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NLS - Q3 2016 Nautilus Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Nautilus third quarter FY16 earnings call.

(Operator Instructions)

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

John Mills - Nautilus Inc - ICR, IR

Thank you. Good afternoon, everyone. Welcome to Nautilus' third quarter 2016 conference call. Participants on the call from Nautilus are Bruce Cazenave, Chief Executive Officer; Sid Nayar, Chief Financial Officer; and Bill McMahon, Chief Operating Officer. Our earnings release was issued earlier today, and may be downloaded from our website, nautilusinc.com on the Investor Relations page. The earnings release includes a reconciliation of the non-GAAP financial measures mentioned in today's call with the most directly comparable GAAP measure.

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

Forward-looking statements are subject to a number of risks and uncertainties, and actual results may differ materially from these statements. For more information about these risks, please refer to our annual and quarterly report filed with the SEC, as well as the Safe Harbor statement in today's press release. Nautilus undertakes no obligation to update publicly any forward-looking statements reflect new information, events, or circumstances after they were made, or to reflect the occurrence of unanticipated events, unless otherwise indicated. All information and comments regarding our operating results pertain to our continuing operations. And with that, it is my pleasure to turn the call over to Bruce. Go ahead, Bruce.



Bruce Cazenave - *Nautilus Inc - CEO*

Thank you, John. Good afternoon, everyone, and thank you for joining our call today. I'd like to start by providing a general overview of our third-quarter results, and then will turn it over to Sid Nayar to review our financial results in more detail. Bill McMahon will follow, providing details on each business segment, as well as updates on product activity. I will close with some summary remarks, before we open up the call for questions.

In the third quarter, we generated increases in every key financial aspect of our business. Total revenue increased 14%. Operating income increased 29%, and EBITDA increased by 42% over the same period prior-year. This operating performance improvement was driven by another strong quarter for our retail business, including double-digit growth in both the organic and Octane Fitness segments.

Our direct business in the quarter was, however, impacted by a decline in sales reflecting a weak consumer response to our response to our media investments, and the resulting in strategic decision we made to defer a significant portion of our planned advertising media spending during the quarter. Bill will further explain the rationale for this decision, given the continued challenging consumer response environment that we referenced on our Q2 earnings call.

At this time, we still believe the situation to be temporary and primarily media-related, but recognize that other factors such as weakening consumer confidence, product lifestyle management, and creative are all additional issues that may be at play. We have made the appropriate adjustments to our direct strategy, and remain hopeful that conditions become more normalized, when heavier seasonal media spending occurs later this year.

Despite these challenges in the direct business, the strong organic retail and Octane Fitness sales growth, combined with improved gross margins in each business and disciplined cost management enabled us to generate significant operating leverage, and report another quarter of profit growth, well in excess of double-digit revenue growth. Now 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. I would like to review the details of our financial results for the third quarter 2016. Net sales for the third quarter totaled \$80.8 million, an increase of 14.3% as compared to the same period in the prior year. For the first nine months of 2016, net sales were \$280.3 million, an increase of 23.7% over the same period last year. Third quarter gross margins increased 140 basis points in the direct segment to 65.7%, and were up 950 basis points in the retail segment to 35.1%, when compared to the same quarter last year.

On an overall basis, total Company gross margins for the third quarter of 2016 decreased by 270 basis points to 48.5% versus the same period prior-year, reflecting the shift in segment mix to increased retail segment revenues. Year-to-date 2016 gross margins of 52.6% are 70 basis points lower than 2015 year-to-date gross margins, as the shift in mix to increase retail sales, more than offset the improved margins within each segment. Total operating expenses for the third quarter of 2016 as a percentage of net sales decreased to 38.4% from 42.2% in the same period last year, reflecting lower sales and marketing expense, and reduced reserves for performance-related incentive programs, partially offset by higher amortization expense related to the Octane Fitness acquisition, and increased spending and product development. Total operating expenses for the first nine months of 2016 as a percentage of sales were 40.4%, as compared to 41% for the same prior period.

Sales and marketing expenses for their third quarter of 2016 were \$21.4 million or 26.5% of net sales, as compared to \$21.7 million or 30.8% of net sales in the same period last year. The reduction in dollar spending primarily reflects lower media spending and finance fees, partially offset by the inclusion of expenses related to Octane Fitness. The improvement in sales and marketing expenses as a percentage of sales reflects the same factors. For the first nine months of 2016, sales and marketing expenses totaled \$81.3 million or 29% of net sales, compared to \$70.2 million or 31% of net sales for the same period in the prior year, with higher media spending being the main driver, coupled with variable expenses related to third-party consumer financing, as well as the addition of Octane Fitness selling expenses.

