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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Nautilus second-quarter fiscal year 2016 earnings call.

(Operator Instructions)

As a reminder, this conference is being recorded. I would now like to turn the conference over to Mr. John Mills, Partner at ICR. Please go ahead, sir.

John Mills - *Nautilus Inc - Partner at ICR*

Great. Thank you, Matt. Good afternoon, everyone. Welcome to Nautilus's second-quarter 2016 conference call. Participants on the call from Nautilus are Bruce Cazenave, Chief Executive Officer; Sid Nayar, Chief Financial Officer; and Bill McMahon, Chief Operating Officer.

Our earnings release was issued earlier today and may be downloaded from our website at nautilusinc.com on the Investor Relations page.

The earnings release includes a reconciliation of the non-GAAP financial measures mentioned in today's call with the most directly comparable GAAP measure. Remarks on today's conference call may include forward-looking statements within the meaning of the securities laws.

These statements include statements concerning the Company's current or future financial and operating trends; anticipated gross margin improvements; factors affecting our future operating results, including channel mix, segment margins, long-term growth and profitability targets, anticipated new product introductions, anticipated capital expenditures, available supply of certain products, the anticipated impact of variation in the effectiveness, availability and price of media time over the near-term, planned and anticipated results of new product and business development initiatives and anticipated benefits and costs of the acquisition of Octane Fitness.

Forward-looking statements are subject to a number of risk and uncertainties and actual results may differ materially from these statements. For more information about these risk, please refer to our annual and quarterly report filed with the SEC as well as the Safe Harbor Statement in today's press release.

Nautilus undertakes no obligation to update publicly any forward-looking statements to reflect new information, events or circumstances after they were made or to reflect the occurrence of unanticipated events unless otherwise indicated. All information and comments regarding our operating results pertain to our continuing operations.

And with that, it is my pleasure to turn the call over to Bruce. Go ahead, Bruce.

Bruce Cazenave - *Nautilus Inc - CEO*

Thank you, John. Good afternoon, everyone, and thank you for joining our call today. I'd like to start by providing a general overview of our second-quarter results and then we will turn it over to Sid Nayar to review our financial results in more detail.

Bill McMahon will then provide details on each business segment as well as updates on product activity. I will then close with some summary remarks before we open up the call for questions.

We are very pleased to report another strong quarter of financial performance. Second-quarter revenue grew by 32% which was driven by a continued mix of solid, organic business growth in both the direct and retail segments and incremental new business from the Octane Fitness acquisition.

The retail business increased 19% organically with strong double-digit growth across both cardio and strength components. Including Octane Fitness, retail revenue increased 89% over the same period prior-year.

Overall, gross margin in the second quarter improved by 190 basis points to 53.3% and increases were achieved in both the direct and retail segments of our business.

We are also reporting an increase in operating income of over 67% and growth in EBITDA from continuing operations of 90% versus the second quarter last year.

With that, I would like to turn the call over to Sid to review our financials in more detail. Sid?

Sid Nayar - *Nautilus Inc - CFO*

Thank you, Bruce. I would like to review the details of our financial results for the second quarter of 2016. Net sales for the second quarter totaled $78.5 million, an increase of 31.6% as compared to the same period in the prior year.

For the first six months of 2016, net sales were $199.5 million, an increase of 27.9% over the same period last year.

Second-quarter gross margins increased 490 basis points in the direct segment to 67.1% and were up 1,000 basis points in the retail segment to 33.5% when compared to the same quarter last year.

Retail margins include a $0.3 million noncash inventory step-up charge related to the Octane Fitness acquisition.

On an overall basis, total Company gross margins for the second quarter 2016 increased by 190 basis points to 53.3% versus the same period prior-year, reflecting improved product and channel mix, leveraging supply chain costs, and lower warranty and allowance-related reserve requirements.

Year-to-date 2016 gross margins are 54.3%, or 10 basis points better than 2015 year-to-date gross margins, as the improved margins within each segment more than offset the shift in channel mix to more retail sales.

