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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Nautilus Q1 FY14 conference call.

(Operator Instructions)

As a reminder, this conference is being recorded today, May 5, 2014.

I would like now to turn the conference over to Mr. John Mills with ICR. Please go ahead, sir.

John Mills - *ICR - IR*

Great, thank you. Good afternoon, everyone. Welcome to Nautilus's first-quarter 2014 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 nautilusinc.com on the Investor Relations page. The earnings release includes a reconciliation of the non-GAAP financial measures mentioned in today's call to the most directly comparable GAAP measure.

Remarks on today's conference call may include forward-looking statements within the meanings of the securities laws. These statements, including 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 facility initiatives, and forecasts related to international sales 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 publicly update any forward-looking statements to reflect new information, events or circumstances after they are 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.

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.

On today's call, I would like to start by providing a general overview of the first quarter, and then we 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, as well as updates on product activity. And then I will close with some summary remarks before we open up the call for questions.

During the first quarter, we achieved top-line growth of 21% over the same period last year, reflecting strong sales increases in both our retail and direct businesses. Operating income for the first quarter increased 50% over the first quarter last year, as all three of our previously communicated key initiative areas -- new product innovation, margin improvement, and improving operating leverage -- all continued to move in a positive direction.

The improved financial performance this quarter also reinforces that the strategies we set in motion three years ago are working well, and have put us on a solid trajectory to build an even stronger and more profitable Company for the future.

At this time, I'd like to turn it over to Sid Nayar, our Chief Financial Officer, who will provide some additional details about the first-quarter financials. Sid?

Sid Nayar - *Nautilus Inc - CFO*

Thank you, Bruce. I would like to review the details of our financial results for the first quarter of 2014.

Net sales for the first quarter totaled $71.9 million, an increase of 21.4% as compared to the same period in the prior year. First-quarter gross margins increased in both our retail and direct segments to 25.4%, up 50 basis points, and 63.7%, up 390 basis points, respectively. On an overall basis, total Company gross margins improved to 53.5%, up 170 basis points versus prior year.

Total operating expenses for the first quarter, as a percentage of sales, decreased to 41% from 41.7% in the same period last year, underscoring our initiatives to leverage operating expenses across higher sales volume. The improvement in operating expenses as a percentage of sales was primarily due to the disproportionately larger growth in the retail business this quarter, and that business carries a much lower variable sales and marketing expense.

General and administrative expenses were $5.8 million or 8.1% of sales for the first quarter of 2014, which compares to $4.9 million or 8.4% of sales in the same period last year. The increased dollar spending in G&A reflects increased legal fees for intellectual property and patent initiatives, and higher incentive reserves based on improved performance. The improvement in G&A as a percentage of sales highlights favorable operating efficiencies, and our ability to leverage the existing operating platform as business expands.

Research and development costs in the first quarter of 2014 were $1.9 million compared to $1.1 million in the same period last year. This increase reflects our commitment to continue to invest in the product development and engineering resources required to innovate and broaden our product portfolio through new and refreshed products.

Operating income for the first quarter of 2014 increased to $9 million, a 50% increase compared to $6 million in the same quarter of last year. The increase reflects higher sales and gross margins in both direct and retail segments, combined with improved operating leverage of sales and marketing, and general and administrative, expenses. Operating margin improved over 200 basis points to 12.5% compared to 10.1% for the same period last year.

Pre-tax income from continuing operations for the first quarter of 2014 was $8.9 million, or $0.28 per diluted share, compared to $5.9 million, or $0.19 per diluted share, in the same period last year. Beginning in the first quarter of 2014, the Company started to record income taxes at a normalized rate, following the partial reversal of its valuation allowances in 2013. We believe that pre-tax income comparisons provide a useful metric to gauge underlying business performance. Given the Company's US net operating loss carryforward position, we expect to have minimal cash tax payments in the near term.

