claims, actions and complaints. Although it is not possible to predict with certainty whether the Company will ultimately be successful in any of these legal matters, or what the impact might be, the

Company believes that disposition of these matters will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

14. OPERATING SEGMENTS

The Company's operating segments include its direct products segment which includes all products marketed directly to consumers through a variety of direct marketing channels. The Bowflex line of fitness equipment and the Nautilus Sleep Systems are the principal products in the Company's direct products segment. The other operating segment is the Nautilus products line which includes products and operations that are not directly marketed to consumers. Products in the segment include Nautilus commercial fitness equipment and Nautilus fitness accessories. Accounting policies used by the segments are the same as those disclosed in Note 1.

The following table presents information about the Company's two operating segments (in thousands):

	Direct Products	Nautilus Products	Total
YEAR ENDED DECEMBER 31, 1999			
Revenues from external customers	\$101,927	\$ 19,091	\$121,018
Interest income	1,002	2	1,004
Depreciation and amortization expense	565	618	1,183
Income tax expense	11,084	411	11,495
Segment net income	19,715	628	20,343
Segment assets	47,753	19,557	67,310
Additions to property, plant and equipment	1,379	550	1,929
YEAR ENDED DECEMBER 31, 1998			
Revenues from external customers	\$ 57,297	-	\$ 57,297
Interest income	527	-	527
Depreciation and amortization expense	302	-	302
Income tax expense	6,708	-	6,708
Segment net income	12,485	-	12,485
Segment assets	24,373	-	24,373
Additions to property, plant and equipment	1,739	-	1,739
YEAR ENDED DECEMBER 31, 1997			
Revenues from external customers	\$ 19,886	-	\$ 19,886
Interest income	119	-	119
Depreciation and amortization expense	96	-	96
Income tax expense	1,226	-	1,226
Segment net income	2,421	-	2,421
Segment assets	7,922	-	7,922
Additions to property, plant and equipment	279	-	279

15. EMPLOYEE BENEFIT PLAN

The Company adopted a 401(k) profit sharing Plan in 1999 covering all employees over the age of 18, who also have three months of service. Each participant in the 401(k) Plan may contribute up to 15% of eligible compensation during any calendar year, subject to certain limitations. The 401(k) Plan provides for Company matching contributions of up to 50% for eligible contributions for participants who have one year of service. In addition, the Company may make discretionary contributions. Employees are 100% vested in

the matching and discretionary contributions after four years of service.
Expense for the Plan was \$103,793 for the year ended December 31, 1999.

DIRECT FOCUS, INC.
Schedule II
Valuation and Qualifying Accounts
Three years ended December 31, 1999
(in thousands)

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions	Balance at End of Period
Allowance for doubtful accounts:				
1997.....	12,000	73,000	-	85,000
1998.....	85,000	-	45,000	40,000
1999.....	40,000	264,727	-	304,727
Sales returns and allowances:				
1997.....	37,000	248,000	-	285,000
1998.....	285,000	315,704	-	600,704
1999.....	600,704	186,217	-	786,921
Warranty reserves				
1997.....	10,000	10,000	-	20,000
1998.....	20,000	50,000	-	70,000
1999.....	70,000	313,356	-	383,356

All other financial statement schedules have been omitted since they are not required, not applicable, or the information is included in the consolidated financial statements or notes thereto.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

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 2000 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is included under the caption "EXECUTIVE COMPENSATION" in the Company's Proxy Statement for its 2000 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this item is included under the caption "SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT" in the Company's Proxy Statement for its 2000 Annual Meeting of Shareholders 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 2000 Annual Meeting of shareholders and is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a)(1) FINANCIAL STATEMENTS

See the Consolidated Financial Statements in Item 8.

(a)(2) FINANCIAL STATEMENT SCHEDULE

See Schedule II - Valuation and Qualifying Accounts in Item 8.

(a)(3) EXHIBITS

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

Exhibit No.
- - - - -

- | | |
|------|--|
| 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 Securities and Exchange Commission (the "Commission") on March 3, 1999. |
| 3.2 | Amended and Restated Bylaws - Incorporated by reference to Exhibit 3.4 of Amendment No. 2 to the Company's Registration Statement on Form S-1, as filed with the Commission on April 30, 1999. |
| 10.1 | Direct Focus, Inc. 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 | Lease Agreement dated September 16, 1992, between Bow-Flex of America, Inc. and Christensen Group, Inc. - Incorporated by reference to Exhibit 10.2 of the Company's Registration Statement on Form S-1, as filed with the Commission on March 3, 1999. |
| 10.3 | First Amendment to Lease dated September 16, 1992, between Bow-Flex of America, Inc. and Christensen Group, Inc. - Incorporated by reference to Exhibit 10.3 of the Company's Registration Statement on Form S-1, as filed with the Commission on March 3, 1999. |

- 10.4 Amendment to Bowflex, Inc. Lease Extension, dated August 27, 1996, between Bowflex, Inc. and Ogden Business Park Partnership - Incorporated by reference to Exhibit 10.4 of the Company's Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
- 10.5 First Amendment to Lease, dated December 10, 1996, between Bowflex, Inc. and Ogden Business Park Partnership - Incorporated by reference to Exhibit 10.5 of the Company's Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
- 10.6 Lease Agreement, dated June 4, 1998, between Direct Focus, Inc. and Hart Enterprises - Incorporated by reference to Exhibit 10.6 of the Company's Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
- 10.7 Amendment to Lease, dated as of October 20, 1998, between Direct Focus, Inc. and LeRoy Hart Rentals. Incorporated by reference to Exhibit 10.6 of the Company's Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
- 10.8 Borrowing Agreement, dated December 16, 1998, between Direct Focus, Inc. and Seafirst Bank - Incorporated by reference to Exhibit 10.8 of the Company's Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
- 10.9 Royalty Agreement, dated as of April 9, 1988, between Bow-Flex of America, Inc. and Tessema D. Shifferaw - Incorporated by reference to Exhibit 10.9 of the Company's Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
- 10.10 Royalty Payment Agreement, dated as of June 18, 1992, between Tessema D. Shifferaw, Brian R. Cook and R.E. "Sandy" Wheeler - Incorporated by reference to Exhibit 10.10 of the Company's Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
- 10.11 First Amended and Restated Merchant Agreement dated as January 27, 1999, between Direct Focus, Inc. and Household Bank (SB), N.A. - Incorporated by reference to Exhibit 10.11 of the Company's Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
- 10.12 Lease Agreement, dated July 19, 1999, between Direct Focus, Inc. and Las Vegas Motor Speedway, LLC.
- 21 Subsidiaries of Direct Focus, Inc. - Incorporated by reference to Exhibit 21 of the Company's Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
- 23 Consent of Deloitte & Touche LLP

24.1	Power of Attorney for Kirkland C. Aly
24.2	Power of Attorney for C. Reed Brown
24.3	Power of Attorney for C. Rowland Hanson
24.4	Power of Attorney for Paul F. Little
24.5	Power of Attorney for Roger J. Sharp
24.6	Power of Attorney for Roland E. "Sandy" Wheeler
27	Financial Data Schedule

(b) REPORTS ON FORM 8-K

No reports on Form 8-K were filed during the quarter ended December 31, 1999.

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 29, 2000

DIRECT FOCUS, INC.

By _____
Brian R. Cook, President

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 29, 2000:

SIGNATURE -----	TITLE -----
 ----- Brian R. Cook	 President (Principal Executive Officer)
 ----- Rod W. Rice	 Chief Financial Officer and Secretary (Principal Financial and Accounting Officer)
Kirkland C. Aly* ----- Kirkland C. Aly	Director
C. Reed Brown* ----- C. Reed Brown	Director
C. Rowland Hanson* ----- C. Rowland Hanson	Director
Paul F. Little* ----- Paul F. Little	Director
Roger J. Sharp* ----- Roger J. Sharp	Director
Roland E. "Sandy" Wheeler* ----- Roland E. "Sandy" Wheeler	Director

*By: _____ March 29, 2000
Rod W. Rice
ATTORNEY-IN-FACT

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 29, 2000

DIRECT FOCUS, INC.

By: _____
Brian R. Cook, President

SIGNATURE - - - - -	TITLE - - - - -
/s/ BRIAN R. COOK - - - - - Brian R. Cook	President (Principal Executive Officer)
/s/ ROD W. RICE - - - - - Rod W. Rice	Chief Financial Officer and Secretary (Principal Financial and Accounting Officer)
/s/ KIRKLAND C. ALY - - - - - Kirkland C. Aly	Director
/s/ C. REED BROWN - - - - - C. Reed Brown	Director
/s/ C. ROWLAND HANSON - - - - - C. Rowland Hanson	Director
/s/ PAUL F. LITTLE - - - - - Paul F. Little	Director
/s/ ROGER J. SHARP - - - - - Roger J. Sharp	Director
/s/ ROLAND E. "SANDY" WHEELER - - - - - Roland E. "Sandy" Wheeler	Director

INDUSTRIAL REAL ESTATE LEASE
(Multi-Tenant Facility)
Exclusively for Las Vegas Motor Speedway Research & Development Center

ARTICLE ONE: BASIC TERMS

This Article One contains the Basic Terms of this Lease between the Landlord and Tenant named below. Other Articles, Sections and Paragraphs of the Lease referred to in this Article One explain and define the Basic Terms and are to be read in conjunction with the Basic Terms.

SECTION 1.01. Date of Lease: July 19, 1999

SECTION 1.02. Landlord: Las Vegas Motor Speedway, LLC, a Nevada limited liability company
Address: 7000 Speedway Boulevard
City, State, Zip: Las Vegas, Nevada 89115

SECTION 1.03. Tenant: Direct Focus, Inc.
Address: 2200 NE 65th Avenue
City, State, Zip: Vancouver, Washington 98661

SECTION 1.04. Property: The demised premises (the "Property") is Building "P", 6857 Speedway Boulevard (the "Building"), as further described on Exhibit "A-1" attached hereto and incorporated herein by reference. "Net Rentable Area" of the Property (as described on Exhibit "A-2") is approximately 53,657 square feet.

SECTION 1.05. Lease Term: Three (3) years beginning on December 1, 1999 or such other date as specified in this Lease, and ending on November 30, 2002.

SECTION 1.06. Rent and Other Charges Payable by Tenant:

- (a) Base Rent: \$.024 per square foot Twelve Thousand Eight Hundred Seventy-seven and 68/100's Dollars (\$12,877.68) per month for the first twelve (12) months, as provided in Section 3.01, and shall be increased EACH TWELVE (12) MONTHS after the Commencement Date, either (i) in accordance with the increase in the United States Department of Labor, Bureau of Labor Statistics, U.S. All Cities Average, Consumer Price Index for Urban Wage Earners and Clerical Workers (for all items 1982-1984 = 100) (the "Index"), as provided in Section 3.02, or (ii) fixed of three and one-half (3.5%) percent Cost of Living Increase annually. If (ii) is completed, then (i) and Section 3.02 are inapplicable.
- (b) Other Periodic Payments: Tenant shall be responsible for payment of certain charges directly such as personal property taxes (See Section 4.02), utilities (See Section 4.03), and certain insurance (See Section 4.04). In addition, Tenant shall be responsible for payment of Tenant's Proportionate Share of Building Operating Costs (See Section 4.05). Tenant's Proportionate Share of Building Operating Costs is currently estimated to be \$0.5 per month for the Property.

SECTION 1.07. Tenant's Proportionate Share: (See Section 4.05) \$2,682.85, (0.37%) (monthly based on 1st twelve months of Lease Term).

SECTION 1.08. Initial Security Deposit: (See Section 3.03 and Paragraph 13.03(C)) \$14,000.00

SECTION 1.09. Tenant's Guarantor: (If none, so state) Direct Focus, Inc.

SECTION 1.10. Permitted Uses: (See Section 5.01) Storage Assembly and Distribution of Consumer Products

SECTION 1.11. Vehicle Parking Spaces Allotted to Tenant: (See Section 4.05) Reciprocal

SECTION 1.12. Brokers: (See Article Fourteen) (If none, so state) Lee & Associates Commercial Real Estate Services and Americana Commercial

SECTION 1.13. Riders: The following Riders are attached to and made a part of this Lease: (If none, so state) Agency Disclosure, Hazardous Waste and ADA

ARTICLE TWO: LEASE TERM

SECTION 2.01. Lease of Property for Lease Term. Landlord leases the Property to Tenant and Tenant leases the Property from Landlord for the Lease Term. The Lease Term is for the period stated in Section 1.05 above and shall begin and end on the dates specified in Section 1.05 above, unless the beginning or end of the Lease Term is changed under any provision of this Lease. The "Commencement Date" shall be the date specified in Section 1.05 above for the beginning of the Lease Term, unless advanced or delayed under any provision of this Lease. At such time as the Commencement Date shall have been established, Landlord and Tenant shall execute Exhibit "B" attached hereto and incorporated herein by reference as a confirmation of said date.