Total operating expenses for the second quarter of 2016 as a percentage of net sales increased 10 basis points to 44.9%, primarily due to higher amortization expense related to the Octane Fitness acquisition, increased spending in product development, and the non-recurrence of a business tax refund recognized in the prior year.

Total operating expenses for the first six months of 2016 as a percentage of sales were 41.3% as compared to 40.4% for the same prior period.

Sales and marketing expenses for the second quarter of 2016 were $24.7 million or 31.5% of net sales, as compared to $20.1 million or 33.6% of net sales in the same period last year.

The increased dollar spending primarily reflects higher media spending as well as the inclusion of sales and marketing expenses related to the Octane Fitness acquisition.

Improvement in sales and marketing as a percentage of sales primarily it relates to the change in channel mix.

For the first six months of 2016, sales and marketing expenses totaled $59.9 million or 30% of net sales compared to $48.5 million or 31.1% of net sales for the same period in the prior year, with higher media spending being the main driver along with the addition of Octane Fitness and expenses related to third-party consumer financing.

General and administrative expenses were $7.2 million or 9.2% of net sales for the second quarter of 2016, which compares to $4.3 million or 7.2% of net sales in the same period last year.

The increased dollar spending in G&A primarily reflects the addition of Octane Fitness expenses as well as higher amortization expense that was also related to the acquisition and the non-recurrence of the business tax refund recognized in the prior year.

General and administrative expenses for the first six months of 2016 as a percentage of net sales totaled 7.7% as compared to 6.3% for the same prior period.

Research and develop costs in the second quarter of 2016 were $3.4 million or 4.3% of net sales compared to $2.4 million or 4% of net sales in the same period last year.

The dollar increase reflects our continued investment in the engineering and design resources required to innovate and broaden our product portfolio, coupled with the addition of Octane Fitness expenses related to the acquisition.

Research and development expenses for the first six months of 2016 as a percentage of net sales totaled 3.5% as compared to 3% for the same prior period.

Operating income for the second quarter of 2016 increased to $6.6 million as compared to operating income of $3.9 million in the same quarter of last year.

The increase reflects higher net sales and gross margins in both segments, partially offset by higher acquisition related expenses of $1.1 million, including the increased amortization expense of $0.8 million and the inventory step-up charge of $0.3 million.

Operating margin for the second quarter of 2016 increased to 8.4% compared to 6.6% for the same period last year. Excluding the noncash inventory step-up charge referenced above, operating income for the second quarter of 2016 was $6.9 million, a 74.6% increase over the same quarter in 2015.

EBITDA from continuing operations in the second quarter of 2016 increased by 90% to $8.5 million versus $4.5 million for the same quarter the prior-year.

For the first six months of 2016, operating income was $25.9 million, or 13% of net sales, an increase of 20.1% over the same period last year. Year-to-date EBITDA from continuing operations totaled $29.6 million versus $22.9 million in the same period last year, an increase of 29.4%.

Income from continuing operations for the second quarter of 2016 was $3.7 million, or $0.12 per diluted share, as compared to $2.2 million, or $0.07 per diluted share, for the same period last year. Excluding the noncash inventory step-up charge income from continuing operations for the second quarter of 2016 was $3.9 million.

For the first six months of 2016, income from continuing operations was $15.3 million, or $0.49 per diluted share, an increase of 16.9% over the same period last year. Excluding the noncash inventory step-up charge, income from continuing operations for the six months ending June 30, 2016 was $15.9 million, or $0.51 per diluted share.

The effective tax rate for the second quarter of 2016 was 38.3% compared to 40.1% in the same period last year.

Total net income, including discontinued operations for the second quarter of 2016, was $3.5 million or $0.11 per diluted share, which includes a $0.2 million loss net of taxes from discontinued operations. This compares to the second quarter last year where we reported total net income including discontinued operations of $2.4 million or $0.08 per diluted share, which included income from discontinued operations of $0.2 million.

