

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

NLS - Q4 2015 Nautilus Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 22, 2016 / 9:30PM GMT



CORPORATE PARTICIPANTS

John Mills *ICR - IR*

Bruce Cazenave *Nautilus, Inc. - CEO*

Sid Nayar *Nautilus, Inc. - CFO*

Bill McMahon *Nautilus, Inc. - COO*

CONFERENCE CALL PARTICIPANTS

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

Frank Camma *Sidoti & Company - Analyst*

Rommel Dionisio *Wunderlich Securities, Inc. - Analyst*

Lee Giordano *Sterne, Agee & Leach - Analyst*

PRESENTATION

Operator

Welcome to the Nautilus Q4 FY15 earnings call.

(Operator Instructions)

As a reminder, this conference is being recorded Monday, February 22, 2016. I would now like to turn the conference over to John Mills of ICR. Please go ahead.

John Mills - ICR - IR

Thank you, Scott. Good afternoon, everyone. Welcome to Nautilus' fourth-quarter and full-year 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 website at www.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 meaning of the securities laws. These statements include statements concerning the Company's current or future financial and operating trends, anticipated gross margin improvements, future operating results, anticipated new product introductions, available supply of certain products, planned and anticipated results of new product and general development initiatives, estimated earnings accretion and other anticipated benefits and costs of the acquisition of Octane Fitness. 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 report filed with the SEC as well as the Safe Harbor statement in today's press release.

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

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



Bruce Cazenave - *Nautilus, Inc. - CEO*

Thank you, John. Good afternoon, everyone, and thank you for joining our call today.

I'd like to start by providing a general overview of our fourth-quarter and the full-year 2015 results, and then we will turn it over to Sid Nayar to review our financial results in more detail. Bill McMahon will then provide details on each business segment as well as updates on product activity. I will then close with some summary remarks before we open up the call for questions.

We are very pleased with our strong finish to FY15. The improved operating performance highlights ongoing execution of key initiatives across many aspects of our business including continued success driving top-line growth through product innovation and increased market penetration.

For the fourth quarter, sales increased 15% to \$109 million, reflecting another quarter of double-digit growth for both the retail and direct segments. It is worth noting that we face challenging year-over-year comparisons in Q4, particularly for our direct business, which makes this strong growth especially satisfying.

For the full year, net sales of \$336 million represents an increase of 22% over the prior year. Direct sales in the fourth quarter increased 16% to \$67 million. Our sales benefited from the continued build and demand of the Bowflex Max Trainer as well as encouraging early sales and consumer interest for the refreshed TreadClimber product line, which was launched in November 2015.

Gross margins in the direct business increased by 170 basis points over the prior year when adjusted for certain unusual items that we discussed on our preliminary results call earlier this month -- or last month and which Sid will review later in his remarks. Regarding our retail business, fourth-quarter sales increased 21% over last year to \$42 million. This sales growth reflects continued retailer and consumer acceptance of our lineup of cardio products along with growth in the SelectTech dumbbells.

In addition, we are also pleased to report retail gross margin improvement of 240 basis points, reflecting favorable product and channel mix including growth in international along with supply chain efficiencies. Improving retail gross margin is an important goal, and we believe that we are now better positioned for modest but steady margin improvement in coming quarters. Bill will touch on this more during his remarks.

Briefly looking at our bottom-line operating performance for the full year of 2015, we were able to achieve an increase in GAAP operating income of 34% or 56% after adjustment to exclude the unusual items Sid will outline. Earnings per share growth of 33% on a GAAP basis and 45% on an adjusted basis are strong when compared to almost any benchmark metrics within, as well as outside of our industry.

Before I turn the call over to Sid, I would like to touch briefly on our acquisition of the Octane Fitness which we completed on December 31 of 2015. Octane Fitness is a leading fitness brand based in Brooklyn Park, Minnesota, and has a strong history of innovation in low-impact cardio products built for the specialty fitness and commercial markets.

This acquisition is a significant milestone for Nautilus. We evaluated many acquisition candidates over the course of more than a year and are extremely excited about the strong synergistic and cultural fit that we have with Octane. In the full year of 2015, Octane generated revenue of approximately \$65 million, and the acquisition is expected to be accretive to our earnings in 2016.

