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PRESENTATION

Sean Naughton *- Piper Jaffray & Co. - Analyst*

Okay, great. Thank you for joining us. We are fortunate enough to have with us here Nautilus. My name is Sean Naughton, senior research analyst with Piper Jaffray. And today, we have with us CEO Bruce Cazenave as well as CFO Sid Nayar.

So maybe just start us off, Bruce -- first of all, thanks for coming. And then maybe just in order to level set everybody in the room who may not be as familiar -- I'm sure most people have heard of the brand before; most people know the name. But maybe you can just give us a quick background on where you've been, where you are now, and how you see the Company evolving moving forward.

Bruce Cazenave *- Nautilus, Inc. - CEO and Director*

Okay, great. Thanks, Sean. Good afternoon, everyone. I think it's been -- most people think of Bowflex as our primary brand as the rod gyms kind of thing, where everybody was trying to be buff and all this kind of stuff. And you run commercials at 2 AM in the morning for about 28 or 30 minutes. We are very different Company than that today.

We are essentially a company that is focused on products for home use only. So even though you might see our products and brands -- excuse me, our brands in the commercial space, meaning the gyms, we are licensing our brand, like Nautilus or Schwinn, into those space, like spinner bikes and things like that. So we focus on products for home use.

The big thing about our Company is we have a strong portfolio of brands today: Nautilus, Bowflex is by far the number one brand in the fitness equipment category as well as we have Universal and Schwinn. One of our business models is over the last four years in particular has been to grow and to grow profitably. That's very different than maybe what the Company might've been doing in the 2000s, where there was a lot of revenue growth, but not necessarily the coincidental profit growth.

So over the last four years, we have grown revenues approximately twice what they were four, five years ago. We are approximating -- the analysts have us approximating about $330 million this year in revenue. And our operating margins have improved from basically negative, or 1% in 2011, to over 11% last year. And we anticipate to do a little bit better than that again, based on the analysts' estimates this year. So very much profitable growth is what we're about.

We also have a very strong balance sheet. At this point in time, at the end of Q1, we ended the quarter with $82 million in cash and we have no debt. So we are looking at opportunities to take what we call our plus growth drivers in order to put the Company into a growth path that's even higher gear than we are today. And we are doing that through a number of different ways that Sid can talk to you about.

Our business model of what we are today is very unique. We have three legs to the stool. One is -- and our largest is our direct-to-consumer business, so that's products that are products are only accessible from us.

So you might see a TV commercial or you might see an ad on your computer or iPad or even on your phone. And then you place an order with us. We ship it directly to your home. That is the way we operate in North America. That is the largest portion of our business.

We also have a very vibrant retail business, and those would be products that we sell to people like Amazon, Walmart, Dick's, Sports Authority. Basically every place you can find fitness equipment, we are there. And that's primarily with the Schwinn brand that we use, although more recently, we've been reintroducing the Nautilus brand into that space.

The third leg is what we call our royalty or licensing business. It is the smallest of the three, but probably the highest margin. It's about 100% margin. So we like that, and it is taking our brands that I mentioned earlier, Nautilus and Schwinn, into the commercial space via licensing. But also we have a strong portfolio of intellectual property patents that we license to other people, including some of our competitors, and we collect a royalty for them using those patents.

So that's our business model. The other thing that's very unique -- and then I'll turn it over to you -- is our working capital model is pretty sweet. We have put a lot of effort into inventory turns we turn our inventories north of 6 times turn, which is pretty significant considering most -- all of our product comes from Asia. All of our factories are sourced. We don't have our own factories; they are all partners overseas, strong partners that we have.

We have extended payables and we have a pretty sharp receivable turns. And when we ship a product in our direct-to-consumer, whether it be a credit card they are paying with or with refinancing, we are basically collecting the cash as soon as we ship it or within 24 hours of shipping. On the retail side, we have the normal retail type of turns, which is still pretty reasonable.

So you'll see a very -- in terms of working capital as a percentage of revenue, it is probably one of the lowest in, if not the industry, but in the entire lifestyle type brands altogether.

So that is a little bit about where we are. I can shift into where we are headed.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

That would be great.

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

Is that okay?