Year-to-date net income for 2016 totaled $15 million, or $0.48 per diluted share, versus $13.2 million, or $0.41 per diluted share, for the same prior period.

Turning now to our segment results, net sales in the direct business totaled $44.9 million for the second quarter of 2016, a 7.9% increase over the same quarter last year.

Direct segment sales benefited from continued strong demand for our cardio products, primarily driven by the sales of Bowflex Max Trainer product line. Year-to-date sales of $126.2 million are up 9% year-over-year.

Gross margin for the direct business improved to 67.1% for the second quarter of 2016, compared to 62.2% in the same quarter of last year.

Gross margin improvement was due to favorable product mix driven by higher sales of the Max Trainer M7 product and lower reserve requirements, primarily related to improved warranty experience.

Operating income for the second quarter of 2016 in our direct business was $7.5 million compared to $5.1 million in the same quarter prior-year. Operating income benefited from higher net sales and gross margins in the second quarter of 2016.

Year-to-date 2016 operating income for the direct segment totaled $28.7 million, or 22.7% of net sales, compared to $24.7 million, or 21.3% of net sales, in the same prior period.

Net sales in our retail segment for the second quarter of 2016 were $32.9 million, an increase of 89.1% compared to $17.4 million in the second quarter of last year.

The improvement in retail net sales reflects strong double-digit growth across both the cardio and strength components of the organic retail business, coupled with improved international sales year-over-year and the addition of Octane Fitness sales to the retail segment.

While the consumer category within the specialty retail segment did face some continued headwinds from slower retail traffic and market disruption related to acquisition activity within the specialty store category, we are encouraged by the improvement versus prior quarter.

Gross margins for the retail business improved by 1,000 basis points to 33.5% from the second quarter of 2016 as compared to 23.5% for the prior period.

Organic retail gross margins were favorably impacted by leveraging of supply chain costs and lower sales and returns allowance reserve requirements for certain customers.

The inclusion of Octane Fitness products, which generate higher gross margins, also helped buoy the margins.

Year-to-date 2016 gross margins for retail totaled 31.6%, up 890 basis points versus the same period in the prior year, primarily driven by the same factors.

In the second quarter of 2016, operating income for the retail business totaled $4.1 million as compared to $1.2 million in the same period of last year.

The increase is attributable to the higher revenue and gross margins and the addition of the octane business. Year-to-date 2016 operating income for the retail business totaled $8.1 million versus $2.7 million for the same period in the prior year.

Now turning to the consolidated balance sheet, cash and investments totaled $73.5 million as of June 30, 2016, with $72 million of debt. This compares to $60.8 million in cash and debt of $80 million at December 31, 2015.

Inventories were $43 million as of June 30, 2016 compared to $42.7 million at December 31, 2015 and $28.4 million at June 30, 2015. The increase in inventory compared to June 30, 2015 primarily reflected the addition of Octane Fitness.

Crate payables were $43.2 million as of June 30, 2016 compared to $61.7 million at the end of 2015, reflecting seasonality of purchases.

Capital expenditures totaled $0.7 million for the six months ended June 30, 2016, with spending primarily on production tooling and IT assets. We anticipate full-year CapEx to be in the range of $5.5 million to $6.5 million.

At this time, I would like to turn it over to Bill McMahon, our Chief Operating Officer, who will provide additional insights into our business and key products. Bill?

Bill McMahon - *Nautilus Inc - COO*

Thank you, Sid. Good afternoon, everyone. I would like to provide additional background on our recent results and the overall position of our business.

Starting with the direct segment, we reported another quarter of solid revenue growth of 8% and operating income growth of over 47% compared to the second quarter last year. This is primarily driven by higher net sales and gross margins.

The growth was especially encouraging given the second quarter is considered the off-season for our direct business and the prior-year comparison was challenging at over 28% growth.

We continue to benefit from the strong demand for cardio products, especially the Bowflex Max Trainer product line.