SECTION 2.02. Delay in Commencement. Landlord shall not be liable to Tenant if Landlord does not delivery possession of the Property to Tenant on the first date specified in Section 1.05 above. Landlord's non-delivery of the Property to Tenant on that date shall not affect this Lease or the obligations of Tenant under this Lease. However, the Commencement Date shall be delayed until possession of the Property is delivered to Tenant provided the delay is caused solely by Landlord. The Lease Term shall be extended for a period equal to the delay in delivery of possession of the Property to Tenant, plus the number of days necessary to end the Lease Term on the last day of a month. If delivery of possession of the Property to Tenant is delayed, Landlord and Tenant shall, upon such delivery, execute Exhibit "B" as confirmation of the Commencement Date.

SECTION 2.03. Early Occupancy. If Tenant occupies the Property prior to the Commencement Date with Landlord's permission, Tenant's occupancy of the Property shall be subject to all of the provisions of this Lease, including, without limitation, all insurance requirements. Early occupancy of the Property shall not advance the expiration date of this Lease. Tenant shall pay Base Rent and all other charges specified in this Lease for the early occupancy period.

SECTION 2.04. Holding Over. Tenant shall vacate the Property upon the expiration or earlier termination of this Lease. Tenant shall reimburse Landlord for and indemnify Landlord against all damages incurred by Landlord from any delay by Tenant in vacating the Property; including, without limitation, any claim made by any succeeding tenant based on or resulting from such failure to surrender. If Tenant does not vacate the Property upon the expiration or earlier termination of the Lease and Landlord thereafter accepts rent from Tenant, Tenant's occupancy of the Property shall be a "month-to-month" tenancy only, and not a renewal hereof or an extension for any further term, subject to all of the terms of this Lease applicable to a month-to-month tenancy, except that the Base Rent then in effect shall be increased by fifty percent (50%). Nothing in this Section 2.04 shall be construed as a consent by Landlord to any holding over by Tenant and Landlord expressly reserves the right to require Tenant to surrender possession of the Property upon the expiration of the Lease Term or upon the earlier termination hereof and to assert any remedy in law or equity to evict Tenant and/or collect damages in connection with such holding over.

ARTICLE THREE: BASE RENT

SECTION 3.01. Time and Manner of Payment. Upon execution of this Lease, Tenant shall pay Landlord the Base Rent in the amount stated in Paragraph 1.06(a) above together with an estimate of Additional Rent (as hereinafter defined) for the first full month of the Lease Term. The Base Rent shall be appropriately prorated for any fractional month on the basis of a thirty (30) day month. On the first day of the second month of the Lease Term and each month thereafter, Tenant shall pay Landlord the Base Rent, in advance, without offset, deduction or prior demand. The Base Rent shall be payable at Landlord's address or at such other place as Landlord may designate in writing.

Initials

Landlord _____

Tenant _____

SECTION 3.02. Cost of Living Increases. The Base Rent shall be increased at the times specified in Paragraph 1.06(a) above, in proportion to the increase in the Index which has occurred between the month three (3) months prior to the first month of the Lease Term and the month three (3) months prior to the month in which the Base Rent is to be increased. Landlord shall notify Tenant of each increase by delivering a written statement setting forth the Indices for the appropriate months, the percentage increase between those two Indices, and the new amount of the Base Rent. The Base Rent shall not be reduced from the last previous adjusted Base Rent by reason of any decrease in the Index. Tenant shall pay the new Base Rent from its effective date until the next periodic increase. Landlord's notice may be given after the effective date of the increase since the Index for the appropriate month may be unavailable on the effective date. In such event, Tenant shall pay Landlord the necessary rental adjustment for the months elapsed between the effective date of the increase and Landlord's notice of such increase within ten (10) days after Landlord's notice. If the format or components of the Index are materially changed after the Date of Lease, Landlord shall substitute an Index which is published by the Bureau of Labor Statistics or similar agency and which is most nearly equivalent to the Index in effect on the Date of Lease. Landlord shall notify Tenant of the substituted Index, which shall be used to calculate the increase in the Base Rent unless Tenant objects in writing within fifteen (15) days after receipt of landlord's notice. If Tenant objects, the substitute Index shall be determined in accordance with the rules and regulations of the American Arbitration Association. The cost of such arbitration shall be borne by Tenant.

SECTION 3.03. Security Deposit Increases. Each time the Base Rent is increased, Tenant shall deposit additional funds with Landlord sufficient to increase the Security Deposit to an amount which bears the same relationship to the adjusted Base Rent as the initial Security Deposit bore to the initial Base Rent.

SECTION 3.04. Termination; Advance Payments. Upon termination of this Lease under Article Seven (Damage or Destruction), Article Eight (Condemnation) or any other termination not resulting from Tenant's default, and after Tenant has vacated the Property in the manner required by this Lease, an equitable adjustment shall be made concerning advance rent, any other advance payments made by Tenant to Landlord, and accrued real property taxes, and landlord shall refund the unused portion of the Security Deposit to Tenant or Tenant's successor.

ARTICLE FOUR: OTHER CHARGES PAYABLE BY TENANT

SECTION 4.01. Additional Rent and Definitions.

- (a) Additional Rent. All charges payable by Tenant other than Base Rent are called "Additional Rent." Unless this Lease provides otherwise, all Additional Rent shall be paid with the next monthly installment of Base Rent. The term "rent" shall mean Base Rent and Additional Rent.
- (b) Definitions. The Property is part of a multi-tenant industrial/commercial real property development of landlord (the "Project"). The Project includes the land, the buildings and all other improvements located thereon, and the Common Areas (as hereinafter defined). As used in this Lease, "Building" shall mean the building of which the Property is a part. As used in this Lease, "Common Areas" shall mean all areas within the Project which are available for the common use of tenants of the Project and which are not leased or held for the exclusive use of Tenant or other tenants, including, but not limited to, parking areas, driveways, sidewalks, loading areas, access roads, corridors, landscaping and planted areas. Landlord may from time to time change the size, location, nature and use of any of the Common Areas, including converting Common Areas into leasable areas, constructing additional parking facilities (including parking structures) in the Common Areas, and increasing or decreasing Common Area land and/or facilities. Tenant acknowledges that such activities may result in occasional inconvenience to Tenant from time to time. Such activities and changes shall be expressly permitted if they do not materially affect Tenant's use of the Property.

SECTION 4.02. Taxes.

- (a) Payment. Tenant shall be liable for and shall pay before delinquency (and, upon demand by Landlord, Tenant shall furnish Landlord with satisfactory evidence of the payment thereof) all taxes and assessments of whatsoever kind or nature, and penalties and interest thereon, if any, levied against Tenant's personal property and any other personal property of whatsoever kind and to whomsoever belonging situated or installed in or upon the Property, whether or not affixed to the realty. Any leasehold improvements in excess of those provided at Landlord's expense pursuant to this Lease shall be deemed Tenant's personal property for the purposes of this Section 4.02. If at any time during the term of this Lease any such taxes on Tenant's property are assessed as part of the tax on the real property of which the Property is a part, then in such event Tenant shall pay to Landlord the

amount of such additional taxes as may be levied against the real property by reason thereof. Tenant shall use its best efforts to have Tenant's property assessed separately from said real property.

- (b) Impositions. For the purposes of Section 4.05 of this Lease, "Impositions" means:
- (i) Any real estate taxes, assessments or other charges assessed against the Building and related structures and parking facilities and the land on which they are located.
 - (ii) All personal property taxes on personal property used in connection with the Building and related structures other than taxes payable by Tenant under Paragraph 4.02(a) hereof and taxes of the same kind as those described in said Paragraph payable by other tenants in the Building pursuant to corresponding provisions of their leases.
 - (iii) Any and all environmental levies or charges now in force affecting the building or any portion thereof, or which may hereafter become effective, including, but not limited to, parking taxes, levies, or charges, employer parking regulations and any other parking or vehicular regulations, levies, or charges imposed by any municipal, state or federal agency or authority.
 - (iv) Any other taxes levied or assessed in addition to or in lieu of such real or personal property taxes.
- (c) Exclusion. Notwithstanding anything to the contrary contained in this Section 4.02, Tenant shall not be liable for any of the following taxes and assessments:
- (i) Personal property, fixture or equipment taxes assessed against the property used by Landlord in operating, managing or leasing the Building;
 - (ii) Inheritance tax, estate taxes, gift taxes, income taxes, transfer taxes and excess profit taxes.
- (d) Substituted Taxes. If at any time during the term of this Lease, under the laws of the United States, Nevada or any political subdivision thereof, a tax or excise on rents or other tax (except income tax), however described, is levied or assessed by the United States, Nevada or said political subdivision against Landlord on account of any rent reserved or space leased under this Lease, all such tax or excise on rents or other taxes shall be paid by Tenant. Whenever Landlord shall receive any statement or bill for any such tax or shall otherwise be required to make any payment on account thereof, Tenant shall pay the amount due hereunder within ten (10) days after demand therefore accompanied by delivery to Tenant of a copy of such tax statement, if any.
- (e) Right to Contest. Tenant shall have the right to contest any taxes the payment of which, in whole or in part, is the obligation of Tenant hereunder. Said right to contest shall not excuse Tenant of its obligation to pay such taxes as herein provided. However, in the event that the effect of such contest is to extend or postpone the date on which such taxes are delinquent, Tenant may, instead of payment, deposit with Landlord the amount of such claimed tax payable by Tenant, together with interest and penalties thereon, pending resolution of such contest, and within a reasonable time, deliver to Landlord either (a) evidence satisfactory to Landlord that such claim of taxability has been withdrawn or defeated, in which event such deposit shall be returned to Tenant to the extent it exceeds any monies then payable by Tenant or (b) an instruction that such claim of taxability has not been defeated and that such deposit be applied towards payment of Tenant's obligations therefor. Such deposit shall not relieve Tenant of the obligation to make any additional payments for which Tenant would otherwise be responsible hereunder. Tenant shall indemnify, save and hold Landlord, the Building, the Project and the Property free, clear and harmless from any and all liability, loss, costs, charges, penalties, obligations, liens, expenses, reasonable attorneys' fees, litigation, judgments, damages, claims and demands of any kind whatsoever in connection with, arising out of, or by reason of any contest of taxes pursuant to this Paragraph 4.02(e).
- (f) Prorata Share. All taxes and assessments of whatever kind or nature and penalties and interest thereon, if any, levied against Tenant, other than Tenant's personal property as set forth in Paragraph 4.02(a) herein, shall be determined based upon Tenant's prorata portion of said tax and/or assessment equal to Tenant's Proportionate Share.

SECTION 4.03. Utilities. Tenant shall be solely responsible for and

shall promptly pay, directly to the appropriate supplier, the cost of all natural gas, heat (including filter replacement), light (including light bulbs and ballast replacement), power, sewer service, telephone, water, refuse disposal and other

Initials

Landlord _____

Tenant _____

utilities and services supplied to the Property. However, if any services or utilities are jointly metered with other property, Landlord shall make a reasonable determination of Tenant's proportionate share of the cost of such utilities and services and Tenant shall pay such share to Landlord as provided in Section 4.05 hereof.

SECTION 4.04. Insurance Premiums.