Net income from continuing operations for the first quarter was $5.7 million, or $0.18 per diluted share, compared to $5.5 million, or $0.18 per diluted share, for the same period last year. Total net income, including discontinued operations for the first quarter of 2014, was $5.4 million or $0.17 per diluted share. This includes a $0.4-million loss net of taxes, or $0.01 loss per diluted share, from discontinued operations. This compares to the first quarter last year where we reported total net income, including discontinued operations, of $5.2 million, or $0.17 per diluted share, which included a loss from discontinued operations of $0.4 million net of taxes, or $0.01 loss per diluted share.

Turning now to our segment results, net sales in the direct business totaled $50.7 million for the first quarter of 2014, a 19% increase over the same quarter last year. Direct segment sales benefited from strong demand for our cardio products, with continued strength of the Bowflex TreadClimber category and initial sales of the recently launched Bowflex MAX Trainer product line. This growth was partially offset by a decline in strength products in the direct channel, as we continue to see some of these products cascade into the retail business.

US credit approval rates rose to 41.3% in the first quarter of 2014, up from 35.1% for the same period last year, attributable to several factors, including our media strategy focused on driving quality customer leads and an expanded lender base.

Gross margin for the direct business improved to 63.7% for the first quarter of 2014, compared to 59.8% in the same quarter of last year. The direct business gross margin benefited from overall overhead operating efficiency and product cost improvements. Operating income for the first quarter of 2014 in our direct business was $10.4 million, compared to $6.7 million in the same quarter prior year. The higher sales and gross margin were partially offset by higher expenses from media and advertising, as we made investments in new creative, designed to help drive new product awareness and expand sales leads.

Net sales in our retail segment for the first quarter of 2014 were $20.1 million, an increase of 32.8% compared to $15.1 million in the first quarter of last year. The improvement reflects strong retailer sell-through of the Company's new lineup of cardio products. Gross margins for the retail business increased by 50 basis points to 25.4% in the first quarter of 2014, as compared to 24.9% for the prior period, driven by the mix of new products and improved overall overhead operating efficiency. In the first quarter of 2014, operating income for the retail business increased $0.5 million to $2.5 million, as compared to the $2 million in the same period of last year.

Now turning to the consolidated balance sheet: We continue to improve our financial position. Cash, cash equivalents and marketable securities increased to $55.6 million as of March 31, 2014, with no debt. This compares to $41 million in cash, cash equivalents and marketable securities, and no debt at the end of 2013.

Inventories were $13.5 million as of March 31, 2014, compared to $15.8 million at the end of 2013. Trade payables were $27.3 million as of March 31, 2014, compared to $37.2 million at the end of 2013. Capital expenditures totaled $0.5 million for the quarter, and we anticipate spending $3.0 million to $3.5 million for the year.

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 add a few comments regarding our operations, and provide additional background on our first-quarter results and the overall position of our Business.

Starting with our direct business, we made strong progress in this segment in the first quarter, and delivered robust sales and operating income growth, as Sid outlined. Our direct business is experiencing continued improvement in consumer financing approval rates, and this, combined with favorable lead generation driven by strong creative assets, is allowing us to expand our marketing efforts in the higher visibility television networks, as well as the broader mix of web marketing, social media, and public relations efforts.

Sales of our Bowflex TreadClimber products continues to grow. As we discussed on our last call, we increased our investment in television media in Q4 2013 with the objective of capitalizing on our strong creative to build our base of leads, and this same investment continued into Q1 of this year. Our strong TreadClimber sales indicate that our investment in this product was justified.

We were also very pleased with the initial performance of the Bowflex MAX Trainer; our new, revolutionary high-performance cardio machine that combines the movements of a traditional elliptical with a stair stepper. The television launch of MAX Trainer was in early January, and we have continued to be encouraged by consumer reception of this product, both from a media and sales perspective, but also in terms of satisfaction after the sale.

Early response to the MAX Trainer was stronger than anticipated, and we spent much of Q1 working with our supply chain to increase production capacity related to the product. Given the observed media metrics in conversion, we anticipate that MAX Trainer will be an area of significant media investment in 2014. We are confident that, going forward, our supply chain will be ready for potential sales in this category.

