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PRESENTATION

Operator

Welcome to the Nautilus Q2 FY15 conference call.

(Operator Instructions)

As a reminder, this conference call is being recorded Monday, August 3, 2015.

I will now like to turn the conference call over to John Mills, partner at ICR. Go ahead, sir.

John Mills - *Nautilus, Inc. - Partner with Integrated Corporate Relations, Inc.*

Great. Thank you.

Good afternoon, everyone. Welcome to Nautilus' second-quarter 2015 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 site at nautilusinc.com on the Investor Relations page.

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 new product introductions, available supply of certain products, planned and anticipated results of new product and channel development initiatives, expectations concerning future income tax payments and forecasts related to sales performance of individual products and in international markets.

Forward-looking statements are subject to a number of risks and uncertainties and actual results may differ materially from those statements. For more information about these risks, please refer to our quarterly and annual reports 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 pertaining to our continuing operations.

With that, it's my pleasure to turn the call over to Bruce. Go ahead, Bruce.

Bruce Cazenave - *Nautilus, Inc. - CEO*

Thank you, John.

Good afternoon, everyone. Thank you for joining our call today. On today's call I would like to start by providing a general overview of the second quarter and then will turn it over to Sid Nayar to review our financial results in more detail. Bill McMahon will then add some 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 pleased to report another strong quarter of financial performance for our company. Second-quarter sales increased 23% compared to the same period prior year, which was driven by double-digit growth in both our direct and retail segments. This top-line performance is a result of a number of initiatives him products but is mostly attributable to successful development and marketing of new products.

On the direct side, our business benefited from strong continued sales of the Bowflex Max Trainer, which was launched early last year. Our retail business sales growth reflects good base momentum across a range of products and our ability to continue to meet the evolving need -- demands of our retail partners. The new-line of treadmills, which we launched initially to select distribution late last year, provided incremental sales in the quarter and, because of that positive feedback, we will be increasing distribution this fall.

In the second quarter, our continued focus on leveraging fixed cost across higher sales volume enabled us to generate operating income of $3.9 million, which represents a 65% increase compared to the same period last year. We are particularly pleased with the strong operating performance in light of the fact that Q2 is historically the most seasonally challenging quarter for our company and the industry overall.

At this time I'd like to turn it over to Sid Nayar, our Chief Financial Officer, who will provide some additional details on our second-quarter financials. 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 2015. Net sales for the second quarter totaled $59.7 million, an increase of 23% as compared to the same period in the prior year. Year-to-date net sales for 2015 totaled $155.9 million, up 29.5% as compared to net sales of $120.5 million for the same period last year. Second-quarter gross margins increased 50 basis points in the direct segment to 62.2% and were down 90 basis points in the retail segment to 23.5% when compared to the same quarter last year.

On an overall basis, total Company gross margins for the second quarter 2015 improved to 51.4%, up 40 basis points versus the same period prior year, primarily reflecting channel mix. For the first six months of 2015, total gross margins improved to 54.2%, up 170 basis points as compared to the same prior period. Total operating expenses for the second quarter of 2015 as a percentage of sales decreased to 44.8% from 46.1% in the same period last year, reflecting improved leverage of expenses across the higher revenue base. Operating expenses for the six months ended June 30, 2015, as a percentage of sales, totaled 44% as compared to 43.1% for the same prior period.

Sales and marketing expense for the second quarter of 2015 was $20.1 million, or 33.6% of sales, as compared to $15.7 million, or 32.3% of sales, primarily reflecting higher media spending. For the six months ended June 30, 2015, sales and marketing expenses totaled $48.5 million, or 31.1% of sales, compared to $37.5 million, or 31.1% of sales for the same period in the prior year, with higher media spending being the main driver.

General and administrative expenses were $4.3 million, or 7.2% of sales, for the second quarter of 2015, which compares to $5 million, or 10.2% of sales, in the same period last year. The decreased dollar spending in G&A primarily reflects credits related to a state tax refund of $0.5 million. The improvement in G&A as a percentage of sales highlights favorable operating efficiencies and our ability to leverage the existing operating base as the business expands. General and administrative expenses for the first six months of 2015 as a percentage of sales totaled 6.3%, as compared to 8.9% for the same prior period.

Research and development costs in the second quarter of 2015 were $2.4 million, or 4% of net sales, compared to $1.8 million, or 3.6% of net sales, from the same period last year. The dollar increase reflects our ongoing commitment to invest in the product development and engineering resources required to continue to innovate and broaden our product portfolio through new and refreshed products. Research and development costs for the first six months of 2015 totaled $4.7 million, or 3% of net sales, as compared to $3.7 million, or 3% of net sales, for the same prior period.