- (a) **Liability Insurance.** At all times during the Lease Term, Tenant shall maintain an policy of comprehensive public liability insurance, at Tenant's expense, insuring Landlord against liability arising out of the ownership, use, occupancy, or maintenance of the Property. The initial amount of such insurance shall be at least Two Million Dollars (\$2,000,000), Combined Single Limit, for injuries to persons and property, and shall be subject to periodic increase based upon inflation, increased liability awards, recommendation of professional insurance advisers, and other relevant factors. However, the amount of such insurance shall not limit Tenant's liability nor relieve Tenant of any obligation hereunder. The policy shall contain cross-liability endorsements, if applicable, and shall insure Tenant's performance of the indemnity provisions of Paragraphs 5.04(a), (b), and (e). Tenant shall, at Tenant's expense, maintain such other liability insurance as Tenant deems necessary to protect Tenant, including, without limitation, workers compensation insurance in the manner required by law.
- (b) **Hazard and Rental Income Insurance.** During the Lease Term, Landlord shall maintain policies of insurance at Tenant's expense, covering loss of or damage to the Property in the full amount of its replacement value. Such policies shall provide protection against all perils included within the classification of fire, extended coverage, vandalism, malicious mischief, special extended perils (all risk), sprinkler leakage, earthquake sprinkler leakage, and inflation guard endorsement, and any other perils (except flood and earthquake, unless required by any lender holding a security interest in the Property) which Landlord deems necessary. Landlord may, but is not obligated to, obtain insurance coverage for Tenant's fixtures, equipment or building improvements installed by Tenant in or on the Property. Tenant shall, at Tenant's expense, maintain such primary or additional insurance on its fixtures, equipment and building improvements as Tenant deems necessary to protect its interest. During the Lease term, Landlord shall also maintain a rental income insurance policy at Tenant's expense with loss payable to Landlord in an amount equal to one year's Base Rent, Operating Expenses for one year, estimated real property taxes and insurance premiums. Tenant will not be named in any such policies carried by Landlord and shall have no right to any proceeds therefrom. Tenant shall not do or permit to be done anything which invalidates any such insurance policies.
- (c) **Payment of Premiums; Insurance Policies.** Subject to Section 4.05 of this Lease, Tenant shall pay all premiums for the insurance policies covering the Property described in Paragraphs 4.04(a) and (b) within fifteen (15) days after receipt by Tenant of a copy of the premium statement or other evidence of the amount due. If the insurance policies maintained by Landlord cover improvements or real property other than the Property, Landlord shall also deliver to Tenant a statement of the amount of the premiums applicable to the Property showing, in reasonable detail, how such amount was computed. If the Lease Term expires before the expiration of the insurance policy period, Tenant's liability for insurance premiums shall be prorated on an annual basis. All insurance shall be maintained with companies holding a "General Policyholder's Rating" of A+ or better, as set forth in the most current issue of "Best's Insurance Guide." Tenant shall be liable for the payment of any deductible amount under Landlord's insurance policies.
- (d) **Use.** Tenant shall not use or occupy, or permit the Property to be used or occupied in a manner which will increase the rates of insurance for the Property or the Building, which will make void or voidable any insurance then in force with respect thereto, which would constitute a defense to any action thereon, or which will make it impossible to obtain any insurance with respect thereto. If, by reason of the failure of Tenant to comply herewith, any insurance rates for the Property or the Building become higher than they otherwise would be, Tenant shall reimburse Landlord, on the first day of the calendar month next succeeding notice by Landlord to Tenant of said increase, for that part of all insurance premiums thereafter paid by Landlord which shall have been charged because of such failure of Tenant. Any policy of insurance maintained by Tenant insuring against any risk in, upon, about or in any way connected with the Property or Tenant's use thereof shall, to the extent reasonably obtainable, contain an express waiver of any and all rights of

subrogation thereunder whatsoever against landlord, its officers, agents and employees.

- (e) Additional Insureds. Tenant and landlord shall be named as insureds (and at landlord's option, any other persons, firms or corporations designated by Landlord shall be additionally named insured) under each such policy of insurance which shall provide that landlord, although named as an insured, shall nevertheless be entitled to recovery thereunder for any loss suffered by it, its agents, servants and employees by reason of Tenant's negligence or the negligence of its subtenant or assignee.
- (f) Cancellation. Every policy required pursuant to this Section 4.04 shall provide that it will not be canceled or modified except after thirty (30) days' written notice to landlord and any lender of landlord requesting such notice, and that it shall not be invalidated by any act or neglect of landlord or Tenant, nor by occupation of the Property for purposes more hazardous than permitted by such policy, nor by any foreclosure or other proceedings relating to the Building, nor by change in title to the Building or landlord's interest therein.
- (g) Evidence of Insurance. Tenant shall deliver to Landlord and any lender of Landlord requiring the same original policies or certificates of insurers satisfactory to Landlord and such lender, if any, evidencing the existence of all insurance which is required to be maintained by Tenant hereunder, fully paid, such delivery to be made (i) promptly after the execution and delivery hereof and (ii) within thirty (30) days prior to the expiration of any then current policies. Tenant shall not obtain or carry separate insurance concurrent in form or contributing in the event of loss with that required by this Section 4.04 unless Landlord is a named insured therein (and, at Landlord's option, any other persons, firms or corporations designated by Landlord shall be additionally named insureds). Tenant shall immediately notify Landlord whenever any such separate insurance is obtained and shall deliver to Landlord and any lender of Landlord the policies or certificates evidencing the same.
- (h) Primary Insurance - Subrogation. Any insurance provided for the benefit of landlord by Tenant shall be primary insurance as respects any claim, loss or liability arising directly or indirectly from Tenant's operations and any other insurance maintained by Landlord shall be excess and non-contributory with the insurance provided hereunder by Tenant. Landlord and Tenant each hereby waive any and all rights of recovery against the other, or against the officers, employees, agents or representatives of the other, for loss of or damage to its property or the property of others under its control, if such loss or damage is covered by any insurance policy in force (whether or not described in this Lease) at the time of such loss or damage. Upon obtaining the policies of insurance described herein, Landlord and Tenant shall give notice to the insurance carrier or carriers of the foregoing mutual waiver of subrogation.

SECTION 4.05. Common Areas; Use and Costs.

- (a) Payment. Throughout the term hereof, Tenant will pay to Landlord monthly in advance in addition to the Base Rent, as further Additional Rent, a prorata portion of the Building Operating Costs incurred by landlord during each calendar year occurring during the term of this Lease. Tenant's prorata portion of said amount shall equal the percentage which the number of net rentable square feet of the Property bears to the total number of net rentable square feet of the Building ("Tenant's Proportionate Share").
- (b) Included Costs. "Building Operating Costs" shall include all costs and expenses of every kind or nature incurred by Landlord directly in the management, operation, maintenance and repair of the Building and related structures and Common Areas in a manner reasonable and appropriate and for the best interest of the entire Building and that are generally passed on to tenants in first class buildings in the Las Vegas metropolitan area under lease provisions similar to this Section 4.05, as determined and expensed in accordance with generally accepted accounting principles. Without otherwise limiting the generality of the foregoing, there shall be included in such costs and expenses, all Impositions (as herebefore defined), premiums with respect to public liability, property damage, workmen's compensation, fire and other insurance carried on or with respect to the building and related structures, payroll taxes, unemployment taxes, social security taxes, cleaning of any facilities, landscaping, signs, lighting, music systems, janitorial services or common areas, management fees consistent with other first class projects in the Las Vegas metropolitan area, reasonable legal and accounting expenses, supervising of attendants and employment of other personnel used in such operations, maintenance and repairs, fuel, energy and utilities (not separately metered by Tenant), providing for security and fire

protection services, alarm systems and equipment, materials and supplies, painting, striping, removing of rubbish or debris, depreciation of rentals of machinery and equipment, costs of replacement of paving, curbs and walkways, drainage, repair and maintenance of parking and other common areas, roof repairs and an administrative fee equal to fifteen percent (15%) of all of the foregoing excluding costs of Impositions and insurance.

Initials

Landlord _____

Tenant _____

- (c) Payment. The Additional Rent provided to be paid in this Section 4.05 shall be estimated in advance by Landlord annually and one-twelfth (1/12) of such estimate shall be paid in advance by Tenant on the first day of each month without further demand or any deduction or set-off whatsoever. When Landlord shall ascertain the actual Building Operating Costs for a calendar year, Landlord shall so notify Tenant and Tenant shall pay to Landlord on demand the amount, if any, equal to the difference between the amount due for such year pursuant to this Section 4.05 and the amount previously paid hereunder. Should the estimated payments have exceeded the actual amount due, said excess shall be held by Landlord and applied to the next monthly payment of Additional Rent provided to be paid under this Section 4.05, and, if necessary, each monthly payment thereafter until fully exhausted. Tenant shall not be entitled to receive interest on any Additional Rent paid hereunder. No delay by Landlord in submitting any statement shall constitute a waiver of landlord's right to submit such statement and/or receive any Additional Rent pursuant hereto. The Additional Rent due hereunder shall be prorated for the calendar year in which this Lease terminates. Said amount shall be calculated and paid as herein provided even though said calculation may not occur until after the end of the term hereof.
- (d) Excluded Costs. There shall not be included in Building Operating Costs the payments (such as salaries or fees) to Landlord's executive personnel; costs for items that, by standard accounting practice, should be capitalized, unless these costs reduce operating expense and are amortized over the reasonable life of the capital item in accordance with generally accepted accounting principles and the yearly amortization does not exceed the actual cost reduction for the relevant year; depreciation or interest (unless it is related to allowable capital items); taxes on Landlord's business (such as income, excess profits, franchise, capital stock, estate, inheritance); leasing commissions; legal fees not directly relating to the operation and maintenance of the entire Building such as landlord and tenant issues; cost to correct original construction defects; expenses paid directly by a tenant for any reason (such as excessive utility use); costs for improving any tenant's space; any repair or work necessitated by condemnation, fire, or other casualty service or benefits or both provided to some tenants, but not to Tenant; and any costs, fines, and the like due to Landlord's violation of any government rule or authority.
- (e) Audit. Tenant shall have the right, upon fifteen (15) days' written notice to Landlord, to audit, at Tenant's expense, landlord's books and records as they relate to the Building Operating Costs. Should said Building Operating Costs be five percent (5%) higher than said Building Operating Costs as determined by the audit, Landlord shall be obligated to pay the reasonable cost of said audit.
- (f) Dispute. Should a dispute arise as to the Building Operating Costs, then the matter shall be determined by arbitration in accordance with the rules of the American Arbitration Association then prevailing.
- (g) Parking. Tenant, its employees and business invitees shall have the nonexclusive right, in common with Landlord and all others to whom Landlord has granted or may hereafter grant rights, to use Common Areas in or adjoining the Building (including, but not limited to, the parking lot, walkways and sidewalks) as are designated from time to time by Landlord, subject to such rules and regulations as landlord may from time to time impose, including the designation of specific areas in which cars operated by Tenant, its employees and business invitees must be parked. Tenant shall be entitled to use the vehicle parking spaces in the Project allocated to Tenant in Section 1.11 of the Lease without paying any Additional Rent. Tenant's parking shall not be reserved and shall be limited to vehicles no larger than standard size automobiles or pickup utility vehicles. Tenant shall not cause large trucks or other large vehicles to be parked within the Project except in designated areas and spaces or on the adjacent public streets. Temporary parking of large delivery vehicles in the Project may be permitted by the rules and regulations established by Landlord. Vehicles shall be parked only in striped parking spaces and not in driveways, loading areas or other locations not specifically designated for parking. If Tenant parks more vehicles in the parking area than the number set forth in Section 1.11 of the Lease, such conduct shall be a material breach of the Lease. In addition to Landlord's other remedies under the Lease, Tenant shall pay a reasonable daily charge for each such additional vehicle. Landlord may at any time close any Common Area to make repairs or changes (provided the closure does not unreasonably impede access to the Leased Property by customers and employees of

Tenant), to prevent the acquisition of public rights in such areas, or to discourage non-customer parking. Landlord may do such other acts in and to the Common Areas as in its judgment may be desirable, including, but not limited to, the conversion of portions thereof to other uses. Tenant shall upon request furnish to landlord the license numbers of cars operated by Tenant and its employees. Tenant shall not at any time interfere with the right of landlord, other tenants, its and their agents, employees, servants, contractors, subtenants, licensees, customers and business invitees to use any part of the parking lot or other Common Areas. Landlord assumes no responsibility to police the use of said parking areas and landlord shall not be liable for the use thereof by Tenant, landlord's other tenants, its or their agents, employees, servants, contractors, subtenants, licensees, customers and/or business invitees or by any other person or persons, entity or entities whomsoever.

- (h) Bulletin Board. The bulletin board or directory of the Building, if any, shall be provided exclusively for the display of the names and locations of tenants only and other matters relating to the Building, and Landlord reserves the right to exclude any other names therefrom and otherwise limit the number of listings thereon.

SECTION 4.06. Late Charges. Tenants' failure to pay rent promptly may cause Landlord to incur unanticipated costs. The exact amount of such costs is impractical or extremely difficult to ascertain. Such costs may include, but are not limited to, processing and accounting charges and late charges which may be imposed on Landlord by any ground lease, mortgage or trust deed encumbering the Property. Therefore, if Landlord does not receive any rent payment within ten (10) days after it becomes due, Tenant shall pay Landlord a late charge equal to ten percent (10%) of the overdue amount. The parties agree that such late charge represents a fair and reasonable estimate of the costs Landlord will incur by reason of such late payment. The parties further agree that the payment of late charges and the payment of interest provided for in Section 4.07 below are distinct and separate from one another in that the payment of interest is to compensate Landlord for the use of Landlord's money by Tenant, while the payment of a late charge is to compensate Landlord for the additional administrative expense incurred by Landlord in handling and processing delinquent payments.

SECTION 4.07. Interest on Past Due Obligations. Any amount owed by Tenant to Landlord which is not paid when due shall bear interest at the rate of fifteen percent (15%) per annum from the due date of such amount until paid. However, interest shall not be payable on late charges to be paid by Tenant under this Lease. The payment of interest on such amounts shall not excuse or cure any default by Tenant under this Lease. If the interest rate specified in this Lease is higher than the rate permitted by law, the interest rate is hereby decreased to the maximum legal interest rate permitted by law.

ARTICLE FIVE: USE OF PROPERTY

SECTION 5.01. Permitted Uses. Tenant may use the Property only for the Permitted Uses set forth in Section 1.10 above and for no other purpose without the prior written consent of Landlord.