Turning now to our retail business, retail customer response to our new lineup that we launched in the Fall of 2013 continues to be positive. Our retail business grew in Q1 versus prior year in all key categories, including bikes, elliptical machines, and home gyms. The success that we had with Schwinn exercise bikes and ellipticals gives us confidence that we have strong products that will perform on the retail floor. We plan to build on this foundation, and we will expand on our product offerings as we move into the selling season for Fall 2014 store placements.

In addition to our successful model-year 2013 Schwinn line of bikes and ellipticals, we anticipate launching a complete line of model-year 2014 Nautilus-branded cardio products. These bikes and ellipticals will carry feature sets representative of the Nautilus brand, which is focused on fitness enthusiasts and those who aspire to make serious fitness a part of their lives. These products are designed to be compliant with international product regulation, and are expected to play a key role in our international growth.

One category that has been conspicuously absent in our product mix for several years is treadmills. While elliptical machines represent the fastest-growing category in fitness, it is still treadmills which remain the largest category, accounting for about 25% of wholesale fitness volume in the United States alone.

We have previously noted that the treadmill category is commoditized, and is rife with competition; and thus, we would not enter the space unless we felt we had compelling product that would support profitable sales. For Fall 2014, we feel we have developed that product that can compete in this space, and do so at reasonable margins. We plan to launch treadmills at the $799 and $999 price points under both the Schwinn and Nautilus brands. With the launch of our treadmill line, we will now have a complete set of cardio products under both the Schwinn and Nautilus brands, which will allow us to better compete in the global cardio fitness market.

On our last call, we discussed that in 2014 we plan to devote more energy on growth in the international market. While starting from a low base, we are pleased to report that international retail sales grew significantly year over year in Q1, and we project that international sales will continue to grow at a strong pace. With our brands that are well recognized in many global markets, we see good opportunity to further increase our international business.

Finally, we would like to add some comment on our operational structure moving forward. Our performance over the past few years is enabling us to make investments in our infrastructure to support growth. To briefly describe some of our investment areas for 2014: In the area of information systems, this Spring we launched a new cloud-based ERP and CRM system. This platform is far better fit for our future plans, and will provide significant improvement in access to data by our key decision makers.

In regards to our distribution and fulfillment network: Our sales growth necessitates that we add a second United States distribution center, which we anticipate opening in the Fall of 2014. This new facility will be located in the midwest, and it will be leased. This expansion will allow us to better serve our customers on the east coast with improved delivery times, as compared to our current Portland, Oregon, center alone. Also, it is important to note that this dual-positioning capability is expected to reduce our outbound freight costs overall.

Having sufficient distribution center capability to support growth will also enable us to make prudent additional investments in finished goods inventory, especially in our high-volume, high-velocity SKUs. Improved safety [sought] positions will better enable us to react to surges in direct channel demand or emergent opportunities in retail.

Finally, our mission as an Organization is to design and market equipment that helps consumers achieve their fitness goals. We have continually increased our investment in product development and innovation over the past two years. Our three-year product road map necessitates the addition of new resources and capabilities.

In order to support our research and development needs, we are investing in consolidation of our rapid prototype and lab facilities into a new building, also leased, adjacent to our corporate headquarters in Vancouver, Washington. Bringing our entire product development team together in one space will drive significant efficiencies in our go-to-market processes.

In summary, we are off to a strong start in 2014, and we are well positioned moving forward. As Bruce said, we remain focused on the key initiatives that have driven our improvement over the past couple of years. The foundation of our Business has improved, including a more diverse product portfolio and better product margins in each segment. Lastly, we will also continue to focus on investing our media strategically to drive revenue while keeping a focus on our bottom line.

And now I would like to turn the call back over to Bruce for his final comments. Bruce?

Bruce Cazenave - *Nautilus Inc - CEO*

Thank you, Bill. Before opening up the call for questions, I would like to make a few final summary comments. The first quarter represents another quarter of meaningful improvement for our Business, and gives us strong momentum to start the year.