Sean Naughton - *Piper Jaffray & Co. - Analyst*

Yes, absolutely.

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

One of the key things for us is continuing to do what we've been doing all along, for particularly the last four years. We have three key focus areas. One is product innovation and keeping that pipeline very vibrant. We are always looking out at least three years in advance in terms of what are the products that we want to introduce and what's the value proposition going to be to the consumer.

So that's a very steady kind of invest that we have. We have tripled our investment in R&D, mostly in the form of mechanical and electrical engineers, as well as what we call a consumer insights function, which I think is something different than many of our competitors -- or that our competitors don't do. So that has helped differentiate us from an innovation standpoint.

The second thing is margin discipline. So we are very, very strict about when a new product is coming through the pipeline that it will be accretive to its fleet average in that category. So as you introduce more and more new products over time, whether it be bikes or ellipticals or weights, etc., and you keep raising the individual margins, then basically the whole fleet raises. And that's what you have seen over the last 5 years or so, where we've increased our margins 700 basis points, I believe, over that time frame.

The third is to leverage our operating infrastructure. And you'll see our OpEx -- 5, few years ago, it was in the low 50%s. Today we're running at about 40%, most of which is spent in media and marketing in our sales and marketing line.

And we intend to continue to leverage our operating expense, whether it be G&A, whether it be product development -- although we're still continuing to invest in product development -- and then also our sales and marketing expense. So we intend to continue that. It has been a successful formula for us, Sean. And we want to continue that path going forward.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

When you think about the industry just overall, there's obviously always a lot of turnover in the gym memberships. I know you are competing in obviously a different market. But how do you see with the proliferation of some of the lower cost clubs that are out there in the marketplace -- is that bringing more people into the fold or how does that impact your business? If at all?

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

Yes, it does impact us, maybe not so much as if we were in the commercial business, okay? But things like Crossfit or the yoga gyms, Pilates, etc., all those things come in and out, even the $10 month type of gyms.

What we feel is that we still feel that there's a strong tailwinds for fitness overall with everything that's going on with the iWatch coming out and Google having its platform for HealthKit, etc., as well as just people understanding that obesity is tremendous issue, not just in North America, but around the world. Healthcare costs are important to contain, and people are taking more accountability for that themselves. And that we feel feeds overriding pyschographic trends that are going to be positive for our industry overall.

So we do not mind these little things that come in and out so much anymore. We are not going to turn the ship right or a hard left. Basically we think that there is a long runway, we still are very small in the industry of fitness equipment, so we got a long way to go just within those guardrails.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

And I guess you mentioned Google, the iWatch, Fitbit, etc., all these things that are going on out there in the connected fitness world. And everybody is looking to measure things. How are you guys integrating into that ecosystem? Is that a -- it feels like it could be a nice growth driver for you over time. But how are you integrating that into the products and services that you're selling?

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

Yes. That's a great question. And maybe we do something a little different than our competitors might do. We have been working hard on what we call from the neck up of all of our products, meaning the consoles, the connectivity, the tracking, and so forth.

But we haven't built it necessarily into the equipment itself. We build the capabilities that tie in (technical difficulty) these other things. Like one of our partners is MyFitnessPal, that we are exclusive with them, and they were recently acquired by Under Armour. And they have like 40 million people that are subscribers, okay? So you can take any one of our cardio products and basically download your activity to MyFitnessPal.

Same thing with Apple's platform or Google's. We are one of the few people, I think, that can actually do that. So the difference is where other people might build all that intelligence into the product itself, our view is we'll build the capability to interface with those other platforms. That way, we have the flexibility for other platforms that are out there to be developed.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

Okay. And then I guess if you think about the core consumer today across your portfolio and recognizing you have a number of different products that you selling, who is the core demographic you really feel like you're going after, or who is your customer?

And then I guess as a follow-up to that question is who is the -- what is the repeat purchase rate for somebody to buy a new product? I just think about somebody just buy one of these and then lets it sit there and then doesn't do anything with it. Or are these people that you are engaging with now because the product is changing and there is more things for them to do? How do you drive that repeat purchase?

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

It's a very good question. The way we classify ourselves and the beauty of having the portfolio of brands we have is that we can cater all the way to the beginning -- somebody that is just starting their fitness journey. Just getting off the couch, want to lose weight, or their doctor says you have got to lose weight or you're -- and so forth.