In March of this year, we launched the Max Trainer M7 and, as noted in our prior earnings call, the demand for this model exceeded our early expectations.

M7, as with all of our Max models, continues to perform well and we have aligned our manufacturing plans and now have ample capacity to fill demand during the coming fitness season.

This quarter, we were also pleased to launch a new version of bowflex.com, the website. We had moved our website to an industry leading hosting platform and infrastructure. This site changes much more than a redesign and, rather, on our new platform, we have significantly improved our capabilities to integrate all of our digital marketing and sales programs.

These capabilities are mission-critical in today's e-commerce environment.

More than 62% of our sales in the first half of 2016 were online, and of those sales, one-third were on mobile devices. Further, over half of our web visits are now coming from mobile devices.

The continued increase in acceptance and use of digital and e-commerce capabilities by consumers is a favorable trend for our business. We have long embraced online as a key segment and our new capabilities will further enhance our efforts.

As we previously discussed, in years when there are Olympics and/or a presidential election, we routinely adjust our media approach due to the potential impact on viewership and media availability.

In July, we noticed some unusual and pronounced choppiness in the media markets corresponding with the timing of the political conventions.

If this pattern were to continue, it would make it more challenging to execute our normal lead and traffic generation plans for the quarter.

Importantly, our conversion and approval rates remain strong which continues to signal overall good, long-term health in the direction of the business for 2016.

Now, turning to our retail segment, we are very excited to report sales growth of 89% compared to last year. This growth primarily reflects the inclusion of Octane Sales.

However, this number also includes 19% growth from our sporting goods and online accounts, and those sales were driven by solid performance across both cardio and strength modalities.

Further, Max Trainer and Airdyne sales in the global market continued to grow and these modalities continue to gain acceptance outside of North America.

We feel our retail channel growth is outpacing industry performance, and based on our known orders and account feedback on plans for the fall, we anticipate continued retail segment growth in the second half of 2016.

A key product launch in Q2 was the Octane ZR8000, which is a full commercial club quality Zero Runner. Since its introduction, the Zero Runner platform has delivered zero impact running capability to consumers in their homes.

The ZR8000 is a key addition to the line, featuring 15 resistance levels, 11 programs, aluminum construction, and advanced consoles that can include coaching capabilities.

These products are backed by the industry-leading Octane support team. ZR8000 offers club owners the ability to offer treadmill-quality running with much lower impact and none of the worries of worn belts and motors.

The ZR8000 was launched in June and we are very pleased with the early installations and feedback from customers.

As Bruce and Sid mentioned, we are also very encouraged to report that retail gross margin increased by 1,000 basis points compared to the second quarter last year.

Excluding the impact to cost of sales of the $0.3 million inventory step-up charge Sid described, retail gross margins would have been 34.4%, up 10.9 points compared to the same quarter last year.

This growth was primarily the result of accretive of growth and operating margins as well as the additional incremental categories Octane Fitness contributes.

A key initiative that we have been exploring for well over one year is the challenge of how can we leverage the reach and messaging of our direct business within the retail channel without doing harm to direct in the process?

Our direct marketing efforts have created more than 5 billion impressions on US consumers in the past year and, as we reported, demand for Max Trainer continues to grow.

Our research shows that despite this success and continued growth, we are still reaching large segments of the consumer market who are interested in our products but will not buy unless they can try it or purchase it from a traditional retailer.

In response to this reality, this fall, we will test a concept in which one Max Trainer model, the M3, at $999, will be available for in-store only purchase with one national retail account.

We have controls in place for this effort and we feel there is minimal risk to our direct business performance, but potentially significant upside in terms of reaching incremental consumers.

At its heart, this is our first step towards identifying ways to implement an omni-channel like approach to our business, and if successful, we will further enhance the leverage of our already strong media performance.