While it is easy to look at the quarter's results in isolation, it is important to note that the factors contributing to the improved results this quarter were started, in some cases, as far back as three years ago. The ideation of MAX Trainer started over three years ago, and the consumer research and development of the new retail cardio line started two years ago. Last year, we made the strategic decision to invest in incremental media during our seasonally slowest, and historically most profit-challenged, second quarter, in order to test creative and build leads well before the peak season started. Clearly, these and other decisions we made have provided early-stage investment returns that are very encouraging and provide a basis to build upon.

On the flip side, we also learned from decisions that did not produce an acceptable or desired result, and in those cases, our team exhibited the ability and agility to recognize, adapt quickly, and redirect our efforts as appropriate. Bottom line is: I am very proud of our team for continuing to find and drive improvements in the Business, and the rigor and prioritization applied in the decision-making process. Looking ahead, our plans and strategies support moving into another stage of steady, profitable growth, and we are fortunate that there are a number of robust growth opportunities in sight.

In order to fully optimize the returns on existing investments and/or opportunities we have already created, whether it be MAX Trainer, the additional new cardio line, or international, we still have a number of operational and infrastructure investments to put in place this year. Some of these investments are the ones Bill previously mentioned, like information system enhancements, an R&D innovation center, and an additional US distribution point. All of these have been advancing for a while, and are being implemented starting this year. Most importantly, they are strategic enablers for future growth.

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

QUESTIONS AND ANSWERS

Operator

Thank you, sir.

(Operator Instructions)

Reed Anderson from Northland Securities.

Reed Anderson - *Northland Securities, Inc. - Analyst*

Thank you. Good afternoon, and congratulations on just a terrific quarter. Great start to the year.

Bruce Cazenave - *Nautilus Inc - CEO*

Thank you, Reed.

Reed Anderson - *Northland Securities, Inc. - Analyst*

Thanks. A couple questions.

Bruce, I've got to start with the big one -- obviously, we knew, we all suspected MAX was off to a good start, seeing the delivery times, et cetera, and clearly the numbers bear that out. Where are you in terms of capacity? Because I know that is something that, it's a good problem to have, but where are you in terms of ramping that up? And when does it normalize this year? Is it 2Q? Is it later in the second half? Just get a sense of where we are in that cycle, please?

Bill McMahon - *Nautilus Inc - COO*

Reed, this is Bill, I'll take that.

We believe that our partners who produce the product are at capacity sufficient for our future growth plans at this point, and we are catching up as we speak. There's some time on the water for product. Our promise periods are coming down, and we would anticipate, certainly by the end of this quarter, that we will have normal order today and ship out very shortly thereafter.

Reed Anderson - *Northland Securities, Inc. - Analyst*

Is a normal order cycle, Bill, like if I went and placed an order, that I would have a product within the two to three weeks? Or should it actually be shorter than that?

Bill McMahon - *Nautilus Inc - COO*

It should be shorter than that. That is a combination of two answers for you on that. One is the reason we want a second distribution point, is just to cut down distribution time period from two weeks down to five days, let's say. On the other hand, with MAX, there is a promise period that has been communicated and that has been steadily declining as we have acquired more product and we catch up on the orders.

Certainly, our supplier has more than sufficient capacity to meet our needs. It was a case of the product exceeded our expectations out of the gate.

Reed Anderson - *Northland Securities, Inc. - Analyst*

Well, that's great. That's a good problem to have.

And then, Bill, I guess, as long as I have got you -- in terms of, you talked about making the incremental investments you made late last year and continued on the creative side and on television, et cetera. Does the success you have had -- two part question -- does the success you have had with those -- better conversion rates, et cetera -- does that allow you to be even more efficient going forward? Or does it make you want to invest more? How should we think about that piece of the puzzle in driving continued growth?