SECTION 5.02. Manner of Use. Tenant shall not cause or permit the Property to be used in any way which constitutes a violation of any law, ordinance, or governmental regulation or order, which annoys or interferes with the right of tenants of the development of which the Property is part, or which constitutes a nuisance or waste. Tenant shall obtain and pay for all permits, including a Certificate of Occupancy, required for Tenant's occupancy of the Property and shall promptly take all substantial and non-substantial actions necessary to comply with all applicable statutes, ordinances, rules, regulations, orders and requirements regulating the use by Tenant of the Property, including the Occupational Safety and Health Act.

SECTION 5.03. Signs and Auctions. Tenant shall not place any signs on the Property without Landlord's prior written consent. Tenant shall not conduct or permit any auction or sheriff's sales at the Property.

SECTION 5.04. Indemnity. Tenant shall indemnify Landlord against and hold Landlord harmless from any and all costs, claims or liability arising from: (a) Tenant's use of the Property; (b) the conduct of Tenant's business or anything else done or permitted by Tenant to be done in or about the Property; (c) any breach or default in the performance of Tenant's obligations under this Lease; (d) any misrepresentation of breach of warranty by Tenant under this Lease; or (e) other acts or omissions of Tenant. Tenant shall defend Landlord against any such cost or liability at Tenant's expense with counsel reasonably acceptable to Landlord or, at Landlord's election, Tenant shall reimburse Landlord for any legal fees or costs incurred by Landlord in connection with any such claim. As a material part of the consideration to Landlord, Tenant hereby assumes all risk of damage to property or injury to persons in or about the Property arising from any cause, and Tenant hereby waives all claims in respect thereof against Landlord, except for any claim arising out of Landlord's gross negligence or willful misconduct.

SECTION 5.05. Landlord's Access. Landlord or its agents may enter the Property at all reasonable times to show the Property to potential buyers, investors or tenants or other parties, or for any other purpose Landlord deems necessary. Landlord shall give Tenant prior notice of such entry, except in the case of an emergency. Landlord may place customary "For Sale" or "For Lease" signs on the Property.

Initials

Landlord _____
Tenant _____

SECTION 5.06. Quiet Possession. If Tenant pays the rent and complies with all other terms of this Lease, Tenant may occupy and enjoy the Property for the full Lease Term, subject to the provisions of this Lease.

ARTICLE SIX: CONDITION OF PROPERTY; MAINTENANCE; REPAIRS AND ALTERATIONS

SECTION 6.01 Existing Conditions. Except as set forth in any rider requiring landlord to perform work on the Property prior to the Commencement Date, Tenant accepts the Property in its condition as of the execution of this Lease, subject to all recorded matters, laws, ordinances, and governmental regulations and orders. Tenant acknowledges that neither Landlord nor any agent of Landlord has made any representation as to the condition of the Property or the suitability of the Property for Tenant's intended use. Without limiting the foregoing, Tenant agrees to abide by and conform to any covenants, conditions and restrictions or reciprocal easement agreements relating to the Property described as follows: 6857 Speedway Boulevard, Building "P", Las Vegas, Nevada 89115 (if none, so indicate). Tenant acknowledges receipt of such documents, if any.

SECTION 6.02. Exception of Landlord from Liability. Landlord shall not be liable for any damage or injury to the person, business (or any loss of income therefrom), goods, wares, merchandise or other property of Tenant, Tenant's employees, invitees, customers or any other person in or about the Property, whether such damage or injury is caused by or results from (a) fire, steam, electricity, water, gas or rain; (b) the breakage, leakage, obstruction or other defects of pipes, sprinklers, wires, appliances, plumbing, air conditioning or lighting fixtures or any other cause; (c) conditions arising in or about the Property or upon other portions of any building of which the Property is a part, or from other sources or places; or (d) any act or omission of any other tenant of any building of which the Property is a part. Landlord shall not be liable for any such damage or injury even though the cause of or the means of repairing such damage or injury are not accessible to Tenant. The provisions of this Section 6.02 shall not, however, exempt Landlord from liability for Landlord's negligence or willful misconduct.

SECTION 6.03. Tenant's Obligations.

- (a) Except as provided for elsewhere herein, Tenant shall keep the Property in good order, condition and repair during the Lease Term, including, but without limitation, the exterior and interior portion of all doors, windows, plate glass, all plumbing and sewage facilities within the Property (including maintaining free flow up the main sewer line); interior fixtures, sprinkler system, walls, floors and ceilings in the Property; and any work performed by or on behalf of Tenant hereunder. Tenant shall promptly replace any portion of the Property or system or equipment in the Property that cannot be fully repaired, regardless of whether the benefit of such replacement extends beyond the Lease Term. It is the intention of Landlord and Tenant that, at all times during the Lease Term, Tenant shall maintain the property in an attractive, first-class and fully operative condition.
- (b) All of Tenant's obligations to maintain and repair shall be accomplished at Tenant's sole expense. If Tenant fails to maintain and repair the Property, Landlord may, on ten (10) days' prior notice (except that no notice shall be required in case of emergency) enter the Property and perform such repair and maintenance on behalf of Tenant. In such case, Tenant shall reimburse Landlord for all costs so incurred immediately upon demand.

SECTION 6.04.

- (a) Landlord's Obligations. Landlord agrees to keep in good order, condition and repair the foundations, exterior walls and roof of the Property and the Building (but excluding the exterior and interior of all windows, doors, and plate glass) and the Common Areas, except for reasonable wear and tear and except for any damage thereto caused by any act or negligence of Tenant or its agents, employees, servants, contractors, subtenants, licensees, customers or business invitees. Landlord shall provide any Common Areas within the Building with heating, ventilation and air conditioning during the customary periods of the year therefor during normal business hours of 8:00 a.m. to 6:00 p.m., Saturdays, Sundays and legal holidays excluded. If the Building contains an elevator, Landlord shall provide adequate elevator service to the Property and the Building. Landlord's obligation to furnish services shall be conditioned upon the availability of adequate energy sources. Landlord shall have the right to reduce heat, lighting and power as required by any mandatory or voluntary fuel or energy conservation program provided the voluntary reduction does not adversely affect Tenant's comfort, use and occupancy of the Property. Landlord may, from time to time, prescribe rules and regulations for implementation of this paragraph.
- (b) Limitation. Landlord shall not be obligated to perform any service or to repair or maintain any structure or facility except as provided in this Section 6.04 and Section 4.05 hereof. Tenant shall be responsible for its own janitorial

services for the Property. Landlord shall not be responsible for light bulb or ballast replacement. Landlord shall not be obligated to provide any service or maintenance or to make any repairs when such service, maintenance or repair is made necessary because of the negligence or misuse of Tenant, Tenant's agents, employees, servants, contractors, subtenants, licensees, customers or business invitees. Landlord reserves the right to stop any service when Landlord reasonably deems such stoppage necessary, whether by reason of accident or emergency, or for repairs or improvements or otherwise. Landlord shall not be liable for loss or injury however occurring, through or in connection with or incident to any stoppage of such services. Landlord shall have no responsibility or liability for failure to supply any services or maintenance or to make any repairs when prevented from doing so by any cause beyond Landlord's control. Landlord shall not be obligated to inspect the Property and shall not be obligated to make any repairs or perform any maintenance hereunder unless first notified of the need thereof in writing by Tenant. In the event that Landlord shall fail to commence such repairs or maintenance within twenty (20) days after said notice, Tenant shall, after further notice to Landlord, make such repairs or perform such maintenance at Landlord's expense; provided, however, that the amount of such costs not exceed the reasonable value of such repairs or maintenance. Landlord shall not be liable for any loss or damage to persons or property sustained by Tenant or other persons, which may be caused by the Building or the Property, or any appurtenances thereto, being out of repair or by bursting or leakage of any water, gas, sewer or steam pipe, whether or not it is the obligation of Landlord to repair the same, by theft, by fire, oil or electricity, by any act of neglect of any tenant or occupant of the Building, or of any other person, or by any other cause of whatsoever nature, unless caused by the negligence of Landlord.

SECTION 6.05. Alterations, Additions, and Improvements.

- (a) Tenant shall not make any alterations, additions, or improvements to the Property without Landlord's prior written consent. Landlord may require Tenant to provide demolition and/or lien and completion bonds in form and amount satisfactory to Landlord. Tenant shall promptly remove any alterations, additions, or improvements constructed in violation of this Paragraph 6.05(a) upon Landlord's written request. All alterations, additions, and improvements will be accomplished in a good and workmanlike manner, in conformity with all applicable laws and regulations, and by a contractor approved by Landlord. Upon completion of any such work, Tenant shall provide Landlord with as built plans, copies of all construction contracts, and proof of payment for all labor and materials.
- (b) Tenant shall pay when due all claims for labor and material furnished to the Property and shall not permit the filing of any mechanic's lien or other lien in connection with any alterations, additions, or improvements. Tenant shall give Landlord at least fifteen (15) days' prior written notice of the commencement of any work on the Property. Landlord may elect to record and post notices of non-responsibility on the Property. If a mechanic's lien or other lien is filed against the Property or the Project and Tenant fails to timely discharge such lien, Landlord may, without waiving its rights and remedies based on such breach of Tenant and without releasing Tenant from any of its obligations, cause such liens to be released by any means it shall deem proper, including payment in satisfaction of the claim giving rise to such lien. Tenant shall pay to Landlord within thirty (30) days following notice by Landlord, any sum paid by Landlord to remove such liens, together with interest at landlord's cost of money from the date of such payment by Landlord.

SECTION 6.06. Condition upon Termination. Upon the termination of the Lease, Tenant shall surrender the Property to Landlord, broom clean and in the same condition as received except for ordinary wear and tear which Tenant was not otherwise obligated to remedy under any provision of this Lease. However, Tenant shall not be obligated to repair any damage which Landlord is required to repair under Article Seven (Damage or Destruction). In addition, Landlord may require Tenant to remove any alterations, additions or improvements (whether or not made with Landlord's consent) prior to the termination of the Lease and to restore the Property to its prior condition, all at Tenant's expense. All alterations, additions and improvements which Landlord has not required Tenant to remove shall become Landlord's property and shall be surrendered to Landlord upon the termination of the Lease, except that Tenant may remove any of Tenant's machinery or equipment which can be removed without material damage to the Property. Tenant shall repair, at Tenant's expense, any damage to the Property caused by the removal of any such machinery or equipment. In no event, however, shall Tenant remove any of the following materials or equipment without Landlord's prior written consent:

Initials
Landlord _____

any power wiring or power panels; lighting or lighting fixtures; wall coverings; drapes, blinds or other window coverings; carpets or other floor coverings; heaters, air conditioners or any other heating or air conditioning equipment; fencing or security gates; or other similar building operating equipment and decoration.

ARTICLE SEVEN: DAMAGE OR DESTRUCTION

SECTION 7.01. Partial Damage to Property. Tenant shall notify Landlord in writing immediately upon the occurrence of any damage to the Property. If the Property is only partially damaged and if the proceeds received by Landlord from the insurance policies described in Paragraph 4.04(b) are sufficient to pay for the necessary repairs, this Lease shall remain in effect and Landlord shall repair the damage as soon as reasonably possible. Landlord may elect to repair any damage to Tenant's fixtures, equipment, or improvements. If the insurance proceeds received by Landlord are not sufficient to pay the entire cost of repair, or if the damage was due to a cause not covered by the insurance policies which Landlord maintains under Paragraph 4.04(b), Landlord may elect to (a) repair the damage as soon as reasonably possible in which case this Lease shall remain in full force and effect, or (b) terminate this Lease as of the date the damage occurred. Landlord shall notify Tenant within thirty (30) days after receipt of notice of the occurrence of the damage, whether Landlord elects to repair the damage or terminate the Lease. If Landlord elects to repair the damage, Tenant shall pay Landlord the "deductible amount" (if any) under Landlord's insurance policies, and, if the damage was due to an act or omission of Tenant, Tenant shall pay the difference between the actual cost of repair and any insurance proceeds received by Landlord. If Landlord elects to terminate the Lease, Tenant may elect to continue this Lease in full force and effect, in which case Tenant shall repair any damage to the Property and any building in which the Property is located. Tenant shall pay the cost of such repairs, except that, upon satisfactory completion of such repairs, Landlord shall deliver to Tenant any insurance proceeds received by Landlord for the damage repaired by Tenant. Tenant shall give Landlord written notice of such election within ten (10) days after receiving Landlord's termination notice. If the damage to the Property occurs during the last six (6) months of the Lease Term, Landlord may elect to terminate this Lease as of the date the damage occurred regardless of the sufficiency of any insurance proceeds. In such event, Landlord shall not be obligated to repair or restore the Property and Tenant shall have no right to continue this Lease. Landlord shall notify Tenant of its election within thirty (30) days after receipt of notice of the occurrence of the damage.

SECTION 7.02. Total of Substantial Destruction. If the Property is totally or substantially destroyed by any cause whatsoever, or if the Building is substantially destroyed (even though the Property is not totally or substantially destroyed), this Lease shall terminate as of the date of the destruction occurred regardless of whether Landlord receives any insurance proceeds. However, if the Property can be rebuilt within one (1) year after the date of destruction, Landlord may elect to rebuild the Property at Landlord's own expense, in which case, this Lease shall remain in full force and effect. Landlord shall notify Tenant of such election within thirty (30) days after the occurrence of total or substantial destruction. If the destruction was caused by an act or omission of Tenant, Tenant shall pay Landlord the difference between the actual cost of rebuilding and any insurance proceeds received by Landlord.