So that person all the way to the serious fitness nut, we have a product for you for home use. Okay? So we look at anybody in that. That could be young age, 18 years, 20 years -- although those probably don't have the discretionary income yet to afford some of our direct-to-consumer products, where you might have more like $70,000 to $75,000 worth of average median household income. But all the way to the fitness nut person who is very serious about fitness. And they will buy more likely our Nautilus and some of our Bowflex items.

So contrary to other companies, particularly in the sneaker world, who might go after the aspirational person, in terms of they want to dunk a basketball like Lebron James or something like that -- maybe very topical for those of you that are following that these days. We are not into that. We're kind of like wherever you are in your fitness and wellness and health journey, we have the product for you.

So we have people that have been basically a weight loss that has transformed their lives. And we put those people on our commercials. We do not pay them; they volunteer to be on our commercials and offer up their success stories. And that brings the authenticity to the product that people say, okay, this is what this product is all about and quality of the brand that is behind it.

So that is one of the big things. The second part of your question was --?

Sean Naughton - *Piper Jaffray & Co. - Analyst*

I was just saying, how do you drive a repeat purchase --

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

Oh, the repeat purchase, yes.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

-- or an incremental purchase from somebody? How do you drive a repeat customer?

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

Well, the nice thing about the business, too, is the technology and capabilities of the products are changing so much that people will come in, come back. So sometimes, you'll be with something for maybe five years and something new comes out, whether it be connectivity or design or our new Bowflex Max Trainer, which is a whole new unique modality. Somebody might've said, I have an elliptical that's five years old. This is a whole lot better machine. So they will come back in the marketplace.

So there's that kind of -- innovation will create the faster turn between what normally would have happened. But we have a strong -- on our direct-to-consumer business a strong conversion stream. We have a database of about 13 million names of people that have bought our products or required about our products, and we keep marketing to those folks over time. And it works pretty well.

Sid Nayar - *Nautilus, Inc. - CFO*

I think it is fair to say that the Max Trainer in particular had a very, very strong sense of brand. We have folks came who had prior Bowflex type products were the early adopters for the Max Trainer. Probably resonates with the success of the product.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

Yes. And then cardio seems like it's doing very well. Strength seems to be down a little bit. Just wondering is that the natural ebb and flow of product cycle? Or is there something more secular along those themes, where we're seeing people just more focused on the cardio product? Just curious how that -- why that number is down the way that it is.

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

Yes. You have to peel it back a little bit because actually as an industry, the cardio represents the bulk of the dollars. We're talking treadmills, bikes, ellipticals; those are the biggest categories in fitness overall. But in terms of participation, you still have a lot in strength, almost equal to as cardio. Just the dollars are not there.

For us, internally, we are not walking away from strength. We are still very active in strength. In fact, we have a new -- the first ever smart dumbbells coming out later this year that we have talked about. We call them the SelectTech 560s. And we have pipeline of strength products that are continuing over the next three years. So it's still a very much vibrant part of the business, so it should not be taken lightly.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

Okay. So not shying away from that. Are there questions in the audience? Yes, go ahead, please.

Unidentified Audience Member

What are the average transaction plans again? I think it's at like 250, 500, or 1,000. And I guess you asked also as well like what is the frequency of repeat purchases among customers? And if it's low, how do you reconcile a high transaction value and a low frequency of repurchase with having to identify a growing number of new customers every year? Adding all those people together.

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

Right. Well, the average -- it's very different in our direct business than it is in our retail business. The direct -- as an example, the TreadClimber is a very popular item of ours that is unique to us, and the average ticket on that is about $2,200. And it will go up to $3,200 and as low as $1,000. Max Trainer is $1,000 and $1,500. So those are kind of the price points you are talking about.

On the retail side, a lot of the bread and butter products in bikes are sub-$600, $700 at retail. Okay? And you go into ellipticals, you're into the $799, $1,000. Treadmills are about the same price point and so forth. So typically lower than what you'd have in our direct-to-consumer business.