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

Sid Nayar - *Nautilus, Inc. - CFO*

Thank you, Bruce.

Net sales for the fourth quarter of 2015 totaled \$109.1 million, an increase of 15% as compared to the same period in the prior year. Net sales for the year ended December 31, 2015 totaled \$335.8 million versus \$274.4 million for the same prior period, an increase of 22.3%.

As we had highlighted on our preliminary earnings call, during the fourth quarter of 2015, we experienced several unusual items that we believe obscured the underlying business performance. I will be speaking to several non-GAAP measures which exclude these items that impacted both gross margins and operating expenses.

These items include the following: transaction expenses related to the acquisition of Octane Fitness, the settlement of a previously disclosed arbitration proceeding, the write-off of inventory related to the nutrition business, unrecorded royalty revenue related to a licensing dispute, the reserve for a potentially uncollectible accounts receivable balance with a large sporting goods retailer, and the release of a valuation allowance related to foreign tax credit.

I will refer to any financial measures excluding these unusual items as adjusted in the following commentary. For a detailed reconciliation of these items to their GAAP measures, please refer to our press release that was issued earlier today.

Fourth-quarter gross margins decreased 410 basis points in the direct segment to 60.5% and were up 240 basis points in the retail segment to 27.6% when compared to the same quarter last year. Adjusted to exclude unusual items, direct gross margins improved 170 basis points to 66.3% in the fourth quarter.

On an overall basis, total Company gross margins for the fourth quarter 2015 declined 300 basis points to 48.1% versus the same period prior year. Adjusted total Company gross margins in the fourth quarter improved 120 basis points to 52.3%, reflecting margin improvements in both channels. Year-to-date 2015 gross margins of 51.6% are 40 basis points better than 2014 year-to-date gross margins and on an adjusted basis are 180 basis points higher.

Total operating expenses for the fourth quarter of 2015 as a percentage of net sales increased to 36.8% from 35.8% in the same period last year, reflecting higher spending in sales and marketing and in product development, partially offset by improved leverage of general and administrative expenses across the higher revenue base. Operating expenses for the year ended December 31, 2015 as a percentage of sales improved to 39.6% as compared to 40.2% for the same prior period. On an adjusted basis, operating expenses as a percent of sales for the year ended December 31, 2015 would have been 39.2%.

It is important to remember that we measure our improvement in operating expenses as a percent of revenue on an annual basis. Our quarterly expenses will fluctuate from quarter to quarter depending on many factors including investment in media, longer-term marketing initiatives and new product development spend.

Sales and marketing expenses for the fourth quarter of 2015 were \$31.4 million or 28.8% of net sales as compared to \$26.5 million or 27.9% of net sales in the same period last year, primarily reflecting higher media spending as well as the reserve from bad debt I previously mentioned. For the year ended December 31, 2015, sales and marketing expenses totaled \$101.6 million or 30.3% of net sales compared to \$81.1 million or 29.5% of net sales for the same period in the prior year, with higher media spending being the main driver along with expenses related to third party consumer financing. On an adjusted basis, sales and marketing expenses were \$30.5 million or 28% of net sales for the fourth quarter of 2015 and \$107 million or 30% of net sales for the full year of 2015.

General and administrative expenses were \$6.1 million or 5.6% of net sales for the fourth quarter of 2015, which compares to \$5.6 million or 5.9% of net sales in the same period last year. The increased dollar spending in G&A was primarily due to acquisition-related costs. The improvement of G&A as a percentage of net sales highlights favorable operating efficiencies and our ability to continue leveraging the existing operating base as the business expands.

General and administrative expenses for the year 2015 as a percentage of net sales totaled 6.4% as compared to 8.1% for the same prior period. On an adjusted basis, general and administrative expenses would have totaled 6.2% of net sales for the year ended December 31, 2015.

Research and development costs in the fourth quarter of 2015 were \$2.6 million or 2.4% of net sales compared to \$1.9 million or 2% of net sales in the same period last year. The dollar increase was driven by additional resources to continue to supplement our new product development capability

that is required to innovate and broaden our product portfolio. Research and development costs for the year 2015 as a percentage of sales totaled 2.9% as compared to 2.6% for the same prior period.