Bill McMahon - *Nautilus Inc - COO*

You've hit one of the key factors of Direct on the head. We're definitely interested in continuing the growth profitability in the Direct business year over year, but we are not pulling back and going to completely optimize. We continue to invest in media and expand our media where possible. So we feel like in the long run we have strong creative and certainly credit approval that supports our efforts.

We should be able to get onto additional networks, higher volume networks, and continue to grow the business while still containing the targets Bruce sets for us, which is to grow our profitability at a more robust pace, and even the revenue. So it is always that balance. We are looking for expanded networks that we can reasonably project will perform for us in the long run. But as you saw last year, sometimes those investments are up front in a down period to start to gain traction, and then they pay off later in the year.

Reed Anderson - *Northland Securities, Inc. - Analyst*

Yes. And then, just a couple more, and I'll let somebody else jump in.

First, on the treadmill that you are going to introduce -- the $799/$999 -- just curious, will that be more of a price point differentiator and brand differentiator? Or will there maybe be some unique features? I'm sure there's some (inaudible), but just some quick comment, if you would?

And then lastly, Bruce, really for you, big picture. Given the start you've had to the year, given the success you've had in the last couple of years, are you contemplating maybe bumping up, so your long-term expectations, whether it is sales growth or margins? It feels like we're where we need to be and you have got some headroom from here. Thank you.

Bruce Cazenave - *Nautilus Inc - CEO*

Let me turn it over to Bill for the first part of that, and then I will come back to your latter question.

Bill McMahon - *Nautilus Inc - COO*

On the treadmills, Reed, there are differentiators between the $799 and $999, and then there are also differentiators based on the brands. Schwinn brand and Nautilus brand have different target consumer segments, and the products are designed to meet those segments and those price points and be competitive on the floor with the existing product. And we think, obviously, a little biasedly, that our product is better.

Reed Anderson - *Northland Securities, Inc. - Analyst*

Okay, thanks.

Bruce Cazenave - *Nautilus Inc - CEO*

And we have gotten some favorable feedback on some of the features, going back as early as three or four months ago, from customers. So we are optimistic that we think we've hit the mark again, just like we did on some of the cardio products that we've already introduced.

But to your question in terms of the longer-range operating margin targets -- we actually are going through the process, I would say, over the next three or four months. We have an annual strategic planning process that we are in right now, and we discuss thoroughly with our Board of Directors. And during that process we lay out, here is where we see our growth opportunities, what will it take to realize them, and what does that mean both resource-wise and financially, bottom line, working capital, et cetera.

And I would say that we are -- fair to say preliminarily that, when we have that plan complete and approved by the Board, then we will start to share that in terms of what the new -- newer -- longer-range ideal state metrics would be for our Company. But it is fair to say that it will probably be on some key metrics will be higher, a higher level of performance than what we laid out originally up to now.

Reed Anderson - *Northland Securities, Inc. - Analyst*

Great. I'll leave it at that. Thanks very much, and I'll let somebody else jump in. Best of luck.

Bruce Cazenave - *Nautilus Inc - CEO*

Thank you, Reed.

Operator

Andrew Burns from D.A. Davidson.

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

Thanks, good afternoon.

Just a follow-up on Reed's question in terms of the marketing investment. And I was hoping you might be able to spend a little bit more time in terms of the return parameters you are seeing on the higher visibility networks versus digital media? Where is the bulk of the incremental marketing dollars going to these days? Thanks.

Bill McMahon - *Nautilus Inc - COO*

The bulk of our -- Andrew, this is Bill.

The bulk of our media still is spent on television, but we are increasing spend wherever possible on digital and online and other social media aspects. Important to note, though, that without the general TV efforts to create the overall awareness, we see a fall-off in performance of the other elements.

On an individual ROI basis, your search terms, branded search terms, may deliver a higher ROI than TV alone does. But it is really the collection of our entire media effort that we measure by. And we know that there is impacts if we cut back on some of the more expensive elements that will eventually impact the other elements that are really deriving some of their benefit due to the awareness that television creates.

I know that is a little roundabout, but does that make sense?

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

Sure, it does, thank you.