As far as finding new customers and so forth, it happens both ways. One is if you bring innovation to the marketplace, then you will bring people back that are already into the business. To be honest with you, they end up wanting a variety. That's a big thing where there is a lot of variety seeking in terms of -- that is why things like CrossFit or you hear Orangetheory, people are looking for different things where they can basically get their exercise regime. Same thing with nutrition; nutritional things are coming out.

So what we do is we market to those people with the new innovations that we are coming about. And that basically they come in that way. So by keeping that alive and keeping the messages out there in terms of what our products can do for you, that's how we end up generating more frequency.

Unidentified Audience Member

What is the frequency of repurchase? Is it every one, three, five years? Every two years? (inaudible)

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

It would be -- I would say that is probably closer to five years or longer. But it is not unusual for somebody to potentially want the latest best thing because of connectivity and particularly that's changed so rapidly in the last five years or within the last five years that they will come back in the marketplace. You have to figure out how to get your old machine out, which is sometimes the biggest obstacle. And sometimes, we help you with that. We can come in and take your old machine out if you want. For a price (laughter).

Sean Naughton - *Piper Jaffray & Co. - Analyst*

So top line, it's been really pretty strong last few years. How do we -- what are the drivers to build on that? It sounds like Max Trainer has got great momentum. That is still going to be a good driver in the back half of 2015.

But if we think out to 2016 and 2017, how do you see the pipeline? You talked a little bit about some strength things that you're doing. But how is the overall pipeline shaping up, and what do you think about for your longer-term growth trajectory?

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

Okay. In the back half of this year, we have a new Airdyne bike that's coming in that's actually targeted towards the Cross gyms. It is going to sell for $1,000 at retail. Really, really neat product we are excited about. We have the new smart dumbbells that will be sold in both direct and select retail, initially, in the fourth quarter.

And then we are refreshing the TreadClimber, which is one of our bread-and-butter items unique to us. And a whole new look, particularly in the console area, of the TreadClimber will be coming out in the fourth quarter of this year. So that just takes us between now and then.

We just recently last fall introduced the whole Nautilus cardio line internationally, and we were in a show earlier this year just basically presenting it to distributors and customers overseas. So that is also going to carry us a little ways into that.

But going out beyond that, we normally don't disclose what we have for 2016, 2017, and 2018 and so forth. But believe me: the products are in the works.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

Okay. That's great.

Sid Nayar - *Nautilus, Inc. - CFO*

The other thing I would add is from a diversification standpoint, it's also channel diversification. When you look out the next couple of years, international is a big growth area for us. A couple of retail channels, whether it's the vertical markets or the specialty retail channel, where we don't have much of a presence today, we are going to be expanding to them.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

Yes, it's an interesting question, because I know that some of the specialty retailers that carry the product, they've -- it was a couple years ago they thought about deemphasizing some of the products. Maybe they went a little bit too far. Now they're thinking about reintroducing some of them again. I mean, where we in that cycle in just the North America retail business at this point in time?

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

It has stabilized, I would say. From what you read, at least from the public companies, in terms of the space they are allocating to fitness equipment. I think they have finally dialed it in the way they want.

Honestly, we were delighted to see that there was that kind of disruption in terms of them trying to find what the right space was and what the right products, what the right brands were to carry, because we are such small shareholders. When somebody goes from 15 treadmills on the floor to 8 and we don't have treadmills, then it doesn't hurt us, you know what I mean? But when our product -- starting with the fall of 2013, when we introduced a whole new cardio line of ellipticals and bikes to start with and then treadmills last fall, we are now picking up a lot of shares.

So even though the space might be a little bit stabilized and smaller, the dot-com side of retail is still growing very actively, those dot-com arms. And so that's basically, we're feeding it into wherever it needs to go.

The nice thing -- again, I keep reiterating this -- is that we're so small in the grand scheme of things compared to our brands that we don't feel those kind of headwinds the way that larger players might.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

And then I think I read that Amazon is close to 11% of your business. And I think overall, that's correct, with close to a third of the retail business. So it's a big component of it. I guess I'm just surprised because you guys do have a relatively large direct arm.

Are you selling that? Is it a differentiated product that you can get on Amazon, or is it just like that's just such a big feeder where people are going in community looking for those reviews to understand products better? Is that really was driving it, or is it a differentiated product from your direct channel versus the retail side of things?