SECTION 7.03. Temporary Reduction of Rent. If the Property is destroyed or damaged and Landlord or Tenant elect to repair or restore the Property pursuant to the provisions of this Article Seven, any rent payable during the period of such damage, repair and/or restoration shall be reduced according to the degree, if any, to which Tenant's use of the Property is impaired. However, the reduction shall not exceed the sum of one year's payment of Base Rent and Additional Rent. Except for such possible reduction in Base Rent and Additional Rent, Tenant shall not be entitled to any compensation, reduction, or reimbursement from Landlord as a result of any damage, destruction, repair, or restoration of or to the Property.

SECTION 7.04. Waiver. Tenant waives the protection of any statute, code or judicial decision that grants a tenant the right to terminate a lease in the event of the substantial destruction of the leased property. Tenant agrees that the provisions of Section 7.02 above shall govern the rights and obligations of Landlord and Tenant in the event of any substantial or total destruction to the Property.

ARTICLE EIGHT: CONDEMNATION

SECTION 8.01. Taking. If all or any portion of the Property is taken under the power of eminent domain or sold under the threat of that power (all of which are called "Condemnation"), this Lease shall terminate as to the part taken or sold on the date the condemning authority takes title or possession, whichever occurs first. If more than twenty percent (20%) of the floor area of the Building is taken, Landlord may terminate this Lease as of the date the condemning authority takes title or possession, by delivering written notice to Tenant within ten (10) days after the receipt of written notice of such taking or in the absence of such notice, within ten (10) days after the condemning authority takes possession). If neither Landlord nor Tenant terminates this Lease, this Lease shall remain in effect as to the portion of the Property not taken, except that the Base Rent shall be reduced in proportion to the reduction in the floor area of the Property. Any Condemnation award or payment shall be distributed in the following order: (a) first, to any ground lessor, mortgagee or beneficiary under a deed of trust encumbering the Property, the amount of its interest in the Property; (b) second, to Tenant, only the amount of any award specifically designated for loss of or damage to Tenant's trade fixtures or removable personal property; and (c) third, to Landlord, the remainder of such

award, whether as compensation for reduction in the value of the leasehold, the taking of the fee, or otherwise. If this Lease is not terminated, Landlord shall repair any damage to the Property caused by the Condemnation, except that Landlord shall not be obligated to repair any damage for which Tenant has been reimbursed by the condemning authority. If the severance damages received by Landlord are not sufficient to pay for such repair, Landlord shall have the right to either terminate this Lease or make such repair at Landlord's expense.

SECTION 8.02. Temporary Taking. If all or any portion of the Property is condemned or otherwise taken for public or quasi-public use for a limited period of time, this Lease shall remain in full force and effect and Tenant shall continue to perform all of the terms, conditions and covenants of this Lease, including without limitation, the payment of Base Rent and all other amounts required hereunder. Tenant shall be entitled to receive the entire award made in connection with any other temporary condemnation or other taking attributable to any period within the Term. Landlord shall be entitled to the entire award for any such temporary condemnation or other taking which relates to a period after the expiration of the Term or which is allocable to the cost of restoration of the Property. If any such temporary condemnation or other taking terminates prior to the expiration of the Term, Tenant shall restore the Property as nearly as possible to the condition prior to the condemnation or other taking, at Tenant's sole cost and expense; provided that, Tenant shall receive the portion of the award attributable to such restoration.

ARTICLE NINE: ASSIGNMENT, SUBLETTING, AND SALE BY LANDLORD

SECTION 9.01. Landlord's Consent Required. No portion of the Property or of Tenant's interest in this Lease may be acquired by any other person or entity, whether by assignment, mortgage, sublease, transfer, operation of law, or other act of Tenant, without Landlord's prior written consent, except as provided in Section 9.02 below. Landlord shall grant or withhold its consent as provided in Section 9.04 below. Any attempted transfer without consent shall be void and shall constitute a non-curable breach of this Lease. If Tenant is a partnership, any cumulative transfer of more than twenty percent (20%) of the partnership interests shall require Landlord's consent. If Tenant is a corporation, any change in a controlling interest of the voting stock of the corporation shall require Landlord's consent.

SECTION 9.02. Tenant Affiliate. Tenant may assign this Lease or sublease the Property, without Landlord's consent, to any corporation which is controlled by or is under common control with Tenant, or to any corporation resulting from the merger of or consolidation with Tenant, (collectively, "Tenant's Affiliate"). In such case, any Tenant's Affiliate shall assume in writing all of Tenant's obligations under this Lease. Proof of an entity's eligibility to become an assignee or subtenant pursuant to this Section 9.02 shall be promptly furnished to Landlord upon Landlord's request.

SECTION 9.03. No Release of Tenant. No transfer permitted by this Article Nine, whether with or without Landlord's consent, shall release Tenant or change Tenant's primary liability to pay the rent and to perform all other obligations of Tenant under this Lease. Landlord's acceptance of rent from any other person is not a waiver of any provision of this Article Nine. Consent to one transfer is not a consent to any subsequent transfer. If Tenant's transferee defaults under this Lease, Landlord may proceed directly against Tenant without pursuing remedies against the transferee. Landlord may consent to subsequent assignments or modifications of this Lease by Tenant's transferee, without notifying Tenant or obtaining its consent. Such action shall not relieve Tenant's liability under this Lease.

SECTION 9.04. Landlord's Election. Tenant's request for consent to any transfer described in Section 9.01 above shall be accompanied by a written statement setting forth the details of the proposed transfer, including the name, business and financial condition of the prospective transferee, financial details of the proposed transfer (e.g., the term of and rent and security deposit payable under any assignment or sublease), and any other information Landlord deems relevant. Landlord shall have the right (a) to withhold consent, if reasonable; (b) to grant consent; or (c) if the transfer is a sublease of the Property or an assignment of this Lease, to terminate this Lease as of the effective date of such sublease or assignment, in which case Landlord may elect to enter into a direct lease with the proposed assignee or subtenant.

SECTION 9.05. No Merger. No Merger shall result from Tenant's sublease of the Property under this Article Nine, Tenant's surrender of this Lease or the termination of this Lease in any other manner. In any such event, Landlord may terminate any or all subtenancies or succeed to the interest of Tenant or sublandlord thereunder.

SECTION 9.06. Sale by Landlord. In the event of any sale or other transfer of landlord's interest in the Building, other than a transfer for security purposes only,

Initials
Landlord _____
Tenant _____

Landlord shall be automatically relieved of any and all obligations and liabilities on the part of Landlord accruing from and after the date of such transfer.

ARTICLE TEN: DEFAULTS; REMEDIES

SECTION 10.01. Covenants and Conditions. Tenant's performance of each of Tenant's obligations under this Lease is a condition as well as a covenant. Tenant's right to continue in possession of the Property is condition upon such performance of all covenants and conditions.

SECTION 10.02. Defaults. Tenant shall be in material default under this Lease:

- (a) If Tenant abandons the Property or if Tenant's vacation of the Property results in the cancellation of any insurance described in Section 4.04;
- (b) If Tenant fails to pay rent or any other charge required to be paid by Tenant, as and when due;
- (c) If Tenant fails to perform any of Tenant's non-monetary obligations under this Lease for a period of thirty (30) days after written notice from Landlord; provided that if more than thirty (30) days are required to complete such performance, Tenant shall not be in default if Tenant commences such performance within the thirty (30) day period and thereafter diligently pursues its completion. However, Landlord shall not be required to give such notice if Tenant's failure to perform constitutes a non-curable breach of this Lease. The notice required by this Paragraph is intended to satisfy any and all notice requirements imposed by law on Landlord and is not in addition to any such requirement.
- (d)
 - (i) If Tenant or any guarantor hereunder, or any general partner of Tenant, if Tenant is a partnership, makes a general assignment or general arrangement for the benefit of creditors;
 - (ii) If a petition for adjudication of bankruptcy or for reorganization or rearrangement is filed by or against Tenant or any guarantor hereunder, or any general partner of Tenant, if Tenant is a partnership, and is not dismissed within thirty (30) days.
 - (iii) If a trustee or receiver is appointed to take possession of substantially all of Tenant's assets located at the Property or of Tenant's interest in this Lease and possession is not restored to Tenant within thirty (30) days; or
 - (iv) If substantially all of Tenant's assets located at the Property or if Tenant's interest in this Lease is subjected to attachment, execution or other judicial seizure which is not discharged within thirty (30) days.

If a court of competent jurisdiction determines that any of the acts described in this subparagraph (d) is not a default under this Lease, and a trustee is appointed to take possession (or if Tenant remains a debtor in possession) and such trustee or Tenant transfer Tenant's interest hereunder, then Landlord shall receive, as Additional Rent, the difference between the rent (or any other consideration) paid in connection with such assignment or sublease and the rent payable by Tenant hereunder.

SECTION 10.03. Remedies. On the occurrence of any material default by Tenant, Landlord may, at any time thereafter, with or without notice or demand and without limiting Landlord in the exercise of any right or remedy which Landlord may have:

- (a) Terminate Tenant's right to possession of the Property by any lawful means, in which case this Lease shall terminate and Tenant shall immediately surrender possession of the Property to Landlord. In such event, Landlord shall be entitled to recover from Tenant all damages incurred by Landlord by reason of Tenant's default, including:
 - (i) The worth at the time of the award of the unpaid Base Rent, Additional Rent and other charges which had been earned at the time of the termination;
 - (ii) The worth at the time of the award of the amount by which the unpaid Base Rent, Additional Rent and other charges which would have been earned after termination until the time of the award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided;
 - (iii) The worth at the time of the award of the amount by which the unpaid Base Rent, Additional Rent and other charge which would have been paid for the balance of the Lease Term after the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; and
 - (iv) Any other amount necessary to compensate Landlord

for all the detriment proximately caused by Tenant's failure to perform its obligations under the Lease or which in the ordinary course of things would be likely to result therefrom, including, but not limited to, any costs or expenses incurred by Landlord in maintaining or preserving the Property after such default, the cost of recovering possession of the Property, expenses of reletting, including necessary renovation or alteration of the Property, Landlord's reasonable attorney's fees incurred in connection therewith, and any real estate commission paid or payable. As used in subparts (i) and (ii) above, the "worth at the time of the award" is computed by allowing interest on unpaid amounts at the rate of fifteen percent (15%) per annum, or such lesser amount as may then be the maximum lawful rate. As used in subpart (iii) above, the "worth at the time of the award" is computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of the award, plus one percent (1%). If Tenant shall have abandoned the Property, Landlord shall have the option of (i) retaking possession of the Property and recovering from Tenant the amount specified in this Paragraph 10.03(a), or (ii) proceeding under Paragraph 10.03(b);

- (b) Maintain Tenant's right to possession, in which case this Lease shall continue in effect whether or not Tenant shall have abandoned the Property. In such event, Landlord shall be entitled to enforce all of Landlord's rights and remedies under this Lease, including the right to recover the rent as it becomes due hereunder;
- (c) Pursue any other remedy now or hereafter available to Landlord under the laws or judicial decisions of the state in which the Property is located.

SECTION 10.04. Abandonment Remedy. Tenant covenants to occupy the Property throughout the term hereof. Tenant expressly recognizes that Landlord will be injured should Tenant not comply with this provision and that the amount of Landlord's damages thereby are incapable of measurement and Tenant, therefore, expressly covenants to pay to Landlord as liquidated damages for the breach of this covenant an amount, in addition to all other rents and other monies due Landlord hereunder, equal to twenty-five percent (25%) of the Base Rent due for the remainder of the term after such breach.

SECTION 10.05. Cumulative Remedies. Landlord's exercise of any right or remedy shall not prevent it from exercising any other right or remedy.

ARTICLE ELEVEN: PROTECTION OF LENDERS

SECTION 11.01. Subordination. Landlord shall have the right to subordinate this Lease to any ground lease, deed of trust or mortgage encumbering the Property, any advances made on the security thereof and any renewals, modifications, consolidations, replacements or extensions thereof, whenever made or recorded. However, Tenant's right to quiet possession of the Property during the Lease Term shall not be disturbed if Tenant pays the rent and performs all of Tenant's obligations under this Lease and is not otherwise in default. If any ground lessor, beneficiary or mortgagee elects to have this Lease prior to the lien of its ground lease, deed of trust or mortgage and gives written notice thereof to Tenant, this Lease shall be deemed prior to such ground lease, deed of trust or mortgage whether this Lease is dated prior or subsequent to the date of said ground lease, deed of trust or mortgage or the date of recording thereof.