General and administrative expense were \$6.2 million or 7.6% of net sales for the third quarter of 2016, which compares to \$5.5 million or 7.8% of net sales in the same period last year. The increase in dollar spending in G&A primarily reflects the addition of Octane Fitness, as well as higher amortization expense that was also related to the acquisition, partially offset by lower performance-related incentive reserve requirements and a

legal settlement. General and administrative expenses for the first nine months of 2016 as a percentage of net sales totaled 7.7% as compared to 6.8% for the same prior period, reflecting the addition of Octane Fitness and amortization expense related to the acquisition.

Research and development costs in the third quarter of 2016 were \$3.4 million or 4.3% of net sales, compared to \$2.69 million or 3.6% of net sales in the same period last year. (sic - see press release "\$2.6 million"). The dollar increase reflects continued investment and resources required to continue to innovate and broaden our product portfolio, coupled with the addition of incremental product development resources at Octane Fitness. Research and development expenses for the first nine months of 2016 as a percentage of net sales totaled 3.7%, as compared to 3.2% for the same prior period.

Operating income for the third quarter of 2016 increased to \$8.2 million, as compared to operating income of \$6.4 million in the same quarter of last year. The increase reflects higher net sales and the retail segment, coupled with increased gross margins as a percent of sales in both segments, partially offset by the higher acquisition-related expenses of \$0.9 million which includes the increased amortization expense of \$0.8 million, and an inventory step-up charge of \$0.1 million. Operating margin for the third quarter of 2016 increased to 10.2%, compared to 9% for the same period last year.

EBITDA from continuing operations in the third quarter of 2016 increased by 42.4% to \$10.2 million, versus \$7.2 million for the same quarter of the prior-year. For the first nine months of 2016, operating income was \$34.1 million or 12.2% of net sales, an increase of 22.1% over the same period last year. Year-to-date EBITDA from continuing operations totaled \$39.8 million, versus \$30.0 million in the same period last year, an increase of 32.5%.

Income from continued operations for the third quarter of 2016 was \$7.8 million or \$0.25 per diluted share, as compared to \$3.9 million or \$0.12 per diluted share for the same period last year. For the first nine months of 2016, income from continuing operations was \$23.1 million or \$0.74 per diluted share, an increase of 36.4% over the same period last year.

The effective tax rate for the third quarter of 2016 was 1.9%, compared to 39.8% in the same period last year. The lower effective tax rate resulted from the Company realizing a nonrecurring tax benefit of \$2.7 million or \$0.09 per diluted share related to the release of previously unrecognized tax benefits, upon us completing the deregistration of a non-US entity.

Total net income including discontinued operations for the third quarter of 2016 was \$7.6 million or \$0.24 per diluted share, which includes a \$0.3 million loss net of taxes from discontinued operations. This compares to the third quarter of last year, where we reported total net income including discontinued operations of \$3.7 million, or \$0.12 per diluted share which included a net loss of from discontinued operations of \$0.1 million. Year-to-date net income for 2016 totaled \$22.6 million or \$0.72 per diluted share versus \$16.9 million or \$0.53 per diluted share for the same period last year.

Turning now to our segment results, net sales in the direct business totaled \$33.7 million for the third quarter of 2016, a 21.4% decrease over the same quarter last year. Direct segment sales were impacted by challenging media conditions and lower awareness metrics during the quarter, resulting in the Company intentionally scaling down media spending, which in turn further impacted lead generation activity. Bill will provide more color on our actions and outlook for this segment in his comments.

Year-to-date sales of \$159.9 million are up 0.8% year over year. Gross margin for the direct business improved to 65.7% for the third quarter of 2016, compared to 64.3% in the same quarter of last year. Gross margin improvement was primarily due to favorable product mix, driven by higher sales of the Max Trainer M7 product, as well as lower discounts and allowances.

Operating income for the third quarter of 2016 in our direct business was \$2.6 million, compared to \$5.4 million in the same quarter prior year. Operating income was negatively impacted by the lower net sales and gross margin dollars in the third quarter of 2016. Year-to-date 2016 operating income for the direct segment totaled \$31.3 million or 19.5% of net sales, compared to \$30.1 million or 19% of net sales in the same prior period.