Operating income for the fourth quarter of 2015 decreased 14.8% to \$12.3 million as compared to operating income of \$14.5 million in the same quarter of last year. On an adjusted basis, operating income increased 32.2% to \$19.2 million. The increase reflects higher net sales and adjusted gross margins in both segments, combined with improved operating leverage of general and administrative expenses.

Adjusted operating margin for the fourth quarter of 2015 increased to 17.6% compared to 15.3% for the same period last year. For the full year 2015, operating income totaled \$40.3 million or 12% of net sales, up 33.6% compared to the prior year.

On an adjusted basis, operating income for the full year 2015 totaled \$47 million or 14% of net sales. Income from continuing operations for the fourth quarter of 2015 was \$9.9 million or \$0.32 per diluted share as compared to \$10.5 million or \$0.33 per diluted share for the same period last year.

On an adjusted basis, diluted earnings per share was \$0.39 in the fourth quarter of 2015. The effective tax rate for the fourth quarter of 2015 was 20.3% compared to 28.3% for the same period last year.

Income from continuing operations for the year of 2015 totaled \$26.8 million or \$0.85 per diluted share as compared to \$20.4 million or \$0.64 per diluted share for the year of 2014. Excluding the unusual items, diluted earnings per share was \$0.93 in 2015, up 45% versus the prior year.

Turning now to our segment results, net sales in the direct business totaled \$67 million for the fourth quarter of 2015, a 15.5% 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 Max Trainer product line.

Gross margin for the direct business including the unusual items declined to 60.5% for the fourth quarter of 2015 compared to 64.6% for the same quarter of last year. On an adjusted basis, direct gross margins increased 170 basis points to 66.3%. The channel benefited from improved product mix, leverage of supply chain efficiencies and lower reserve requirements.

Operating income for the fourth quarter of 2015 in our direct business was \$9.9 million compared to \$11 million in the same quarter prior year. Adjusted operating income for the direct channel was \$13.8 million, an increase of 25.4% versus the prior year.

Net sales in our retail segment for the fourth quarter of 2015 were \$41.8 million, an increase of 20.7% compared to \$34.6 million in the fourth quarter of last year. The improvement was from continued retailer and consumer acceptance of our lineup of cardio products along with growth in SelectTech dumbbells.

Gross margins for the retail business improved by 240 basis points to 27.6% in the fourth quarter of 2015 as compared to 25.2% for the prior period, driven by favorable channel and product mix and leveraging our supply chain efficiencies. In the fourth quarter of 2015, operating income for the retail business totaled \$7 million as compared to \$5.7 million in the same period of last year. This included a \$0.9 million reserve of bad debt for the quarter.

Excluding the bad debt reserve, adjusted operating income increased 36.7% to \$7.9 million. The increase in adjusted retail operating income reflects higher revenues and gross margins.

Now turning to the consolidated balance sheet that includes the December 31, 2015 Octane balance sheet numbers. Cash totaled \$60.8 million as of December 31, 2015, with \$80 million of term debt. This compares to \$72.2 million in cash and no debt at December 31, 2014.

Working capital totaled \$69.4 million as of year-end 2015 compared to \$83.1 million at the end of 2014. The decreases in cash and working capital and the increase in debt as of 2015 year end compared to 2014 is due to the acquisition of on Octane Fitness on December 31, 2015.



Inventories were \$42.7 million as of December 31, 2015 compared to \$24.9 million at December 31, 2014. The increase in inventory versus year-end 2014 reflects the Octane acquisition, higher revenues, new product introduction and the addition of a new distribution center. Trade payables were \$61.7 million as of December 31, 2015, compared to \$47.6 million at the end of 2014, primarily reflecting the Octane acquisition.

Capital expenditures totaled \$5.7 million for the year ended December 31, 2015, with spending primarily on facility infrastructure, product tooling and IT assets. We anticipate full-year CapEx for 2016 to be in the range of \$7 million to \$8 million. The Company also repurchased \$11.6 million of stock during the year as part of the previously disclosed \$15 million stock buyback program.