SECTION 11.02. Attornment. If Landlord's interest in the Property is acquired by any ground lessor, beneficiary under a deed of trust, mortgage, or purchaser at a foreclosure sale, Tenant shall attorn to the transferee of or successor to Landlord's interest in the Property and recognize such transferee or successor as landlord under this Lease. Tenant waives the protection of any state or rule of law which gives or purports to give Tenant any right to terminate this Lease or surrender possession of the Property upon the transfer of Landlord's interest.

SECTION 11.03. Signing of Document. Tenant shall sign and deliver any instrument or documents necessary or appropriate to evidence any such attornment or subordination or agreement to do so. Such subordination and attornment documents may contain such provisions as are customarily required by any ground lessor, beneficiary under a deed of trust or mortgagee. If Tenant fails to do so within ten (10) days after written request, Tenant hereby makes, constitutes and irrevocably appoints Landlord, or any transferee or successor of Landlord, the attorney-in-fact of Tenant to execute and deliver any such instrument or document.

Initials
Landlord _____
Tenant _____

SECTION 11.04. Estoppel Certificates.

- (a) Upon Landlord's written request, Tenant shall execute, acknowledge and deliver to landlord a written statement certifying: (i) that none of the terms or provisions of this Lease have been changed (or if they have been changed, stating how they have been changed); (ii) that this Lease has not been canceled or terminated; (iii) the last date of payment of the Base Rent and other charges and the time period covered by such payment; (iv) that Landlord is not in default under this Lease (or, if Landlord is claimed to be in default, stating why); and (v) such other matters as may be reasonably required by Landlord or the holder of a mortgage, deed of trust or lien to which the Property is or becomes subject. Tenant shall deliver such statement to Landlord within ten (10) days after Landlord's request. Any such statement by Tenant may be given by Landlord to any prospective purchaser or encumbrancer of the Property. Such purchaser or encumbrancer may rely conclusively upon such statement as true and correct.
- (b) If Tenant does not deliver such statement to Landlord within such ten (10) day period, Landlord, and any prospective purchaser or encumbrancer, may conclusively presume and rely upon the following facts: (i) that the terms and provisions of this Lease have not been changed except as otherwise represented by Landlord; (ii) that this Lease has not been canceled or terminated except as otherwise represented by Landlord; (iii) that not more than one month's Base Rent or other charges have been paid in advance; and (iv) that Landlord is not in default under the Lease. In such event, Tenant shall be estopped from denying the truth of such facts.

SECTION 11.05. Tenant's Financial Condition. Within ten (10) days after written request from Landlord, Tenant shall deliver to Landlord such financial statements as are reasonably required by Landlord to verify the net worth of Tenant, or any assignee, subtenant, or guarantor of Tenant. In addition, Tenant shall deliver to any lender designated by Landlord any financial statements required by such lender to facilitate the financing or refinancing of the Property. Tenant represents and warrants to Landlord that each such financial statement is a true and accurate statement as of the date of such statement. All financial statements shall be confidential and shall be used only for the purposes set forth herein.

ARTICLE TWELVE: LEGAL COSTS

SECTION 12.01. Legal Proceedings. Tenant shall reimburse landlord, upon demand, for any costs or expenses incurred by Landlord in connection with any breach or default of Tenant under this Lease, whether or not suit is commenced or judgment entered. Such costs shall include legal fees and costs incurred for the negotiation of a settlement, enforcement of rights or otherwise. Furthermore, if any action for breach of or to enforce the provisions of this Lease is commenced, the court in such action shall award to the party in whose favor a judgment is entered, a reasonable sum as attorneys' fees and costs. Such attorneys' fees and costs shall be paid by the losing party in such action. Tenant shall also indemnify Landlord against and hold Landlord harmless from all costs, expenses, demands and liability incurred by Landlord if Landlord becomes or is made a party to any claim or action (a) instituted by Tenant, or by any third party against Tenant, or by or against any person holding any interest under or using the Property by license of or agreement with Tenant; (b) for foreclosure of any lien for labor or material furnished to or for Tenant or such other person; (c) otherwise arising out of or resulting from any act or transaction of Tenant or such other person; or (d) necessary to protect landlord's interest under this Lease in a bankruptcy proceeding, or other proceeding under Title 11 of the United States Code, as amended. Tenant shall defend Landlord against any such claims or action at Tenant's expense with counsel reasonably acceptable to Landlord or, at Landlord's election, Tenant shall reimburse Landlord for any legal fees or costs incurred by Landlord in any such claim or action.

SECTION 12.02. Landlord's Consent. Tenant shall pay Landlord's reasonable attorneys' fees incurred in connection with Tenant's request for Landlord's consent under Article Nine (Assignment and Subletting), or in connection with any other act which Tenant proposes to do and which requires Landlord's consent.

ARTICLE THIRTEEN: MISCELLANEOUS PROVISIONS

SECTION 13.01. Non-Discrimination. Tenant promises, and it is a condition to the continuance of this Lease, that there will be no discrimination against, or segregation of, any person or group of persons on the basis of race, color, sex, creed, national origin or ancestry in the leasing, subleasing, transferring, occupancy, tenure or use of the Property or any portion thereof.

SECTION 13.02. Landlord's Liability; Certain Duties.

- (a) As used in this Lease, the term "Landlord" means only the current owner or owners of the fee title to the Property or the leasehold estate under a ground lease of the Property at the time in question. Each Landlord is obligated to perform the obligations of Landlord under this Lease only during the time such Landlord owns such interest or title. Any Landlord who transfers its title or interest is relieved of all

liability with respect to the obligations of Landlord under this Lease to be performed on or after the date of transfer. However, each Landlord shall deliver to its transferee all funds previously paid by Tenant if such funds have not yet been applied under the terms of this Lease.

- (b) Tenant shall give written notice of any failure by Landlord to perform any of its obligations under this Lease to Landlord and to any ground lessor, mortgagee or beneficiary under any deed of trust encumbering the Property whose name and address have been furnished to Tenant in writing. Landlord shall not be in default under this Lease unless Landlord (or such ground lessor, mortgagee or beneficiary) fails to cure such non-performance within thirty (30) days after receipt of Tenant's notice. However, if such non-performance reasonably requires more than thirty (30) days to cure, Landlord shall not be in default if such cure is commenced within such thirty- (30) day period and thereafter diligently pursued to completion.
- (c) Upon the execution of this Lease, Tenant shall deposit with Landlord a cash Security Deposit in the amount set forth in Section 1.08 above. Landlord may apply all or part of the Security Deposit to any unpaid rent or other charges due from Tenant or to cure any other defaults of Tenant. If Landlord uses any part of the Security Deposit, Tenant shall restore the Security Deposit to its full amount within ten (10) days after Landlord's written request. Tenant's failure to do so shall be a material default under this Lease. No interest shall be paid on the Security Deposit. Landlord shall not be required to keep the Security Deposit separate from its other accounts and no trust relationship is created with respect to the Security Deposit. If Tenant shall fully and faithfully perform every provision of this Lease to be performed by it, the Security Deposit or any balance thereof shall be returned to Tenant (or, at Landlord's option, to the last assignee of Tenant's interest hereunder) within fourteen (14) days following the later of expiration of the Term and surrender of possession of the Property to Landlord.

SECTION 13.03. Severability. A determination by a court of competent jurisdiction that any provision of this Lease or any part thereof is illegal or unenforceable shall not cancel or invalidate the remainder of such provision or this Lease, which shall be valid and enforceable to the fullest extent permitted by law.

SECTION 13.04. Interpretation. The captions of the Articles or Sections of this Lease are to assist the parties in reading this Lease and are not a part of the terms or provisions of this Lease. Whenever required by the context of this Lease, the singular shall include the plural and the plural shall include the singular. The masculine, feminine and neuter genders shall each include the other. In any provision relating to the conduct, acts or omissions of Tenant, the term "Tenant" shall include Tenant's agents, employees, contractors, invitees, successors or other using the Property with Tenant's expressed or implied permission. If any of the obligations of Tenant hereunder is guaranteed by another person or entity, the term "Tenant" shall be deemed to include all of such guarantors and any one or more of such guarantors.

SECTION 13.05. Incorporation of Prior Agreements, Modification. This instrument along with any exhibits and attachments or other documents affixed hereto, or referred to herein, constitutes the entire and exclusive agreement between Landlord and Tenant with respect to the Property and the estate and interest leased to Tenant hereunder. This instrument and said exhibits and attachments and other documents may be altered, amended, modified or revoked only by an instrument in writing signed by both landlord and Tenant. Landlord and Tenant hereby agree that all prior or contemporaneous oral understandings, agreements or negotiations relative to the leasing of the Property are merged into and revoked by this instrument.

SECTION 13.06. Notices. All notices required or permitted under this Lease shall be in writing and shall be personally delivered or sent by certified mail, return receipt requested, postage prepaid. Notices to Tenant shall be delivered to the address specified in Section 1.03 above, except that upon Tenant's taking possession of the Property, the Property shall be Tenant's address for notice purposes. Notices to Landlord shall be delivered to the address specified in Section 1.02 above. Notices shall be deemed sufficiently served or given at the time of personal delivery or three (3) days after the date of mailing thereof. Either party may change its notice address upon written notice to the other party.

Initials
Landlord _____
Tenant _____

SECTION 13.07. Waivers. All waivers must be in writing and signed by the waiving party. Landlord's failure to enforce any provision of this Lease or its acceptance of rent shall not be a waiver and shall not prevent Landlord from enforcing that provision or any other provision of this Lease in the future. No statement on a payment check from Tenant or in a letter accompanying a payment check shall be binding on Landlord. Landlord, may, with or without notice to Tenant, negotiate such check without being bound to the conditions of such statement.

SECTION 13.08. No Recordation. This Lease or a memorandum thereof may not be recorded without prior written consent from Landlord.

SECTION 13.09. Binding Effect; Choice of Law. This Lease binds any party who legally acquires any rights or interest in this Lease from Landlord or Tenant. However, Landlord shall have no obligation to Tenant's successor unless the rights or interest of Tenant's successor are acquired in accordance with the terms of this Lease. The laws of the state in which the Property is located shall govern this Lease.

SECTION 13.10. Corporate Authority; Partnership Authority. If Tenant is a corporation, each person signing this Lease on behalf of Tenant represents and warrants that he/she has full authority to do so and that this lease binds the corporation. Within thirty (30) days after this Lease is signed, Tenant shall deliver to Landlord a certified copy of a resolution of Tenant's Board of Directors authorizing the execution of this Lease or other evidence of such authority reasonably acceptable to landlord. If Tenant is a partnership, each person signing this Lease for Tenant represents and warrants that he/she is a general partner of the partnership, that he/she has full authority to sign for the partnership and that this lease binds the partnership and all general partners of the partnership. Tenant shall give written notice to Landlord of any general partner's withdrawal or addition. Within thirty (30) days after this Lease is signed, Tenant shall deliver to Landlord a copy of Tenant's recorded statement of partnership or certificate of limited partnership.

SECTION 13.11. Joint and Several Liability. All parties signing this Lease as Tenant shall be jointly and severally liable for all obligations of Tenant.

SECTION 13.12. Force Majeure. If Landlord cannot perform any of its obligations due to events beyond Landlord's control, the time provided for performing such obligations shall be extended by a period of time equal to the duration of such events. Events beyond landlord's control include but are not limited to, acts of God, war, civil commotion, labor disputes, strikes, fire, flood or other casualty, shortages of labor or material, government regulation or restriction and weather conditions. It is expressly agreed that Landlord shall not be obliged to settle any strike to avoid a force majeure event from continuing.

SECTION 13.13. Execution of Lease. This Lease may be executed in counterparts, and, when all counterpart documents are executed, the counterparts shall constitute a single binding instrument. The delivery of this Lease by Landlord to Tenant shall not be deemed to be an offer and shall not be binding upon either party until executed and delivered by both parties.

SECTION 13.14. Limitation of Liabilities. The obligations of Landlord under this Lease do not constitute personal obligations of the individual partners, trustees, directors, officers or shareholders of Landlord, and Tenant shall not seek recourse against the individual partners, trustees, directors, officers or shareholders of Landlord or any of their personal assets for satisfaction of any liability arising out of this Lease. Tenant's sole remedy shall be recourse against Landlord's interest in the Property or the Project of which the Property is a part.

SECTION 13.15. Consents. Whenever the consent of either party is required hereunder such consent shall not be unreasonably withheld.

SECTION 13.16. Modification for Lender. If, in connection with obtaining construction, interim or permanent financing for the Project or Building of which the Property is a part, the lender requests reasonable modifications to this Lease as a condition to such financing, Tenant will not unreasonably withhold, delay or defer its consent thereto, provided that such modifications do not increase the obligations of Tenant hereunder or materially adversely affect the leasehold interest hereby created or Tenant's rights hereunder.