Operating income for the second quarter of 2015 increased to $3.9 million, as compared to income of $2.4 million in the same quarter of last year. The increase reflects higher sales and gross margins in the direct segment combined with improved operating leverage of general and administrative expenses. Operating margin for the second quarter of 2015 improved to 6.6% compared to 4.9% for the same period last year.

For the first six months of 2015, operating income totaled $21.5 million, or 13.8% of net sales, up 89.2% compared to the same period last year. Income from continuing operations for the second quarter of 2015 was $2.2 million, or $0.07 per diluted share, as compared to $1.5 million, or $0.05 per diluted share, for the same period last year.

The effective tax rate for the second quarter of 2015 was 40.1%, compared to 35.8% in the same period last year, which was lower as it included a benefit for an R&D tax credit adjustment. Given the Company's US net operating loss carry-forward position, we expect to continue to have limited cash tax payments for the rest of the year. Income from continuing operations for the first six months of 2015 totaled $13.1 million, or $0.41 per diluted share, as compared to $7.2 million, or $0.23 per diluted share, for the first six months of 2014.

Total net income, including discontinued operations for the second quarter of 2015, was $2.4 million, or $0.08 per diluted share. This includes $0.2 million of income net of taxes, or $0.01 per diluted share from discontinued operation. This compares to the second quarter last year where we reported total net income, including discontinued operations, of $0.6 million, or $0.02 per diluted share, which included a loss from discontinued operations of $0.9 million net of taxes, or a $0.03 loss per diluted share. Total net income for the first six months of 2015 was $13.2 million, or $0.41 per diluted share, compared to $5.9 million, or $0.19 per diluted share.

Turning now to our segment results, net sales in the direct business totaled $41.7 million for the second quarter of 2015, a 28.8% increase over the same quarter last year. Direct segment sales benefited from continued strong demand for our cardio products, primarily driven by sales of the Bowflex Max Trainer product line. Net sales for the first six months of 2015 in the direct segment totaled $115.7 million, up 39.3% over the same period last year, driven primarily by incremental revenue from the launch of Bowflex Max Trainer.

Gross margins for the direct business improved to 62.2% for the second quarter of 2015, compared to 61.7% in the same quarter of last year. Gross margin improvement was due to continued leverage of our supply chain cost.

Operating income in the second quarter of 2015 in our direct business was $5.1 million, compared to $3.9 million in the same quarter prior year. Operating income benefited from higher net sales in gross margins in the second quarter of 2015.

Net sales in our retail segment for the second quarter of 2015 were $17.4 million, an increase of 15.7% compared to $15 million in the second quarter of last year. The improvement reflects robust sales of select type dumbbells coupled with the Company's new lineup of cardio products, including those launched in the fall of 2014.

For the first six months of 2015, net sales for the retail segment totaled $38.7 million, an increase of 10.1% over the same period last year. Gross margins for the retail business declined by 90 basis points to 23.5% of sales in the second quarter of 2015, as compared to 24.4% of sales for the prior period, driven by unfavorable product and customer mix.

In the second quarter of 2015, operating income for the retail business totaled $1.2 million, as compared to $1.3 million in the same period of last year. The decrease is attributable to the lower gross margins, higher marketing and merchandising expenses, and increased R&D and IT related cost allocated to the segment. Our retail operating margins have been negatively impacted in the short-term as we seek to accelerate growth through investments in new product categories and channel development.

Now turning to the consolidated balance sheet, cash and investments totaled $87.2 million as of June 30, 2015, with no debt. This compares to $72.2 million in cash and no debt at December 31, 2014. Inventories were $28.4 million as of June 30, 2015, compared to $24.9 million at December 31, 2014, and $23.2 million at June 30, 2014. The increase in inventory versus year end and June 30, 2014, reflected increased stocking levels for high demand SKUs and the additional product in our new distribution center.

Trade payables were $32.7 million as of June 30, 2015, compared to $47.6 million at the end of 2014. Capital expenditures totaled $1.3 million for the six months ended June 30, 2015, with spending primarily on facility infrastructure. 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.

I'd like to provide additional background on our second-quarter results and the overall position of our business. Starting with our direct business, we reported another quarter of strong revenue and operating income growth, largely driven by the Bowflex Max Trainer, which continues to exceed our growth expectations and importantly, customer satisfaction also remains very high.

We anticipate that the Max Trainer product line will continue to drive growth in our direct segment in the coming quarters, and in order to drive that growth, we plan to continue to prudently and incrementally ramp up media spend. In the last two years, we have had success in driving improved conversion during peak fitness season attributable to these media investments during the summer and fall. Given our knowledge of current media market conditions, we feel conditions are favorable for these investments.