I wanted to provide a quick update on accounting related matters regarding our acquisition of Octane Fitness before I turn it over to Bill. We are continuing to work through the purchase accounting and appropriate valuation of the Octane assets and liabilities, and the amounts noted on the balance sheet presented reflect provisional estimates.

Based on some preliminary work completed on valuations of certain intangible assets, it does appear that the valuations may be higher than initial projections, which would result in higher ongoing non-cash amortization expense. While this will have no impact on EBITDA, it will likely modify our earlier projections on the accretion impact of the transaction to now be in the range of \$0.10 to \$0.15 per diluted share versus the \$0.15 to \$0.17 we had estimated earlier. We also expect the sales seasonality of the newly acquired business to be more aligned to our retail channel with Q3 and Q4 being the seasonally heavy revenue and operating income quarters.

We anticipate completing our valuation analysis by the end of Q1, 2016 and will be in a position to provide more color following the end of the quarter. Our confidence in the underlying business performance is such that our internal projections for the full year 2016 earnings remain substantially unchanged notwithstanding the higher amortization expense.

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

Bill McMahon - Nautilus, Inc. - COO

Thank you, Sid. Good afternoon, everyone. I'd like to provide additional background on our recent results and the overall position of our business starting with the direct segment.

We were extremely pleased with our top-line growth, particularly given the challenging year-over-year comps that we faced as directed sales had increased 35% in Q4 2014 versus the same period in 2013. The Bowflex Max Trainer continues to perform ahead of our expectations. Additionally, our sales benefited from strong initial performance from the launch of TreadClimber TC100 and TC200.

As Sid outlined, we reported strong operating income growth, reflecting higher adjusted gross margin. This is particularly attributable to our full product line selling well at full price and not requiring significant price discounting. We believe that the overall environment for the holidays was challenging, and we were very pleased that we were able to maintain strong product margins throughout the quarter.

While Max Trainer continues to outperform our expectations, our Q4 launch of the Bowflex TreadClimber TC100 and TC200 has also provided favorable impact on the prior rate of decline in the TreadClimber business. As these products gain traction over time, we anticipate that they will continue to help stabilize the TreadClimber category, which still represents an important and significant level of cardio product sales for Nautilus. As we noted in our pre-release earnings call last month, we saw strengths in consumer response beginning in late November, and we are continuing to see favorable response rates as we progress through Q1, 2016.

Now turning to our retail segment, we were pleased to deliver retail sales growth of 21% in Q4. We believe that the overall retail environment was challenging and our growth highlights our success in anticipating the evolving demand of our retail partners and their customers. We gained incremental floor share with key national sporting goods accounts, achieved steady growth with online retail partners, and improved our international sales with the launch of the Max Trainer and Schwinn 88 in a number of markets.

We're encouraged by the strong contributions of several recent product launches including our Nautilus line of cardio products, which consisted of bikes, ellipticals, and treadmills. The Nautilus cardio line helped us gain ground in multiple doors during the year, and our success there was further supported by ongoing sales of the Schwinn branded cardio products. Additionally, our Schwinn 80 Pro and 88 bike launched in Q4 last year has been very well received in the specialty fitness and cross fit environments.

We're especially pleased to report improved retail gross margins of 240 basis points in the fourth quarter. During 2015, we focused much of our effort on this improvement, and it was driven by a variety of factors including pricing, value engineering, supply chain, and mix optimization. While it's important to remember that retail margins are impacted due to our normal seasonal variation in revenue versus fixed channel expenses, based on our current outlook, overall the relative gains in margin we have achieved should be sustainable moving forward.

We recently exhibited several products at ISPO Munich, which is one of the largest sporting goods expositions in the world. There we were very encouraged by the interest from international retailers and customers. We partnered with a number of leading distributors in the international market and are confident that these strategic partnerships will help us steadily accelerate our global growth.

We also noted in our pre-release earnings call last month that we had not yet fully deployed the Bowflex SelectTech 560 product in market. We continue to make good progress on overcoming the manufacturing challenges we uncovered during initial production. We are in production now, and we do anticipate launching this product on a wider scale in the near future.