Net sales in our retail segment for the third quarter of 2016 were \$46.2 million, an increase of 79.6% compared to \$25.7 million in the third quarter of last year. The improvement in retail net sales reflects strong double-digit growth in excess of 16% across both the cardio and strength components



of the organic retail business, coupled with improved international sales year over year. The addition of Octane Fitness also added incremental sales to the retail category, and this category saw robust sales growth of 23% year over year.

Gross margins for the retail business improved by 950 basis points to 35.1% in the third quarter of 2016, as compared to 25.6% for the prior period. Organic retail gross margins were favorably impacted by improved product and channel mix improving by over 600 basis points, while the inclusion of Octane Fitness products would generate higher gross margins, helped to further drive the margin increase. Year-to-date 2016 gross margins for retail totaled 32.9%, up 910 basis points versus the same period in the prior year, primarily driven by the same factors.

In the third quarter of 2016, operating income for the retail business totaled \$9.2 million or 19.8% of net sales, as compared to \$3.2 million or 12.5% of net sales in the same period of last year. The increase is attributable to the higher revenues and gross margins, and the addition of the Octane Fitness business. Year-to-date 2016 operating income for the retail business totaled \$17.2 million or 14.6% of net retail sales, versus \$5.9 million or 9.2% of net retail sales for the same period in the prior year. We're particularly pleased with the improvement in retail operating margins during 2016 that reflect ongoing efforts to grow organic retail gross margins through improved product and channel mix.

Now turning to the consolidated balance sheet, cash and investments totaled \$59.3 million as of September 30, 2016. With \$68 million of debt, this compares to \$60.8 million in cash, and debt of \$80 million at December 31, 2015. Inventories were \$49.2 million as of September 30, 2016, compared to \$42.7 million at December 31, 2015, and \$35.6 million at September 30, 2015. The increase in inventory versus year end 2015 relates to the seasonality of the business, while the increase in inventory compared to September 30, 2015 primarily reflected the addition of Octane Fitness.

Trade payables were \$44.8 million as of September 30, 2016, compared to \$61.7 million at the end of 2015, reflecting the seasonality of purchases. Capital expenditures totaled \$3.2 million for the nine months ended September 30, 2016, with spending primarily on tooling, facility infrastructure, and IT assets. We anticipate full-year CapEx to be in the range of \$5 million to \$6 million. At this time, I would like to turn it over to Bill McMahon, our Chief Operating Officer who will provide additional insights into our business and key products. Bill?

Bill McMahon - Nautilus Inc - COO

Thank you, Sid. Good afternoon, everyone. I'd like to provide additional background on our recent results, and the overall position of our business, and discuss some of our new product activity. Starting with the direct segment, sales decreased 21.4% reflecting emerging softness in consumer response, as well as our decision to defer media spending during the quarter to maintain a profitable media ROI, and contribution margin in the direct segment.

During last quarter's call, we had discussed that we had begun to see some weakness in July, corresponding with the distractions caused by election campaigns and the Olympics. Such Olympics and election disruption is not uncommon every four years, however, in the prior call, we noted that these conditions were more pronounced than normal, and if they continued, lead generation and web traffic volume could be impacted. The weakness in consumer response did in fact continue, and remained consistently soft through the quarter.

As Q3 progressed, we have set several potential drivers to the response rate. Ultimately, our conclusion was to prioritize profitability, and accordingly adjust our media spend downward to levels which generated a better return on investment, although this did further negatively impact revenue generation. For comparison purposes, our media spend in Q3 was 13.7% lower than the same period in 2015, reflecting those adjustments made during the quarter.

Clearly, the Q3 the performance of our direct segment was not our planned outcome. We will manage through these conditions, and are taking all steps to identify and address the causes of the recent downturn. We do have the flexibility to react to new learning and trends, while continuing to manage profitability. To that end, we're monitoring several key metrics in our business to help answer two key questions.

First, is the recent downturn and performance driven by internal, or external factors? And second, what actions can we take to optimize direct channel results, given the environment? To the first question, we know the decline in the direct channel performance can be attributed to weaker than expected consumer response to our advertising, leading to less telephone and web traffic volume than we planned.

This leads to the more important second question, which is what can we do about that low response? While there are multiple media reports of low television viewership in recent months, and soft consumer response rates among certain other consumer companies, our team always focuses on response factors within our control. And those factors are the creative, which are the ads and messages themselves, and the media placement patterns and network mix.