Additionally, we are pleased to report that strength category sales in the direct segment grew year over year for the first time in many quarters. We feel this is a leveling off point for our legacy strength products and this was expected to happen. However, our data and industry data indicates that the market for strength-based fitness is ready for new innovation. We have multiple ideas in our product pipeline and the first strength product in that pipeline will be the Bowflex 560 SelectTech dumbbell launching later this year.

Turning to our other key direct cardio product, Bowflex TreadClimber. As we've stated on prior calls, we are experiencing some cross shopping between TreadClimber and Max Trainer. This is anticipated and is at a rate that is in line with our expectations. The TreadClimber remains an important part of our portfolio, and we are excited to launch the next generation of split-treadle device products in the fourth quarter of this year.

These products will include several key elements that will modernize the platform, including digital integration, greatly enhanced console technologies and the ability to track and export data to a variety of smart devices, including wearables. With this refreshed and modernized interface, we believe our products will be well-positioned for future success. The new models will be priced the same as our current TC10 and TC20 machines.

Another positive factor, and one that continues to develop in the direct segment, is our success in digital mobile platforms. In prior calls, we've discussed how a significant amount of our product leads generated via mobile devices, such as phones and tablets. Building on that success, we've continued to optimize our online experience for customers using those devices to learn about Bowflex products.

Due to these efforts, in the first half of this year, around 15% of our online sales were completed on a mobile device versus a personal computer or laptop. Use of smart devices is now normal behavior in the US market, and our ability to penetrate mobile markets, especially at our average price point level, is a competitive advantage we intend to continue to explore and grow. Mobile platforms are just one element of our plan to communicate with prospective buyers in the manner in which they prefer, and thus remove barriers to purchase wherever possible.

Turning now to our retail business, retail customer response to our recent product launches has continued to be positive, and we know our growth is outpacing industry trends. Our second-quarter results benefited from strong sales of our SelectTech dumbbells as well is positive contributions from our new cardio products, including treadmills. Our focused entry into the treadmill market represents a significant long-term opportunity for Nautilus and we are encouraged by the positive early response to our Nautilus and Schwinn branded treadmills.

In the past few months, we've completed meetings to discuss the fall 2015 merchandising and product selling plans with all of our key retail accounts. Based on our current understanding of retailer intentions, in addition to our actual orders in hand, we anticipate continuing to grow retail market share in the coming fitness season. We have gained both SKUs and doors across a variety accounts in the United States, driven by the strength of our brands and product offerings. Further, initial feedback on Max Trainer with our international account partners has been favorable and we feel this product could have success in a number of global markets over time.

As a final note on our retail segment, I'd like to comment on our gross margins. Retail gross margins declined 90 basis points from the same quarter in the prior year. This was in line with our expectations and represents an improved rate of decline compared to recent quarters. However, it's not our desire to simply slow the decline but rather to reverse the trend and return to a margin improvement path in the retail segment. We have identified the factors that have impacted gross margins negatively over the past few quarters and, based on our current outlook, we feel that we have put into place measures to drive improvement in the trend beginning in the second half of this year.

Product innovation is the core of our business. We are excited about new product launches planned for the third and fourth quarters of this year.

In addition to the refreshed TreadClimber lineup I discussed earlier, we plan to launch the Bowflex SelectTech 560 dumbbell. The SelectTech 560 integrates key elements and represents the first major upgrade in the history of this very successful product line.

Additionally, our new SelectTech dumbbell introduces digital integration and repetition counting technologies, which utilizes smart phone or tablet to improve your workout. Bowflex SelectTech 560 will launch later this year and will be available on both the retail and direct segments.

Additionally, for our retail channel, we are confident we have a strong lineup of products that builds on the success of our product platforms over the past two years. One key product launch to highlight will be the new Schwinn AD Pro bike. The AD Pro is a new platform designed with commercial quality Airdyne components.

Airdyne set the standard for fan bike performance, and it is very popular in the CrossFit and vertical market environment. We have showcased this new product at shows in the United States, Europe, and Asia, and we've received strong favorable feedback. Schwinn AD Pro launches this fall.

Also, we look forward to sharing our new product lineup at our third annual product showcase event in New York in late September. We continue to look at products across a three-year road map with the intentions of maintaining a regular cadence of product launches that leverage our well-established brands and help drive growth in both of our segments. Our continued investment in research and development is fueling that pipeline.