Our teams will create an inviting, in-store experience that highlights the benefits of and introduces new demographics to the Max Trainer. Meanwhile, our own bowflex.com and our telesales team will continue to be the sole purchase point for Max Trainer M5 and M7 in the United States.

We are aware that traditionally a direct business would not cascade products to retail until such time the television media performance had peaked.

That is not the case here, as Max Trainer media is strong and sales are growing. However, just as our business is evolving towards e-commerce and digital markets, we feel it is strategically important for us to best leverage our significant media spend towards the highest profitable return.

This controlled and measured initiative is an important step towards that goal.

Following our solid results in the first half of the year, we are excited for our annual product showcase in late September in New York City. We will be showcasing several new products across all of our channels. We look forward to seeing many of you and talking about the innovative work of our product teams.

Before I conclude my remarks, I would like to point out that we continue to be pleased with the performance of our core businesses and encouraged by the integration of the Octane Fitness business.

During due diligence, we felt that these businesses would be highly complementary, and now six months into integration, we are confirming those assumptions.

Given our strong talent, increased market channel diversification and new, innovative products in the pipeline, we are excited about the outlook for our business and remain focused on delivering a strong return on invested capital, continued increased profitability and revenue growth.

With that, I would like to turn the call back over to Bruce for his final comments.

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Bruce Cazenave - *Nautilus Inc - CEO*

Thank you, Bill. I would like to make a few final comments before we open up the call for questions.

The first half of 2016 has proven to be a great start for another strong year of growth and has established positive momentum as we move into the second half of the year.

By the end of 2016, through internally driven initiatives and the acquisition of Octane Fitness in December last year, we will have broadened our product portfolio, significantly diversified our channels of distribution, and expanded market share both domestically and internationally.

There are many things yet to do and achieve, but we are pleased with the positive energy, sense of urgency, and momentum our teams have created in every corner of our Company.

As previously mentioned, a key part of this is keeping a vibrant innovation pipeline and, to that end, we are excited to share another wave of new products at the upcoming product showcase in September.

In closing, I would like to thank all of our dedicated employees who are instrumental in making these market successes and increased financial performance happen.

Our Company continues to get stronger every quarter thanks to their efforts and initiative.

That concludes our prepared remarks. Now, I would like to open up the call for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Mike Schwartz, SunTrust.

Mike Schwartz - *SunTrust Robinson Humphrey - Analyst*

On the Max Trainer side, understanding you are still seeing some pretty strong demand, and I think at the end of last quarter, you noted there was a pretty sizable backlog.

So could you just give us any indication of maybe what that backlog looks like today if there is one, I guess?

Bill McMahon - *Nautilus Inc - COO*

Hi, Mike. It is Bill. No backlog currently. All sales are up to date. And in terms of comparisons, there was some backlog coming into Q2, but there is also the same case in prior-year. So I wouldn't say that Q2 was artificially inflated indirect due to that.

Mike Schwartz - *SunTrust Robinson Humphrey - Analyst*

Okay. Just on the margin side of the business, trying to get a sense for, in both business, how big of a contributor the lower warranty reserves are and maybe how we should think about that playing out the rest of this year?

In other words, was it more of a one-time benefit to the quarter or is it something that we should see continue to provide a benefit going forward?

Sid Nayar - *Nautilus Inc - CFO*

It is more of a one-time benefit to the quarter. And I would say it was a couple hundred basis points as far as direct margins were concerned.

Mike Schwartz - *SunTrust Robinson Humphrey - Analyst*

Okay.

Sid Nayar - *Nautilus Inc - CFO*

I think the bottom line, Mike, is we still think that the 65% margins that we have in the direct, that we have sort of modeled to still remain a good targeted number, that 65% to 66% range.

Mike Schwartz - *SunTrust Robinson Humphrey - Analyst*

Okay. Just one last question from me. In terms of the CapEx, it looks like your projections for the full year are a bit below prior. Is there anything that got pushed out or is this a currency impact?