And just to be clear, in terms of your strategy for this off-season, Q2, Q3, it is to build lead generations, so invest in marketing as you did last year? And also, as the MAX Trainer product is increasingly available, to ramp that as well, regardless of the month?

Bill McMahon - *Nautilus Inc - COO*

Yes, that would be correct in both cases. There is a seasonality to our media spend, as you know, through the year, but we will continue to invest in the products as our metrics display that they can be supported by that spend.

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

Great, thanks. And it looks like some of the new Schwinn product [branded at] some Dick's Sporting Good stores -- can you talk about the opportunity there?

Bill McMahon - *Nautilus Inc - COO*

Indeed, we are conducting some work with one of our partners, Dick's Sporting Goods, with some of the Schwinn bikes that they had not previously carried. And pending outcome of how that goes, there may be additional opportunities that follow on from that. We can't really talk about too much about fall 2014 coming up; we are right in the middle of the selling season right now. And I would prefer not to speak out of school on anything while they are in the middle of their decision process at all of our key accounts.

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

Okay, thanks.

And last question -- during the call, there was a lot of commentary around investing in media and systems and inventory. Just wondering if there is anything you want to call out just from a modeling perspective? Is this a significant change from how we've been thinking about the business in the past? Any areas that you would like to quantify in terms of investment?

Bill McMahon - *Nautilus Inc - COO*

I think we can do that, maybe, when we have some more specific calls there. Certain things, I know for sure we've modeled what some additional inventory -- not just in a second warehouse, but also what could have been done if we had, had more inventory in the first quarter, as an example.

We turned our inventories at about, almost eight in the first quarter, and that was on top of another eight or so in the fourth quarter. And, frankly, particularly given that our product is on the water for three weeks, almost four weeks in some cases, we have less than a month in the barn. And that is not enough to service our customers the way we would like to. So we will be quantifying going forward a little bit more in terms of what we would like to carry that you can put into your models, Andrew.

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

Okay. Thanks, and good luck.

Bruce Cazenave - *Nautilus Inc - CEO*

Thank you.

Operator

(Operator Instructions)

Frank Camma from Sidoti.

Frank Camma - *Sidoti & Company - Analyst*

Good afternoon, guys.

Bruce Cazenave - *Nautilus Inc - CEO*

Good afternoon, Frank.

Frank Camma - *Sidoti & Company - Analyst*

Just a couple quick questions. One, can you comment on the inventory levels at the retailers themselves? And, since you are going into this seasonally slow part of the year?

Bruce Cazenave - *Nautilus Inc - CEO*

Frank, the reports we are in close communications with all of our retailers, and we have visibility to point of sale. And I would say at this point the retailers are very reasonably stocked on inventory.

Frank Camma - *Sidoti & Company - Analyst*

Okay. And as far as the R&D spend, obviously, you've signaled that, that will go up in the future. Is this the sort of trajectory that we should look at? Is this a normalized level of spending, or was there something unusual in the quarter?

Bruce Cazenave - *Nautilus Inc - CEO*

No, I think if you are comparing year over year, first quarter -- obviously, there was a big jump in, because we've been adding resources and capitalizing for new products and so forth -- capital expenditures for new products. We've said before, Frank, that when we are at 2.3% of sales, that is on the low side of where we think we should be. We should be closer to 3.0%, let's just say, as a percentage of sales, and we are not there yet. I don't think even in the quarter we were there.

Frank Camma - *Sidoti & Company - Analyst*

No. Okay, and a final question, just a big picture question -- you've built up quite a bit of cash now, and I was just wondering if you could talk about the priorities of the cash at this point?

Bruce Cazenave - *Nautilus Inc - CEO*

Yes, I think the first thing is, everything we do relative to, not just cash, but financial resources in general as well as human capital, is we try to look through what we call an investor lens in terms of, how can uses of cash, to your question, best return shareholder and create more shareholder value going forward. It is a pretty rigorous process.