So in summary, we are excited about the outlook for our business. Over the past few years, we've made good progress in improving and diversifying our product portfolio, which puts us in the strong position to continue to gain market share in both the direct and retail segments.

And with that, I'd like to turn the call back over to Bruce for his final comments. Bruce?

Bruce Cazenave - *Nautilus, Inc. - CEO*

Thank you, Bill.

I'd like to make a few final comments before opening up the call for questions. As we begin the back half of 2015, we are in a good position operationally to support continued growth. We also will remain focused in the areas that have served us well: consumer insight driven product innovation; improving margins; and leveraging our infrastructure. That has been our success formula to date and we will continue to be the drivers for our investment decisions and priorities going forward.

You have heard me state before that despite the market successes achieved and the momentum our team has built, we believe that our Company is still in the early stages of realizing its full potential. Gains in the marketplace have to be earned and that means steadily building for the future while optimizing the near-term.

Innovation at Nautilus is not limited to just product. It is also applies to new methods of reaching consumers. And to that end, we will be making investments in the coming quarters to test and prove out concepts that we believe may further differentiate us in the future.

In closing, I am extremely proud and thankful to our team for their continued hard work and dedication and for delivering another strong quarter of results.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Lee Giordano with Sterne Agee.

Lee Giordano - *Sterne, Agee & Leach - Analyst*

Thanks. Good evening, everyone. On the retail side of the business, sounds like you've got some good momentum on the treadmills in your increase in distribution this fall. Can you give us a better sense of how big an opportunity that might be for you? Were you just in select retailers today and how big of an increase would you expect? Thanks.

Bruce Cazenave - *Nautilus, Inc. - CEO*

Lee, I think we are gaining share us with treadmills both on the floor and online right now, but we are still selective about that, given the margin challenges with treadmills. I'm pleased though that our SKUs and doors increase is not just with treadmills. We are also gaining incrementally in some better margin categories like ellipticals, for example.

Lee Giordano - *Sterne, Agee & Leach - Analyst*

Okay, great. And secondly, on the TreadClimber, can you remind us how big a part of your business that is today, and what do you expect going forward with this new update in terms of the opportunity? Thanks.

Sid Nayar - *Nautilus, Inc. - CFO*

Hi, Lee, this is Sid. We don't break out the product detail for TreadClimber and Max Trainer for competitive reasons so probably can't share the exact numbers. But we do expect the new launch coming this fall to certainly, at the very least, hold the trend line the way it is and we are optimistic it will actually reverse the sales trend and get it back up again.

Lee Giordano - *Sterne, Agee & Leach - Analyst*

Great, thank you.

Bruce Cazenave - *Nautilus, Inc. - CEO*

Thanks Lee.

Operator

Andrew Burns with D.A. Davidson.

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

Thanks. Good afternoon and congratulations on the quarter. Had a couple of follow-ups. I'm not sure if I missed it, but the credit approval rate in the quarter?

Bill McMahon - *Nautilus, Inc. - COO*

Yes. Hi, Andrew, its Bill. The credit approval rate in the quarter was 46% overall, which was improved from last year 39% and that is roughly in line with our year-to-day run rate on approvals so we are pleased with that. But I would emphasize, too, that our credit card sales or sales closed with credit card as payment method is still outpacing growth in financing so we're pretty pleased with the payment mix we are seeing overall.

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

Great, thanks. And in terms of thinking about the revenue impact for the 560 and the TreadClimber refresh for 4Q, will those be widely available for the bulk of the revenue, the key revenue period for Q4? Or should we be thinking about that launching and then ramping in materiality in the first quarter?

Bruce Cazenave - *Nautilus, Inc. - CEO*

I think the latter comment is most appropriate. As with most of our products, especially anything in direct, there will be some ramping element to it. Especially with 560, out of the gate it will not be on TV, so it will take some time to gain some awareness. We will be using a variety of methods to drive that but wouldn't expect a huge contribution in Q4 from that.

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

On that note about marketing spend on the 560, it looks like you may have finally hit a core level in terms of strength product. What is the willingness to invest marketing behind new products in that category? Can strength really be a growth engine for you? Or just the evolution of the consumer mean that's going to remain a pretty small business for you?

Bruce Cazenave - *Nautilus, Inc. - CEO*

I think there is a lot of answers to that question, Andrew. It's one that we spend a lot of time on. We believe that especially with the brand name Bowflex, there is the opportunity to introduce innovative strength products and do well with them. Even though the general market trend still runs about four-to-one to five-to-one cardio versus strength in sales, certainly the heritage of Bowflex was innovative strength. We're working on some concepts now in our pipeline, and down the road, we feel like we can launch some products that will help move the needle on the strength side.