Turning briefly to our operations, we're very proud of the performance of our Portland, Oregon, and Columbus, Ohio distribution centers during the peak season. Our distribution centers handled extremely high volumes of shipments in December with tight service windows, and they did so quite efficiently.

Our supply chain kept us in stock on key products such as the Max Trainer M3 and M5, as well as our new TreadClimbers throughout the quarter. While our own inventories are elevated over prior year, this primarily reflects our higher revenue and support for growth.

It's important to note that our inventory turns in Q4, 2015 were nearly identical to the same quarter prior year. We feel we are managing inventory effectively and we are well positioned for further growth in 2016. Thus, as we look forward to 2016, given our product mix both in market and what we have in development, we're optimistic and anticipate delivering continued growth in revenue and profitability for all segments of our business.

In direct, we continue to experience strong response to our television and digital advertising while associated conversion remains solid thanks to healthy payment mix of financing and credit card sales. The launch of the Bowflex Max Trainer M7 earlier this month and that model's initial results further fuel our optimism that despite elevated prior year comps, our direct channel should continue to grow.

Our retail outlook for the full year is also positive. The addition of Octane Fitness revenue and profit to our results will be accretive, and we anticipate Octane to grow this year as well. Our legacy retail business is also very healthy overall, especially so given the margin improvements we've recently been able to implement.

As Sid noted in his remarks, we have taken a reserve against the receivable for one of our national sporting goods retailer accounts. We maintain a cautious approach to credit lines in a variety of situations and will continue to do so wherever warranted going forward.

That said, we anticipate another year of growth in 2016 from our retail segment driven by growth online, within the global market and via a variety of bricks and mortar locations. I'd like to emphasize again Sid's earlier comments that both our legacy retail business and our new Octane Fitness business have historical revenue seasonality that is heavier in Q3 and Q4 versus the first half of the year.

Before I conclude my remarks, I'd like to briefly touch on our recent acquisition of Octane Fitness and our plans regarding the integration of that business. Octane is an ideal synergistic fit for Nautilus as there was little to no overlap between our selling channels, but at the same time, we share the same values of offering consumers high-quality, innovative, world-class products.

Octane is focused on zero-impact cardiac machines with [club] quality and durability with price points that are still attainable for the home or specialty commercial markets. This acquisition gives us access to higher-priced products, new modalities, and new distribution channels. Of note, the combination of our two companies will introduce the shift in our channel mix as Octane revenue and profit is added to the overall Nautilus results.

However, our focus will remain the same. We will apply our combined product development capabilities towards the most promising projects, and now with five of the best brands in fitness, there is little doubt we will have a brand and a market for any fitness innovation we can develop.

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

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 2016, we are well positioned to deliver another year of strong sales and profitability growth. Over the past few years, we have significantly broadened and enhanced our product portfolio in both the direct and retail businesses. With the acquisition of Octane, we are now adding more product and channel diversity to our well-established platforms for future growth.

Importantly, our team also continues to remain focused on successfully leveraging operating costs and continually finding improved efficiencies in our business. While we are incredibly proud of all that has been accomplished, it is important to keep in mind that we are still in the early phases of our growth journey, with significant long-term organic growth opportunities still ahead.

Lastly, I'd like to express my appreciation for the hard work of each team member of the Nautilus organization. Our employees' dedication and enthusiasm is the oil that enables our growth engine to hit on all cylinders, and it is their initiative that has allowed us to accomplish so much over the past several years and to build a strong and growing company for our shareholders.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question is from the line of Andrew Burns with D.A. Davidson. Please proceed.

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

Couple of questions for you, just in terms of your 2015 operating margin performance above your long-term model, are you still reviewing that long-term range? Is there a chance that, that would drift up in terms of your long-term operating model?

Sid Nayar - *Nautilus, Inc. - CFO*

Andrew, this is Sid. Yes. We are still in the process of reviewing it, but clearly in light of our 2015 performance, we're more likely than not going to be raising at least the operating margin range. I think we feel that the revenue range that we currently have is still the right one, but given our ability to leverage and improve both on the gross margin and on the operating expense line, we think that will probably be, shortly an increase in that range.