Sid Nayar - *Nautilus Inc - CFO*

No. It is sort of just a reevaluation based on sort of we had overlayed certain CapEx requirements of both businesses and now that we have had a chance to sort of assess exactly where we are going to be placing that during the balance of 2016, we feel in a better position to give an updated estimate on CapEx.

Mike Schwartz - *SunTrust Robinson Humphrey - Analyst*

Okay. Great. Thanks.

Bruce Cazenave - *Nautilus Inc - CEO*

Thanks, Mike.

Operator

Rommel Dionisio, Wunderlich Securities.

Rommel Dionisio - *Wunderlich Securities, Inc. - Analyst*

Thanks very much. Just maybe a little more granularity, if we could, on the overseas expansion of Max Trainer.

I wonder if you could just give us a little more detail. I know you don't necessarily want to break out the specific numbers, but perhaps just how the progress you are seeing and how pleased with that initial launch. Thanks.

Bill McMahon - *Nautilus Inc - COO*

Hello, Rommel. Bill again. Max is indeed doing well and growing. We are seeing success with it in Europe and in Australia and New Zealand. We are continuing to look for more markets to take it to.

So I wouldn't say it has been introduced yet in all foreign markets, but in our key markets, it is in place and it is showing good traction early on.

Rommel Dionisio - *Wunderlich Securities, Inc. - Analyst*

Bill, specifically in Europe, was that just UK or are you on the mainland as well?

Bill McMahon - *Nautilus Inc - COO*

Also on the mainland.

Rommel Dionisio - *Wunderlich Securities, Inc. - Analyst*

Oh. Okay. Thanks very much and congrats on the quarter.

Bill McMahon - *Nautilus Inc - COO*

Thank you, Rommel.

Operator

Andrew Burns, D.A. Davidson.

Andrew Burns - *D.A. Davidson & Co. - Analyst*

Hey, good afternoon.

Bruce Cazenave - *Nautilus Inc - CEO*

Good afternoon.

Andrew Burns - *D.A. Davidson & Co. - Analyst*

Congrats on a solid first half there.

The first one, I guess, would be on the choppiness in media markets that seemed to develop in the third quarter. Could you elaborate on the timing and the impact?

It sounded like it was just around the conventions and maybe you shifted or pulled it back on the spend. Just trying to think about how that's going to impact the quarter in the go-forward marketing strategy. Thanks.

Bill McMahon - *Nautilus Inc - COO*

Hi, Andrew. Good question. We definitely are aware now that, as predicted perhaps, the media spend against this election will be rather significant. We have already started our, what we would call maneuvering around to anticipate that.

It could have some impact on us near-term between now and the election in terms of our ability to generate leads in our normal manner, but we have methods we use to attack that.

It is just, it puts a little bit of pressure on us to perform well on media and we just felt like we better alert everybody that, no surprise, media could be a little rough between now and, say, late October.

Andrew Burns - *D.A. Davidson & Co. - Analyst*

Okay. And would that result in perhaps margins being dented on the side or revenue temporarily slowing down as you chose not to spend?

Bill McMahon - *Nautilus Inc - COO*

Most likely it puts pressure on revenue, but, whereas margins might actually be reinforced if we choose to go against our highest performing networks, let's say.

Andrew Burns - *D.A. Davidson & Co. - Analyst*

Okay. Thanks. And an interesting development there with the M3 available at retail. Is that within a limited, you said, one retailer, is that a limited set of doors within that retailer or any color there?

Bill McMahon - *Nautilus Inc - COO*

Sure. It is one retailer. We are treating this as something that we are pretty excited about, but we want to be careful about it for I think reasons you understand well, Andrew.

It is one retailer. It is not a too limited number of doors. It's a representative number of doors that should give us a good read on our ability to pursue this strategy going forward.

Andrew Burns - *D.A. Davidson & Co. - Analyst*

And that M3, if it was purchased in-store, would that flow into the retail segment revenue with sort of a similar model in terms of the P&L in broad terms similar to the retail gross margin operating margin structure versus direct?