I would say that we are looking at all of the options, and we recognize that we are at a state right now in our Company's maturity where optimum capital deployment is even more critical. But it is going to take -- we are going through a rigorous analytics, having discussions with our Board, looking at a number of different options.

And I think what the one thing that we do as a filter in terms of prioritization is, we want to make sure that we are first and foremost, taking care of putting things in place that will enable us to grow the way we think we can grow profitably. That is a warehouse, that is an R&D center, that is inventory that we didn't have, which consumes cash and so forth. First and foremost, we want to make sure we've got those building blocks in place, and then we will look at some of the other possibilities in terms of, again, continuing to improve shareholder value.

Frank Camma - *Sidoti & Company - Analyst*

Okay. Thanks, that's helpful.

Bruce Cazenave - *Nautilus Inc - CEO*

Thank you, Frank.

Operator

Ian Corydon from B. Riley & Company.

Ian Corydon - *B. Riley & Company - Analyst*

Thank you.

Very strong revenue growth against a tough comp in Direct and very strong margins, as well. Is there anything there that was unusual? Or is it reasonable to think that those metrics can continue at that pace?

Bill McMahon - *Nautilus Inc - COO*

In terms of revenue growth, we certainly, as discussed, Ian -- this is Bill, sorry -- saw increased performance in all of our cardio lines, including the introduction of MAX helped with that. The margin gains; we think most of that is reasonably sustainable going forward. We've had some optimization of our cost structure, so there really weren't any one-time events benefiting that.

But as you know, Direct margins have continued to climb a little bit, and we always say, I'm not sure we can go any higher. I would say I'm not sure we can go any higher on those at this point.

Ian Corydon - *B. Riley & Company - Analyst*

Got it.

And in terms of the treadmills you are adding to Retail, are you getting incremental floor space for that? Or is that at all cannibalizing your other products?

Bill McMahon - *Nautilus Inc - COO*

This would not cannibalize our products at all. And it would be our desire to acquire incremental floor space with every placement.

Ian Corydon - *B. Riley & Company - Analyst*

Great. And then, last question is on the international opportunity. Could you just talk a little bit about whether that opportunity is more cardio or strength? And any particular products that you are going to lead with there?

Bill McMahon - *Nautilus Inc - COO*

Certainly. We think it is, like the global market, it is potentially more cardio than strength. But we to find that our SelectTech product has a good global presence around the world, and has the ability to expand, and it has been one of the drivers of our growth. But having that line of products that, first, the model year 2013 Schwinn, and now the model year 2014 Nautilus that is internationally compliant should open doors for us. And some of those markets are crowded, but our brands are known, and we believe that we should be able to expand in cardio, which is a larger market than strength, globally.

Bruce Cazenave - *Nautilus Inc - CEO*

Ian, let me come back to it, as well, if you do not mind, on the treadmill question.

I think it is important to emphasize that we are going into this very selectively. I think, as Bill mentioned, we are entering the marketplace with a couple of price points, and that is compared to the hundreds of SKUs that are out there. And competing in the treadmill world, we are just going to be, very selectively, I would say, in terms of distribution as well as price points in terms of how we go into that market.

We are not going into it with a shotgun approach. It is very much a selective strategic entry that we are making. It is another way of saying, don't add another whatever big millions of dollars, okay. You got it?

Ian Corydon - *B. Riley & Company - Analyst*

Understood. Thank you.

Bruce Cazenave - *Nautilus Inc - CEO*

Thanks, Ian.

Operator

Steven Martin from Slater.

Steven Martin - *Slater Asset Management - Analyst*

Hello, there.

I would like to approach the operating expense lines in a different way. G&A is up year-over-year from $4.9 million to about $5.8 million. If you had to guess as to the run rate going forward, what would that be?

Sid Nayar - *Nautilus Inc - CFO*

This is Sid, I will respond to that.

Our G&A spending, we did have some timing issues in the first quarter. We had certain legal fees for IP and patent work that spilled into the first quarter that really would have been spread out more evenly through the year. And compared to the prior year we had, there was a reversal of a claim from last year that was settled, which also heightened the gap between the first quarter of last year versus this year.