Andrew Burns - D.A. Davidson & Company - Analyst

Great, thanks. And as you look at your retail business, great performance in 2015. When I look at your key retail partners there, there's a lot of moving parts.

You've got online growth. You have the potential for significant door closures in brick and mortar, and I'm just trying to get a sense of how that impacts the growth of that segment in 2016. Is that a manageable headwind, or is there opportunity to shift more online, any observations there?

Bill McMahon - Nautilus, Inc. - COO

Andrew, Bill here. You correctly I think identified one of the things we look at closely. Near term obviously with one national sporting goods retailer and a little bit of decision making mode, it introduces some uncertainty into the first half of the year.

On the other hand, we believe that there's an overall consumer move towards online or omni channel based retailers, and we have strong position in the online world of fitness. And we continue to work closely with all of our bricks and mortar partners to put the right combination on the floor. So overall, we certainly anticipate continuing to grow our retail business, although there certainly will be a little bit of consolidation at least with one of them.

Andrew Burns - D.A. Davidson & Company - Analyst

Okay. Thanks and I know you don't like to give specific guidance, but I will throw in this last one just in case. In the fourth quarter, the direct segment had the slowest growth of the year in terms of year over year, and retail had the fastest growth they experienced of 2015.

I didn't know if those were good indicators of the momentum in growth trajectory in 2016 or if we should think about the growth rates of those segments differently in 2016. Thanks.

Bruce Cazenave - Nautilus, Inc. - CEO

I think if you look at in two parts, Andrew, this is Bruce, we do anticipate that we will be able to maintain the run rate that we talked about on the long-range basis for both of the businesses, which is that high single-digit, low double-digit. I think that direct because of the significant comps that we have going into even the first quarter, that you will see maybe a little bit less growth there than you might see on the retail side pending some of the things, the headwinds that we have there that you've alluded to and Bill commented on. But we still -- when you combine, we should still be in that high single-digit low double-digit in terms of revenue combined.

Andrew Burns - D.A. Davidson & Company - Analyst

Thanks and good luck.

Bruce Cazenave - Nautilus, Inc. - CEO

Okay. Thanks, Andrew.

Operator

And our next question is from the line of Frank Camma with Sidoti & Company. Please proceed.



Frank Camma - *Sidoti & Company - Analyst*

Hi, good afternoon, guys.

Bruce Cazenave - *Nautilus, Inc. - CEO*

Hi, Frank.

Frank Camma - *Sidoti & Company - Analyst*

Hi, first question is just if you can comment on the marketing spend, it was a little higher than I expected. Sometimes those are a good indicator for you. You must be seeing some good conversions, wonder if you could talk a little more in detail about that.

Bill McMahon - *Nautilus, Inc. - COO*

Yes. Hi, Frank, Bill again. On the media, yes, we're seeing favorable environment. We're seeing good response to our ads, and we think it's a good time right now to be spending to gain additional leads and conversion.

Frank Camma - *Sidoti & Company - Analyst*

And does going into an election year, does that increase your air spend? Can you talk about that as far as the competitiveness for the spending?

Bill McMahon - *Nautilus, Inc. - COO*

Yes. Election year is an important factor. Olympics also is a factor. The Olympics is actually a little more disruptive to the cable environments that we advertise on, though our media plans always anticipate working around that period during the summer, and usually it does not impact our results.

The election year this year we anticipate, of course, still more money being spent on media, but a lot of that is either local advertising or even national TV by super PACs and other groups. Generally that is less disruptive to our actual media spend and performance. However, we keep an eye out, and it can put upward pressure on pricing for individual spots when that happens.

Generally we resort to going with what's appropriate. In other words, if it's a high-performing network, we will keep our placements. And if it's maybe a little less testing or a little bit of trying things we haven't tried because it's too expensive to do that.

So we plan for this. I don't anticipate it will impact our outward or our long-range growth trajectory, but it's definitely something we have on our radar.