Bill McMahon - *Nautilus Inc - COO*

Yes, it would.

Andrew Burns - *D.A. Davidson & Co. - Analyst*

Okay. And any more pop-ups? I know that was a good way to get people on the equipment.

Bill McMahon - *Nautilus Inc - COO*

We had a lot of good learnings from our pop-up store tests from last fall. We have a few ideas we?re pursuing this fall. And, as usual, I have to tease you and say I can't talk about those things quite yet, but we're pretty excited about some concepts that we will be trying in the fall.

Andrew Burns - *D.A. Davidson & Co. - Analyst*

Thanks. One last one in terms of the modeling for the direct segment. Is there any color that you can provide yet in terms of, it sounds like we will see some new product in September that will launch in 2017?

Any timing on the launch, whether that would be material to first quarter or launch in first quarter?

Bill McMahon - *Nautilus Inc - COO*

No. We haven't said yet. We have indicated that we believe it is the first half of 2017. I think we will have more to say about that as we get closer to that time frame.

Andrew Burns - *D.A. Davidson & Co. - Analyst*

Great. Thank you.

Bill McMahon - *Nautilus Inc - COO*

You're welcome.

Bruce Cazenave - *Nautilus Inc - CEO*

Thanks, Andrew.

Operator

Frank Camma, Sidoti.

Frank Camma - *Sidoti & Company - Analyst*

Good afternoon, guys.

Bruce Cazenave - *Nautilus Inc - CEO*

Hello, Frank.

Frank Camma - *Sidoti & Company - Analyst*

Question on Octane. Obviously, you sounded like the results were in line with your expectation, but when you back into it, it looks like revenue was roughly in line with the first quarter.

I am just wondering if you can comment on sort of the disruption a little more that was in the first quarter in the specialty channel. Did that roll over into the second quarter? Any comments there?

Bruce Cazenave - *Nautilus Inc - CEO*

I think there was, the disruption that we commented on in the first quarter did also roll into the second quarter and the consumer dealer base, specialty retail base, Frank.

But we will say that the impact in Q2 was less than it was in Q1. So, that gives us optimism that as we proceed into the back half, a lot of this could be behind us.

Frank Camma - *Sidoti & Company - Analyst*

Good. Okay. The other is on your traditional retailers. Can you give us any [carrots] or feedback or commentary on how you view their inventory levels in the channel itself? Or in the sector itself?

Bill McMahon - *Nautilus Inc - COO*

Frank, this is Bill. For our specific product, we do have visibility to inventory levels at all of our retail accounts. And I would say they are positioned the way they would like to be to go into a new floor set this fall. We do not have any overstock situations that will require us to do any unusual discounting.

Frank Camma - *Sidoti & Company - Analyst*

Good. Okay. Last question is just on the, could you update us on how the launch of the 560s are going? The dumbbells. And any learnings that you have learned from that since you are integrating more technology on the strength side?

Bruce Cazenave - *Nautilus Inc - CEO*

Good question. Thanks, Frank. The 560, we are very pleased with the consumer acceptance early on on that product. At the same time, we are finding it seems to lift all boats as our performance in the other SelectTech categories continues to be strong with 560 in the market as well.

We think it is going to be accretive and educational to us in terms of positioning for SelectTech dumbbells. We will see this product begin to appear in retail markets as well in the coming fall. So we are excited to see what it does.

Frank Camma - *Sidoti & Company - Analyst*

Is that traditional retail or is that online like Amazon or is that both?

Bruce Cazenave - *Nautilus Inc - CEO*

It could be some of both.

Frank Camma - *Sidoti & Company - Analyst*

Okay. Thank you.

Bruce Cazenave - *Nautilus Inc - CEO*

Thanks, Frank.

Operator

(Operator Instructions)

George Kelly, Imperial Capital.

George Kelly - *Imperial Capital - Analyst*

A few questions. Just to start with, the Max Trainer, wondering what the normal, when do you start seeing repeat customers for these types of products and have you started to see repeat people on the Max Trainer?