SECTION 13.17. Mortgagee Protection. Tenant agrees to send by certified or registered mail to any first mortgagee or first deed of trust beneficiary of Landlord, whose address has been furnished to Tenant, a copy of any notice of default served by Tenant on landlord. If Landlord fails to cure such default within the time provided for in this Lease, such mortgagee or beneficiary shall have an additional thirty- (30) day period to cure such default. If such default cannot be cured within the additional thirty- (30) day cure period, then such mortgage or beneficiary shall have such additional time to cure such default as is reasonably necessary under the circumstances.

SECTION 13.18. Building Planning. In the event Landlord requires the Property for use in conjunction with other premises in the Building or for other reasons connected with the building planning program, upon notifying Tenant in writing, Landlord shall have the right to move Tenant to other space in the Building or the Project at Landlord's sole cost and expense, and the terms and conditions of the original Lease shall remain in full force and effect, save and excepting that a revised Exhibit "A" shall become part of this Lease and shall

reflect the location of the new space and Article One of this Lease shall be amended to include and state all correct data as to the new space.

ARTICLE FOURTEEN: BROKERS

The parties recognize that the brokers who negotiated this Lease are the brokers whose names are stated in Section 1.12 hereof and agree that Landlord shall be solely responsible for the payment of brokerage commissions to said brokers, and that Tenant shall have no responsibility therefore. Tenant shall indemnify and hold Landlord free and harmless against any claims, damages, costs, expenses, or liability or any nature arising from claims by any other person or real estate broker claiming a fee through dealings with Tenant arising out of this Lease.

ARTICLE FIFTEEN: TOXIC AND HAZARDOUS SUBSTANCES, HAZARDOUS MATERIALS, REGULATED SUBSTANCES AND HAZARDOUS WASTE

SECTION 15.01. Definition. As used in this Section, the term "Hazardous Waste" means:

- (a) Those substances defined as "hazardous substances," "hazardous materials," "toxic substances," "regulated substances," or "solid waste" in the Toxic Substance Control Act, 15 U.S.C. 2601 ET. SEQ., as now amended or hereafter amended ("TSCA"), the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 U.S.C. 9601 ET. SEQ., as now amended or hereafter amended ("CERCLA"), the Resource Conservation and Recovery Act of 1976, 42 U.S.C. 6901 ET. seq., as now amended or hereafter amended ("RCRA"), the Federal Hazardous Substances Act, 15 U.S.C. 1261 ET. SEQ., as now amended or hereafter amended ("FHSA"), the Occupational Safety and Health Act of 1970, 29 U.S.C. 651 ET. SEQ., as now amended or hereafter amended ("OSHA"), the Hazardous Materials Transportation Act, 49 U.S.C. 2801 ET. SEQ., as now amended or hereafter amended ("HMTA"), and the rules and regulations not in effect or promulgated hereafter pursuant to each law referenced above;
- (b) Those substances defined as "hazardous waste," "hazardous material," or "regulated substances" under the Nevada law, including without limitation, Nevada revised Statues Chapter 459, or in the regulations now existing or hereafter promulgated pursuant thereto, or in the Uniform fire Code, as amended;
- (c) Those substances listed in the United States Department of Transportation table or by the Environmental Protection Agency (or any successor agency) as hazardous substances; and
- (d) Such other substances, mixtures, materials and waste which are regulated under applicable local, state or federal law, or which are classified as hazardous or toxic under federal, state or local laws or regulations (all laws, rules and regulations referenced in Paragraphs (a), (b), (c) and (d) are collectively referred to as "Environmental Laws").

SECTION 15.02. Tenant's Covenants. Tenant does not intend to and Tenant will not nor will Tenant allow any other person (including partnerships, corporations and joint ventures), during the term of this Lease, to manufacture, process, store, distribute, use, discharge or dispose of any Hazardous Waste in, under or on the Property, the Building, the Common Areas, or any property adjacent thereto.

- (a) Tenant shall notify Landlord promptly in the event of any spill or release of hazardous Waste into, on or onto the Property regardless of the source of the spill or release, whenever Tenant knows or suspects that such a release has occurred.

Initials
Landlord _____
Tenant _____

- (b) Tenant will not be involved in operations at or near the Property which could lead to the imposition on the Tenant or the Landlord of liability or the creation of a lien on the Property under the Environmental Laws.
- (c) Tenant shall, upon twenty-four (24) hours' prior notice by Landlord, permit Landlord or Landlord's agent access to the Property to conduct an environmental site assessment with respect to the Property.

SECTION 15.03. Indemnity. Tenant for itself and its successors and assigns undertakes to protect, indemnify, save and defend landlord, its agents, employees, directors, officers, shareholders, affiliates, consultants, independent contractors, successors and assigns (collectively the "Indemnities") harmless from any and all liability, loss, damage and expense, including attorney's fees, claims, suits and judgments that Landlord or any other indemnitee, whether as Landlord or otherwise, may suffer as a result of, or with respect to:

- (a) Any Environmental Law, including the assertion of any lien thereunder and any suit brought or judgment rendered regardless of whether the action was commenced by a citizen (as authorized under the Environmental Laws) or by a government agency;
- (b) Any spill or release of or the presence of any Hazardous Waste affecting the Property whether or not the same originates or emanates from the Property or any contiguous real estate, including any loss of value of the Property as a result of a spill or release of or the presence of any Hazardous Waste;
- (c) Any other matter affecting the Property within the jurisdiction of the United States Environmental Protection Agency, the Nevada State Environmental Commission, the Nevada Department of Conservation and Natural Resources, or the Nevada Department of Commerce, including costs of investigations, remedial action, or other response costs whether such costs are incurred by the United States Government, the State of Nevada, or any indemnitee;
- (d) Liability for clean-up costs, fines, damages or penalties incurred pursuant to the provisions of any applicable Environmental Law; and
- (e) Liability for personal injury or property damage arising under any statutory or common-law tort theory, including, without limitation, damages assessed for the maintenance of a public or private nuisance, or for the carrying of an abnormally dangerous activity, and response costs.

SECTION 15.04. Remedial Acts. In the event of any spill or release of or the presence of any hazardous Waste affecting the Property, whether or not the same originates or emanates from the property or any contiguous real estate, and/or if Tenant shall fail to comply with any of the requirements of any Environmental law, Landlord may, without notice to Tenant, as its election, but without obligation so to do, give such notices and/or cause such work to be performed at the Property and/or take any and all other actions as landlord shall deem necessary or advisable in order to remedy said spill or release of hazardous Waste or cure said failure of compliance and any amounts paid as a result thereof, together with interest at the rate of fifteen percent (15) per annum, from the date of payment by Landlord, shall be immediately due and payable by Tenant to Landlord.

SECTION 15.05. Settlement. Landlord upon giving Tenant ten (10) days prior notice, shall have the right in good faith to pay, settle or compromise, or litigate any claim, demand, loss, liability, cost, charge, suite, order, judgment or adjudication under the belief that it is liable therefore, whether liable or not, without the consent or approval of Tenant unless Tenant within said ten (10) day period shall protest in writing and simultaneously with such protest deposit with Landlord collateral satisfactory to Landlord sufficient to pay and satisfy any penalty and/or interest which may accrue as a result of such protest and any judgment or judgments as may result, together with attorneys' fees and expenses, including, but not limited to, environmental consultants.

ARTICLE SIXTEEN: RULES AND REGULATIONS

Tenant shall faithfully observe and comply with the "Rules and Regulations," a copy of which is attached hereto and marked "Exhibit C" and all reasonable and nondiscriminatory modifications thereof and additions thereto from time to time put into effect by Landlord. Landlord shall not be responsible to Tenant for the violation or non-performance by and other tenant or occupant of the Building or the Project of any of said Rules and Regulations.

ARTICLE SEVENTEEN: GUARANTY

This Lease shall be guaranteed by Direct Focus, Inc. (collectively, the "Guarantors"). Concurrently with the execution of this Lease, the Guarantors shall execute and deliver to Landlord a guaranty in the form attached hereto as Exhibit "D" (the "Guaranty").

Landlord and Tenant have signed this Lease at the place and on the dates specified adjacent to their signatures below and have initialed all Riders which are attached to or incorporated by reference in this Lease.

"TENANT"

DIRECT FOCUS, INC.

By: BRIAN R. COOK

Name: Brian R. Cook

Title: President/CEO

Date: -----

"LANDLORD"

LAS VEGAS MOTOR SPEEDWAY, LLC, a Nevada
limited liability company

By: -----

Name: Chris Powell

Title: Executive Vice President & General
manager

Date: -----

	Initials
Landlord	_____
Tenant	_____

EXHIBIT "A-2"

NET RENTABLE AREA

The term "Usable Area" shall mean the entire area included within the Property, being the area bounded by the outside surface of any exterior glass walls (or the outside surface of the permanent exterior wall where there is no glass) of the Building bounding such Property, the inside surface of the exterior walls separating such Property from any public corridors or such other public areas on such floor, and the centerline of all walls separating such Property from other areas leased or to be leased to other tenants on such floor.

The term "Net Rentable Area" shall mean the computation of multiplying the Usable Area of the Property by the quotient of the division of the Rentable Area of the floor (the area of the floor to the outside surface of the dominant portion of the permanent outer Building walls, excluding any major vertical penetration of the floor, by the Useable Area of the floor.

See Tenant improvements attached to be supplied by Landlord at Landlord's sole cost and expense.

1. LANDLORD TO INSTALL AN 6' WIDE OPENING BETWEEN P103 AND P104.
2. LANDLORD TO INSTALL AN 8' WIDE OPENING BETWEEN P101 AND P102.
3. LANDLORD TO INSTALL WAREHOUSE ACCESS DOOR TO RESTROOM LOCATED AT EAST END OF BUILDING.
4. LANDLORD TO INSTALL A GRADE LEVEL DOOR 12' X 14' AT BEST POSSIBLE LOCATION.
5. LANDLORD TO INSTALL TWO 30 HOLLOW CORE DOORS WITHIN THE 6' WIDE OPENING BETWEEN P103 AND P104.

Initials

Landlord _____

Tenant _____

EXHIBIT "B"

MEMORANDUM OF COMMENCEMENT DATE AND ADDITIONS OR DELETIONS TO LEASE

Re: Industrial Real estate Lease dated July 21, 1999, between LAS VEGAS MOTOR SPEEDWAY, LLC, a Nevada Limited Liability Company ("Landlord") and DIRECT FOCUS INC., ("Tenant").

In accordance with the Lease, we wish to advise and/or confirm as follows:

1. That the Property has been accepted herewith by the Tenant as being substantially complete in accordance with the Lease, and that there is no deficiency in construction.
2. That the Tenant has possession of the Property and acknowledges that under the provisions of the Lease, the term of the lease commenced as of December 1, 1999 for a term of three (3) years ending on November 30, 2002.
3. That in accordance with the Lease, rent commenced to accrue on December 1, 1999.
4. Souvenirs that would be directly in competition with the souvenirs sold by the Landlord and/or Las Vegas Motor Speedway will not be allowed. No hospitality food and/or drink sales during race events shall be allowed. Any such proposed use shall be presented to Landlord for approval.
5. TENANT TO HAVE AN OPTION TO TERMINATE THIS LEASE ANYTIME AFTER THE FIRST TWO YEARS (DECEMBER 1, 2001), UPON
 - a) WRITTEN NINETY (90) DAYS NOTICE
 - b) THE TENANT TO PAY LANDLORD CERTIFIED FUNDS \$22,000.00 TO EXERCISE OPTION TO TERMINATE LEASE.

AGREED AND ACCEPTED

TENANT

LANDLORD

Direct Focus Inc.

Las Vegas Motor Speedway, LLC, a Nevada
limited liability company

By: _____

By: _____

Name: Brian R. Cook

Name: Chris Powell

Title: President/C.E.O.