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

Okay, thanks. Just one more quick one for you. The commentary in terms of testing and proving out some new concepts going forward, was that through the signal to think about R&D a bit differently than just from a modeling perspective? Just trying to think if there is any puts and takes. Normally as we go into 3Q, revenue ticks up and the margin profile ticks up. Seeing if there are any moving parts we should be thinking about to offset that. Thanks.

Sid Nayar - *Nautilus, Inc. - CFO*

Andrew, this is Sid. That was really focused more on selling and marketing. There's going to be some initiatives where we end up spending some merchandising/marketing dollars to test these initiatives. And so I think you would see in the back half some additional dollars, both in Q3 and Q4, which are related to those efforts.

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

Great. Thanks and good luck.

Bruce Cazenave - *Nautilus, Inc. - CEO*

Thanks, Andrew.

Bill McMahon - *Nautilus, Inc. - COO*

Thank you.

Operator

(Operator Instructions)

Frank Camma with Sidoti & Company.

Frank Camma - *Sidoti & Company - Analyst*

Good afternoon, guys.

Bruce Cazenave - *Nautilus, Inc. - CEO*

Hi, Frank.

Frank Camma - *Sidoti & Company - Analyst*

Hey, could you remind us about the timing of the launch of the Bowflex Max Trainer internationally and how you will report that? I assume that it's going be part of retail or are you going to break it out?

Bruce Cazenave - *Nautilus, Inc. - CEO*

Yes, Frank you are right, we did launch in Q2. We did ship some units out during Q2 and we've gotten some feedback on reception of those units in the market. It was not yet a significant contributor to retail, but we do feel that it had some legs. It is successful in the US; it should be successful in parts of the world.

Frank Camma - *Sidoti & Company - Analyst*

Okay.

Bruce Cazenave - *Nautilus, Inc. - CEO*

We will report that -- I'm sorry, we will report that as retail sales internationally when we roll up that number annually.

Frank Camma - *Sidoti & Company - Analyst*

Okay, great. Just a comment if you could on the margins. You discussed the retail margin, I think understand that. But the direct margin relative to the sales increase seemed like you lost some ground there. I'm just comparing it against a 30% increase in revenue almost, but it was off -- it was up year over year, but it was down pretty hard sequentially. Just wondering if you could add some color to that.

Sid Nayar - *Nautilus, Inc. - CFO*

Again, a lot of it has to do with leveraging the revenue in terms of -- just in terms of our fixed expenses, so we certainly would see -- would anticipate an expected decline versus the first quarter. We are really seeing the improvement year over year, in comparing the two quarters, really driven by leveraging some of the warehousing costs and lower freight out of our Ohio distribution center. I think we've indicated low 60%s are an optimal range for the direct margin, profile. And we feel very comfortable in terms of where those percentages are, both for the quarter and for the year.

Frank Camma - *Sidoti & Company - Analyst*

So the 65% that you achieve the first quarter, that would only be -- that's a bit of an outlier on very high revenue base, correct?

Sid Nayar - *Nautilus, Inc. - CFO*

Yes. It really reflects -- I think if you just from a seasonality perspective, you will see the highs and lows on that gross margin trend.

Frank Camma - *Sidoti & Company - Analyst*

Okay. Final question, just on if you could up date us on the Bowflex Body supplement and how that is going.

Bill McMahon - *Nautilus, Inc. - COO*

Yes, Frank, Bill again. Bowflex Body sales increased quite a bit in Q2, they continue to grow. I wouldn't call them a runaway hit, though. We have a lot of efforts that we are doing to continue to raise awareness around the product. The good news for us is for those who try the product, they love the product and it's very well received. The nuts that we are still trying to crack on that are how do we get more people to try it and we are doing that by marketing to our buyers and starting to use some of the other tools we have to raise social awareness in some of the other marketing efforts that we typically use as the product continues to prove itself. So the sales are growing but I would say we have more work to do, and more opportunity to chase.

Frank Camma - *Sidoti & Company - Analyst*

Okay. Great. Thanks, guys.

Bruce Cazenave - *Nautilus, Inc. - CEO*

Thanks, Frank.

Operator

(Operator Instructions)

There are no further questions at this time. I'll turn the call back to the presenters.

Bruce Cazenave - *Nautilus, Inc. - CEO*

Thank you, everyone, for joining our call today and your interest in Nautilus. As Bill mentioned, we will be hosting our new product showcase in New York City in late September with a preview for the investment community on September 29, and we hope to see many of you there. I hope everyone has a great afternoon, and thank you again.

Operator

Ladies and gentlemen that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.