Frank Camma - *Sidoti & Company - Analyst*

Okay. And as you add Octane, is it fair to say that as a percentage of revenue, marketing spend will go down since that's a retail channel? I mean, is that just an obvious assumption?



Bill McMahon - *Nautilus, Inc. - COO*

No. Frank, we see that same percentage because it's really a combination of costs that they have both in the retail, the specialty retail and the commercial channels. They certainly won't be as high as direct, where the media spend is there. The best way we look at it is you can see that they will have comparable operating margins to our retail and direct business.

Frank Camma - *Sidoti & Company - Analyst*

Okay. Fair enough. And last question just on the -- sorry if I missed this, but you mentioned the bad debt with the sporting goods retailer. Are you out of that channel already? Can you comment on that?

Sid Nayar - *Nautilus, Inc. - CFO*

Let's just say it's been a customer that we've been doing business with. And right now we are -- it's suspended -- until some decisions are made, we've suspended shipments into that customer, but that's, I guess, all we can say at this point. We hope that there will still be some business with that customer as the year progresses, maybe some rationalization, some other things, but that remains to be seen.

Frank Camma - *Sidoti & Company - Analyst*

Okay.

Operator

Our next question is from Rommel Dionisio from Wunderlich Securities. Please proceed.

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

Yes. Thanks very much. I had a question on this new Schwinn Airdyne bike you were initially bringing to specialty retail even before the acquisition of Octane Fitness.

What I'm really trying to get at is, how well do your existing brands potentially translate to that channel given the higher price points there? Just wondering how the Airdyne bike was doing there. Thanks.

Bill McMahon - *Nautilus, Inc. - COO*

Rommel, that's a great question. Bill here. First of all, we believe that being able to -- we can accelerate our Airdyne bike sales into specialty with the help of our new partners at Octane who have a lot of experience with that market and specifically with those who sell in that market.

It's being very well received. People are excited about the product. I think it was time for Airdyne to return to that space. We think that will be one of our growth drivers during the course of this year.

You also asked about brands. We certainly have brands with a lot of legacy in that market. Schwinn has no problem playing in the specialty market given its legacy heritage.

Nautilus is a strong brand as well. Octane is probably one of the top brands in all of specialty in emerging brand and commercial. So we feel very confident we have the right brands to compete in that space going forward.



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

Great. That's very helpful. Thanks, Bill.

Bill McMahon - *Nautilus, Inc. - COO*

You're welcome.

Operator

And we have a question from Lee Giordano from Sterne Agee. Please proceed.

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

Thanks. Good evening, guys.

Bruce Cazenave - *Nautilus, Inc. - CEO*

Hi.

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

I was wondering if you could talk a little more about the long-term pipeline for new product development and how the process may have changed over the past few years. And just remind us how long it takes from conceptualization to launch new products. Thanks.

Bruce Cazenave - *Nautilus, Inc. - CEO*

Sure, Lee. We still maintain a three-year product road map where we look out at a cadence of launches and product ideas that are in various stages of coming to market.

We do have product launches planned for the second half of this year, and as is our norm, we will talk about those as we get into later in the year. And the addition of Octane only brings yet another product road map to the table and again, a vision of our combined culture.

They also look at things over a three-year road map. We're taking some time right now and saying okay, what are our best ideas? What are our best innovations that we can bring to market with our combined product development resources?

So in that regard, we have more resources, more capability but still the same philosophy, still the same approach of trying to maintain a regular cadence. So as we speak, we have multiple ideas in the direct pipeline that we're pursuing. Some are closer to market than others.

Retail is a little more set cadence of pace. Every fall you need to have something for retail. We're on pace in regards to both channels to launch some new products later this year.

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

That's great, thank you.



Bruce Cazenave - *Nautilus, Inc. - CEO*

Thanks, Lee.

Operator

(Operator Instructions)

And there are no further questions registered at this time.

Bruce Cazenave - *Nautilus, Inc. - CEO*

Great. Thank you all. This is Bruce and thank you for joining us today and your continued interest in Nautilus.

We look forward to updating you on our progress on our next call in May. Hope everyone has a great afternoon. Thank you.

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 line.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2016, Thomson Reuters. All Rights Reserved.