Again, in terms of the other factors -- that we are accruing some incentive reserves based on performance versus a straight line method that we adopted last year. So we are trying to better match the expense to the period driving the performance. So I think those factors would suggest the first quarter was skewed a little heavier than we see the future quarters.

Steven Martin - *Slater Asset Management - Analyst*

Okay. Same question on the R&D line?

Bruce Cazenave - *Nautilus Inc - CEO*

As I said, R&D, Steven -- it's a big increase year over year for the first quarter, but we've been stepping it up all along. And I think that if you want -- for modeling purposes, we've talked openly about the fact that we are still not where we want to be on an R&D spend basis as a percentage of sales. But as we get closer to 3% of sales, then that is closer to where we think we want to be. And for the reason being, we know what our pipeline looks like for the next three years and that is what we basically have to spend in order to deliver and bring those products in.

Steven Martin - *Slater Asset Management - Analyst*

Right, but your R&D isn't going to vary by quarter, so --

Bruce Cazenave - *Nautilus Inc - CEO*

No, it is not.

Steven Martin - *Slater Asset Management - Analyst*

Right. So when we model it, it's got to be based on some form of annual sales. To follow your 3% lead, we'd have to be looking at a sales projection for the year, because I assume that is what you are doing -- you are looking at your 2014 sales number and saying, we have got to get to 3%.

Bruce Cazenave - *Nautilus Inc - CEO*

Actually, we're building it up more like looking at the next three years; not just this year's revenue. You can take, if you want to, you take whatever your revenue forecast is for the year and apply the high 2%s, or even 3%, and then back that in every quarter, and you would be pretty close because it is building. But once it gets closer to 3% then it is going to slow down, if not stabilize.

Steven Martin - *Slater Asset Management - Analyst*

Okay.

Bruce Cazenave - *Nautilus Inc - CEO*

We can talk more offline if you would like, Steven, on this.

Steven Martin - *Slater Asset Management - Analyst*

Okay, I think I have got that.

Given -- you have a better sense of what the deliveries of the products could have been if you had them in house. Can you give us a better sense of guidance for growth rates going forward as you catch up on your supply chain?

Bruce Cazenave - *Nautilus Inc - CEO*

I think for right now, what we have said is that our ambition is to grow our business -- we're talking revenue now -- in the high single digits, low double digits; and obviously, we are starting the first quarter off very strong. There is still three quarters yet to go, and a big fourth quarter that we are comping from last year.

Right now we are just sticking to that, but that is kind of at a level, say, the low double-digit level of growth coming from both our Retail and the Direct businesses. And then, as we get into later in the year, we might be able to share with you more as a three- or five-year horizon what we can expect on an annual growth rate basis from a revenue standpoint.

Steven Martin - *Slater Asset Management - Analyst*

Let me ask you another question. Knowing full well that you didn't have a sufficient inventory in the pipeline, but you did say you grew your media spend, should we presume you would have spent more if you had more inventory?

Bill McMahon - *Nautilus Inc - COO*

Yes, in retrospect we would have spent more in the MAX Trainer category if we had predicted correctly the response we would have saw out of the gate.

Bruce Cazenave - *Nautilus Inc - CEO*

Yes.

Steven Martin - *Slater Asset Management - Analyst*

All right, thank you.

Bruce Cazenave - *Nautilus Inc - CEO*

Thank you, Steven.

Operator

Those were all the questions on the phone lines at this time. I'd like to turn the call back to you.

Bruce Cazenave - *Nautilus Inc - CEO*

Very good. Thanks again for everyone's participation and interest in our call today. As an FYI, we do plan to attend a couple of investor events over the next few months. We hope to see you at one of these events, and in either way, look forward to speaking to you next on our second quarter 2014 conference call in August. Hope everyone has a great day. Thank you.

Operator

Ladies and gentlemen, that does conclude the conference call for today. We thank you all for your participation and ask you to disconnect your lines. Have a nice day, everybody.