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

It is different than a direct product, but it is basically everything you could sort of see at retail, maybe with some slight differentiation depending on what bricks-and-mortar account you're talking about. But generally, the same product would be available on a dot-com world. Okay?

And you hit on something that's key is the ratings is so important, because with a smaller footprint, you can't see everything that's available. But you can look it up on Amazon and see what the ratings are and then buy. And that's the one thing where we end up really over the top is with our ratings, our consumer ratings on quality, and the fact that they do -- the product does what it's supposed to do is very strong. So we win out typically in that kind of a matchup.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

And you mentioned the royalty rate earlier, and I think it was relatively stable year over year, pretty flat. Again, pretty nice margin business, so it is not really a big problem. But -- and I might've missed this earlier -- are there ways to grow that royalty stream to increase that as a percentage of the mix or even just grow it from a dollar basis moving forward? Or is it relatively a steady-state type of segment?

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

Actually, the licensing is -- last few years, it has been about $5 million worth of income. And actually, this year, we are anticipating it's going to be a little bit lower than that and maybe even into next year, because some of our partners are transitioning. We're moving partners, so it will be a little bit before it picks up again.

But licensing in general, we found -- we went through a major exercise in 2013 and we found that our brands, particularly Bowflex and Nautilus, could extend into a whole bunch of stuff. Everything from furniture to things we never even thought of. Positively transfer into.

But we said that's not where we want to be. We want to maintain the integrity of the brand so we got to stay close to the home. So we ended up -- it became the genesis of our introduction into nutrition, because that's how it first came about through licensing the idea and how powerful Bowflex can be in nutrition.

So we launched a whole nutrition line that's proprietary formulas that we have only last Thanksgiving. And it is not enough to move the needle yet in terms of revenue. But it is building and we are basically testing the best marketing approach to have that be a bigger part of our business going forward.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

Are there questions out there? Yes?

Unidentified Audience Member

Have any of the [telecoms license had], particularly as it relates to the revenue stream that comes with streaming video into the home. What's your view on that?

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

I think it's definitely something that is of interest to people because they are looking for personal training without having to go to a gym to get that personal training kind of thing and coaching. So there are things that potentially are available. You can get certain things on their console today from us. And our new smart dumbbells that we're introducing I mentioned will have a training aspect to it.

So it is becoming more and more of a factor that we're looking into. We are not in that in terms of regular streaming today, but it could be a bigger factor of our business going forward. Good question.

Unidentified Audience Member

(inaudible - microphone inaccessible)

Sid Nayar - *Nautilus, Inc. - CFO*

Sure. I'll talk to that. We have sort of laid out the priorities. Again, I think one of the first layer is really going after or trying to jumpstart some of our organic initiatives, whether that's adding to our distribution, adding to our product tooling in terms of our new product development.

The second priority is acquisition-related, but again, it is going to be very selective. It has to be around key drivers that are going to accelerate some of the plus growth drivers Bruce was talking to earlier. If it allows us to expand in the retail channel or the international channel faster than we could do it ourselves by building a platform there, we certainly would look at an acquisition option.

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

And then we have the -- the third option would be returning capital to shareholders.

Sid Nayar - *Nautilus, Inc. - CFO*

Yes, which would be -- after exhausting the first two, would be looking at either a share buyback or a dividend program.

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

I think we might be out of time.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

Yes. Maybe just one thing on the cash as well, just for those that may not be familiar. What are the capital requirements on the business today, just from growth versus maintenance? What are we looking at?

Sid Nayar - *Nautilus, Inc. - CFO*

Again, on a year-in, year-out basis from a CapEx perspective, we have targeted $5 million to $7 million annually. That should allow us to continue our product introduction cycle. From a distribution, from an inventory standpoint, we have said we need to grow inventories a little bit to support the level of business that we have today. So those would be the organic things we're looking at doing from a capital perspective.

Sean Naughton - *Piper Jaffray & Co. - Analyst*

That is helpful. I think you're right; we are out of time. So thank you so much for coming.

Bruce Cazenave - *Nautilus, Inc. - CEO and Director*

Thank you, Sean.

Sid Nayar - *Nautilus, Inc. - CFO*

Thank you.