Bill McMahon - *Nautilus Inc - COO*

Usually it would be a little bit longer than currently two and a half years or so into launch, George. We do keep an eye on lifetime value as well as purchase behavior of customers in our database. So I'm sure we have had some, but I wouldn't say it's meaningful contribution to Max's growth at the moment.

Bruce Cazenave - *Nautilus Inc - CEO*

I think initially, correct me if I am wrong, Bill, the initial first year or so Max was heavy -- well, I would say, what did represent a lot of existing Bowflex purchasers.

Bill McMahon - *Nautilus Inc - COO*

Certainly rod gym purchasers and tread climber purchases did purchase Max as well.

Bruce Cazenave - *Nautilus Inc - CEO*

Yes.

But somebody coming in for a second or a third Max is a ways away.

George Kelly - *Imperial Capital - Analyst*

Okay. Okay. So the product lasts four or five years until people think about buying the newest one?

Bruce Cazenave - *Nautilus Inc - CEO*

Yes.

George Kelly - *Imperial Capital - Analyst*

Okay. Another question on Max. You, right now, are offering three different models and there is a big range of price points from about $1,000 to $2,200 for the most recent version.

Was the first version sort of under-priced or how do you expect that to change? Will that lineup change in 2017?

Bill McMahon - *Nautilus Inc - COO*

The lineup will be the same in 2017 as currently envisioned. The price points that we chose are historically good sweet spots for us but they also contribute the margin targets that we are looking for in the category.

M7 went to the higher price point of the $2,200. That is not unusual in a direct model. When have a successful product, you look to do line extension. And certainly, in our longer-term strategic planning, we look at Max Trainer as a platform that may even have more extensibility in it.

George Kelly - *Imperial Capital - Analyst*

Okay. Okay. And then last question from me and I hopped in the call late, so I apologize if I missed this. But can you talk about credit approval trends in the quarter?

Bruce Cazenave - *Nautilus Inc - CEO*

Sure. Credit approval was up this quarter in Q2 to 47.3%. Is that right, Sid?

Sid Nayar - *Nautilus Inc - CFO*

Right. Yes.

Bruce Cazenave - *Nautilus Inc - CEO*

That is up from last year's 46% or so. We have been seeing still ongoing historically high, very strong credit approval rates. There is some seasonality to credit. While Q1's credit approval rate was closer to 49%, it's not unusual for Q2 to back off that some.

Right now, we are still very happy with what we are seeing on credit. More importantly to us and to Synchrony, our tier 1 partner, we are seeing very strong performance by our accounts that are in the credit pool and so we are optimistic on financing for our business going forward.

George Kelly - *Imperial Capital - Analyst*

Okay. I guess I do have one more question. The specialty disruption that you have talked about, can you give more detail? What is that? What is happening at the specialty channel?

Bruce Cazenave - *Nautilus Inc - CEO*

There has been, George, some significant acquisitions of some of the retailers in that space. That is primarily one of the main things that has happened.

There has also been some consolidation among the suppliers that are providing product to that channel and it is creating a little bit of uncertainty in terms of who is going to be carrying what in their specific markets.

So that's really started in the first quarter, early in the first quarter, this year. Without going any further, that is basically some of the things that are impacting that channel of distribution. Again, it is only one of five channels of distribution that Octane does business in.

George Kelly - *Imperial Capital - Analyst*

Okay. Thank you.

Operator

That does conclude the Q&A session. At this time, I will turn the call back over to Bruce Cazenave, CEO.

Bruce Cazenave - *Nautilus Inc - CEO*

Thank you all for joining our call today and for your continued interest in Nautilus.

As I mentioned, we will be hosting our product showcase in late September in New York City and we hope to see many of you there. Hope everyone has a great afternoon. Thank you.

Operator

Again, this does conclude today's conference call. Thank you all for your participation.

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