Title: Executive Vice-President & General Manager

Initials
Landlord _____
Tenant _____

EXHIBIT "C"

RULES AND REGULATIONS

1. No sign, placard, picture, aerial display, balloons, advertisement, name or notice shall be installed or displayed on any part of the Building or Project (or within public rights-of-ways adjacent to the Project through the use of truck signs, sign trailers or similar items) without the prior written consent of Landlord, which consent of Landlord shall not unreasonably be withheld. Landlord shall have the right to remove, at Tenant's expense and without notice, any sign installed or displayed in violation of this rule. All approved signs or lettering on doors, walls and service areas of the Property shall be printed, painted, affixed or inscribed at the expense of Tenant by a person chosen by Landlord.
2. If Landlord objects in writing to any curtains, blinds, shades, screens or hanging plants or other similar objects attached to or used in connection with any window or door of the Property, Tenant shall immediately discontinue such use. No awning shall be permitted on any part of the Property. Tenant shall not place anything against or near glass partitions or doors or windows which may appear unsightly from outside the Property.
3. If Tenant requires telegraphic, burglar alarm or similar services, it shall first obtain Landlord's permission to install such service, and comply with Landlord's instructions in their installation.
4. Tenant shall not place a load upon any floor of the Property, which exceeds the load per square foot which such floor was designed to carry and which is allowed by law. Landlord shall have the right to prescribe the weight, size and position of all equipment, materials, furniture or other property brought into the Building. Heavy objects shall, if considered necessary by Landlord, stand on such platforms as determined by Landlord to be necessary to properly distribute the weight. Business machines and mechanical equipment belonging to Tenant, which cause noise or vibration that may be transmitted to the structure of the Building or to any space therein to such a degree as to be objectionable to Landlord or to any tenants in the Building, shall be placed and maintained by Tenant, at Tenant's expense on vibration eliminators or other devices sufficient to eliminate noise or vibration. The persons employed to move such equipment in or out of the building must be acceptable to Landlord. Landlord will not be responsible for loss of, or damage to, any such equipment or other property from any cause, and all damage done to the Building by maintaining or moving such equipment or other property shall be repaired at the expense of Tenant.
5. Tenant shall not allow the Property to be occupied or used in a manner which is offensive or objectionable to Landlord or other occupants of the Project by reason of noise, odors or vibrations.
6. Tenant shall not use any method of heating or air conditioning other than that supplied by Landlord without the written consent of Landlord.
7. Tenant shall not waste electricity, water or air-conditioning and agrees to cooperate fully with Landlord to assure the most effective operation of the Building's heating and air-conditioning and to comply with any governmental energy-saving rules, laws or regulations of which Tenant has actual notice, and shall refrain from attempting to adjust controls other than room thermostats installed for Tenant's use. Tenant shall keep corridor doors closed, and shall close window coverings at the end of each business day.
8. Landlord reserves the right, exercisable without liability to Tenant, to change the name and street address of the Building.
9. Tenant shall close and lock the doors of the Property, including any roll-up doors in any service areas and entirely shut off all water faucets or other water apparatus, and electricity, gas or air outlets before Tenant and its employees leave the Property. Tenant shall be responsible for any damage or injuries sustained by other tenants or occupants of the Building or by Landlord for noncompliance with this rule.
10. The toilet rooms, toilets, urinals, wash bowls and other apparatus shall not be used for any purpose other than that for which they were constructed and no foreign or hazardous substance of any kind whatsoever shall be thrown therein. The expense of any breakage, stoppage or damage resulting from the violation of this rule shall be borne by the Tenant who, or whose employees or invitees, shall have caused the same.
11. Tenant shall not use the Property for any business activity other than that specifically provided for in Tenant's Lease.
12. Tenant shall not install any radio or television antenna, satellite dish, microwave receiver, cellular telephone transmitter or receiver, loudspeaker or other device on the roof or exterior walls of the Building. Tenant shall not interfere with radio or television broadcasting or reception from or in the Building or elsewhere.
13. Tenant shall not mark, drive nails, screw or drill into the partitions, woodwork or plaster or in any way deface the Property or any part thereof. Landlord reserves the right to direct electricians as to where and how telephone and telegraph wires are to be introduced to the Property. Tenant shall not cut or bore holes for wires. Tenant shall not affix any floor covering to the floor of the Property in any manner except as approved by Landlord. Tenant shall repair any damage resulting from noncompliance with this rule at its own expense.

14. Tenant shall not install, maintain or operate upon the Property any vending machines without the prior written consent of Landlord.

15. Canvassing, soliciting and distribution of handbills or any other written material, and peddling in the Project are prohibited, and each Tenant shall cooperate to prevent the same.

16. Landlord reserves the right to exclude or expel from the Project any person who, in Landlord's judgement is intoxicated or under the influence of liquor or drugs or who is in violation of any of the Rules and Regulations of the Building.

17. Tenant shall store all its trash and garbage within the Property or within trash receptacles in the Common Areas nearest the Property. Tenant shall not place in any trash box or receptacle any material which cannot be disposed of in the ordinary and customary manner of trash and garbage disposal. All garbage and refuse disposal shall be made in accordance with directions issued from time to time by Landlord. Tenant shall be responsible for any additional charges or expenses arising from the failure to abide by this rule.

18. The Property shall not be used for the storage of merchandise held for sale to the general public, or for manufacturing of any kind except as specifically authorized in Tenant's Lease, nor shall the Property be used for lodging or any improper, immoral or objectionable purpose. No cooking shall be done or permitted by any tenant on the Property, except that use by Tenant of Insurance Service Office or Underwriters' laboratory approved microwave and other equipment for brewing coffee, tea, hot chocolate, and similar beverage shall be permitted, provided that such equipment and use is in accordance with all applicable federal, state, county and city laws, codes, ordinances, rules and regulations.

19. Without the prior written consent of Landlord, Tenant shall not use the name, picture or representation of the Building in connection with or in promoting or advertising the business of Tenant except as Tenant's address. Landlord shall have the right to prohibit any advertising by Tenant which, in Landlord's opinion, tends to impair the reputation of the Building or its desirability as a location for offices, and upon written notice from Landlord, Tenant shall refrain from or discontinue such advertising.

20. Tenant shall comply with all safety, fire protection and evacuation procedures and regulations established by Landlord or any governmental agency.

21. Tenant assumes any and all responsibility for protecting its property from theft, robbery and pilferage, which includes keeping doors locked and other means of entry to the Property closed.

22. Landlord reserves the right to modify and/or adopt such other reasonable and nondiscriminatory rules and regulations for the parking areas as it deems necessary for the operation of the parking area. Landlord may refuse to permit any person who violates the rules to park in the parking area and any violation of the rules shall subject the car to removal.

23. Cars must be parked entirely within the stall lines. All directional signs and arrows must be observed. The speed limit in the Project shall be 5 miles per hour. Parking is prohibited: (a) in areas not striped for parking, (b) in aisles, (c) where 'no parking' signs are posted, (d) on ramps, (e) in cross hatched areas, (f) in any manner which will interfere with loading or turning areas of loading dock areas, and (g) in such other areas as may be designated by Landlord as reserved for the

Initials
Landlord _____
Tenant _____

exclusive use of others. Washing, waxing, cleaning or servicing of any vehicle by anyone is prohibited. Tenant shall acquaint all persons to whom Tenant assigns parking spaces of these Rules and Regulations.

24. Tenant shall not park its vehicles in any parking areas designated by Landlord as areas for parking by visitors to the Building. Tenant shall not leave vehicles, trailers, containers or truck-tractors in the Building parking area. Common Areas, or on adjacent streets, overnight no park any vehicles in the Building parking areas other than automobiles, motorcycles, motor driven or non-motor driven bicycles or four-wheeled trucks.

25. Landlord may waive any one or more of these Rules and Regulations for the benefit of Tenant or any other tenant, but no such waiver by Landlord shall be construed as a waiver of such Rules and Regulations in favor of Tenant or any other tenant, nor prevent Landlord from thereafter enforcing any such Rules and Regulations against any or all of the tenants of the Building.

26. Tenants, its employees, agents or associates, or other persons entering or leaving the Building at any time when so locked, may require to sign the building register and the watchman or Landlord's agent in charge shall have the right to refuse admittance to any person into the building without a pass or other satisfactory identification showing right of access at such time. Landlord assumes no responsibility and shall not be liable for any damage resulting from the admission or refusal to admit any authorized or unauthorized person to the Building. In case of invasion, mob, riot, public excitement or other commotion, Landlord reserves the right to prevent access to the Building during the continuance of the same by closing the doors, or otherwise.

27. These Rules and Regulations are in addition to, and shall not be construed to in any way modify or amend, in whole or in part the terms, covenants, agreements and conditions of any lease of premises in the Building.

28. Landlord reserves the right to make such other reasonable Rules and Regulations as, in its judgement, may from time to time be needed for safety and security for care and cleanliness of the Building and for the preservation of good order therein. Tenant agrees to abide by all such Rules and Regulations hereinabove stated and any additional rules and regulations which are adopted.

29. Tenants shall be responsible for the observance of all of the foregoing rules by Tenant's employees, agents, clients, customers, invitees and guests.

Initials
Landlord _____
Tenant _____

DISCLOSURE STATEMENT

HAZARDOUS WASTE

Landlord/Owner agrees to disclose to Broker and to prospective tenants any and all information which Landlord/Owner has regarding present and future zoning and environmental matters affecting the Property and regarding the condition of the Property, including but not limited to, structural, mechanical and soil conditions, the presence and location of asbestos, PCD transformers, other toxic, hazardous or contaminated substances, and underground storage tanks, in, on or about the Property. Broker is authorized to disclose any such information to prospective tenants.

AMERICAN WITH DISABILITIES ACT

Please be advised that an owner or tenant of real property may be subject to the Americans With Disability Act (the ADA) a federal law codified at 42 USC Section 12101 et seq. Among other requirements of the ADA that could apply to your property, Title III of the ADA requires owners and tenants of "public accommodations" to remove barriers to access by disabled persons and provide auxiliary aids and services for hearing, vision and speech impaired persons by January 26, 1992. The regulations under Title III of ADA are codified at 28 CFR Part 36.

We recommend that you and your attorney review the ADA and the regulations and if appropriate, your proposed lease agreement to determine if this law would apply to you and the nature of the requirements. These are legal issues. You are responsible for conducting your own independent investigation of these issues. Lee & Associates cannot give you legal advice on these issues.

Please acknowledge your receipt of this Notice by signing and dating it below.

LANDLORD
Las Vegas Motor Speedway LLC

TENANT
Direct Focus Inc.

By: _____
Chris Powell

Title: Executive Vice President
and General Manager

By: _____

Title: _____

Date: _____

By: _____
Brian R. Cook

Title: President/C.E.O.

By: _____

Title: _____

Date: _____

Initials
Landlord _____
Tenant _____

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement No. 333-79643 of Direct Focus, Inc. and subsidiaries on Form S-8 of our report dated February 21, 2000, appearing in the Annual Report on Form 10-K of Direct Focus, Inc. and subsidiaries for the year ended December 31, 1999.

DELOITTE & TOUCHE, LLP
Portland, Oregon
March 27, 2000

EXHIBIT 24.1

POWER OF ATTORNEY
KIRKLAND C. ALY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Kirkland C. Aly, hereby constitutes and appoints Brian R. Cook or Rod W. Rice, 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 Direct Focus, Inc., a Washington corporation, for the fiscal year ended December 31, 1999, 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 NASDAQ National Market System, 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 27th day of March, 2000.

Signature:

/s/ Kirkland C. Aly

Kirkland C. Aly

POWER OF ATTORNEY
C. REED BROWN

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, C. Reed Brown, hereby constitutes and appoints Brian R. Cook or Rod W. Rice, 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 Direct Focus, Inc., a Washington corporation, for the fiscal year ended December 31, 1999, 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 NASDAQ National Market System, 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 27th day of March, 2000.

Signature:

/s/ C. Reed Brown

C. Reed Brown

EXHIBIT 24.3

POWER OF ATTORNEY
C. ROWLAND HANSON

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, C. Rowland Hanson, hereby constitutes and appoints Brian R. Cook or Rod W. Rice, 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 Direct Focus, Inc., a Washington corporation, for the fiscal year ended December 31, 1999, 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 NASDAQ National Market System, 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 27th day of March, 2000.

Signature:

/s/ C. Rowland Hanson

C. Rowland Hanson

POWER OF ATTORNEY
PAUL F. LITTLE

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Paul F. Little, hereby constitutes and appoints Brian R. Cook or Rod W. Rice, 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 Direct Focus, Inc., a Washington corporation, for the fiscal year ended December 31, 1999, 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 NASDAQ National Market System, 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 27th day of March, 2000.

Signature:

/s/ Paul F. Little

Paul F. Little

EXHIBIT 24.5

POWER OF ATTORNEY
ROGER J. SHARP

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Roger J. Sharp, hereby constitutes and appoints Brian R. Cook or Rod W. Rice, 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 Direct Focus, Inc., a Washington corporation, for the fiscal year ended December 31, 1999, 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 NASDAQ National Market System, 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 27th day of March, 2000.

Signature:

/s/ Roger J. Sharp

Roger J. Sharp

POWER OF ATTORNEY
ROLAND E. "SANDY" WHEELER

KNOW ALL MEN BY THESE PRESENTS, that the undersigned, Roland E. "Sandy" Wheeler, hereby constitutes and appoints Brian R. Cook or Rod W. Rice, 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 Direct Focus, Inc., a Washington corporation, for the fiscal year ended December 31, 1999, 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 NASDAQ National Market System, 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 27th day of March, 2000.

Signature:

/s/ Roland E. "Sandy" Wheeler

Roland E. "Sandy" Wheeler

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM DIRECT FOCUS, INC. CONSOLIDATED BALANCE SHEET AS OF DECEMBER 31,1999 AND CONSOLIDATED STATEMENT OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31,1999 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

1,000

YEAR

	DEC-31-1999	
	JAN-01-1999	
	DEC-31-1999	
		35,703
		0
		5,049
		305
		9,168
	52,300	
		11,745
	1,100	
	67,310	
14,091		
		0
0		
		0
		18,602
		34,428
67,310		
		121,018
	121,018	
		34,423
		90,186
		0
		0
		0
		31,838
		11,495
20,343		
		0
		0
		0
		20,343
		2.00
		1.95