First, we've launched new creative for our Bowflex Max Trainer product in October, and the early returns are showing an improvement over the prior control. We will also launch a new Bowflex Tread Climber ad in November. Second, we're closely monitoring the changing trends in viewership patterns, and have noted increases in cable news channels viewing, for example, which is a potential opportunity for us to adjust, to the extent that those trends hold. On the positive side, our credit approval rates remain solid and historically good at 47.9%, which is on par with prior year Q3, 47.8%.

For competitive reasons, we do not disclose our exact conversion rates. I will note though, that our conversion rates for the quarter were good, and were not a contributing factor to the lower revenue, rather the shortfall and top level consumer response was the challenge. Those who did respond, converted to a sale at the rate we expected. These facts give us good confidence that our products themselves are not at issue.

Overall, while we are seeing sales improvement in October, we still have some progress to make. We are hopeful that consumer response rates will improve post-election, and it's important to note that Q4 direct performance has historically been heavily back-loaded from Black Friday onward, so such a change would be quite beneficial if our seasonal pattern continues.

That said, we're mindful that longer-term macro factors could be impacting results. And we'll continue to closely monitor the metrics I mentioned earlier, such as consumer credit approval rates, and will adjust as needed. Nautilus will continue to prioritize media spend for channel profitability, versus spending up into what would be non-profitable media to drive higher revenue. As we move into the fitness season, we believe we have sufficient inventory on hand to meet consumer demand and further, we should be able to respond quickly to any bounce-back in consumer behavior in our direct channel.

Regarding new products, as many of you know in September, we hosted our annual product showcase event in New York City, and unveiled several exciting new products. The event was well-attended once again, and we're pleased with the energy and enthusiasm attendees expressed about the products we unveiled. On the direct side, we debuted the Bowflex HVT. This is the world's first fitness machine to offer hybrid velocity training, a new approach to fitness that combines cardio and strength training into one of the fastest and most effective workouts ever designed. We're very excited about the potential of the HVT, and our research has indicated that the Bowflex customer is attracted to products that deliver quick results, and the HVT is in line with current workout trends. We're planning to launch this product in our direct channel the first half of 2017.

Turning now to our retail segment, we're pleased to report strong retail sales growth which increased 80% compared to the prior-year period, primarily reflecting the inclusion of sales from Octane Fitness. However, we also continue to see strong organic growth of 17% of from our sporting goods and online accounts, which includes contribution from both the cardio and strength products. This organic growth represents continued improvement at our retail presence, and we have gained further market share this fall.

Additionally, we saw strong growth in all of Octane Fitness's segments, particularly in commercial products, reflecting the early acceptance of the commercial Zero Runner platform. While the specialty retail channel continues to face some headwinds overall, we believe the stream of new products is helping to return the segment to a long-term growth trajectory. We do caution that as soft consumer response behaviors spread into the retail markets during peak season, this could impact future revenue in the form of slower reordering by our retail partners. And finally, as Sid mentioned, we also achieved significant margin growth of 950 basis points, reflecting improved product and channel mix, as well as the benefit from inclusion of higher margin Octane products.

Much of our retail business success has been attributable to our product portfolio expansion. At our September product event, we unveiled the Nautilus 618 Performance Series. This series includes an elliptical, recumbent bike, upright bike, and a RunSocial app compatible treadmill.

One of the key areas of focus for our product innovation over the past few years is improving the technology of our products, and offering our consumers the latest innovations for home fitness equipment. Our new products include the built-in Nautilus training programs to add a variety



to an at-home workout routine. And by partnering with RunSocial, users can be virtually transported to another part of the world, offering outside motivation to power through their workouts.

The 618 performance series includes Bluetooth connectivity, which allows users to share data through the free Nautilus trainer app, which in turn synchronizes with a growing list of popular fitness applications such as Apple HealthKit, Google Fit, Under Armour Record, MapMyRide, MapMyRun, MyFitnessPal, and Endomondo. This product line-up became available this month at a variety of retailers. We're encouraged by the positive response from consumers, our retail partners, and the fitness media to our newest product offerings.

As we noted in the last call, one of our key initiatives as we look toward the future of Nautilus is to explore a more omni-channel approach to our business. We're pleased to have kicked off our initiatives with Dick's Sporting Goods to place the Bowflex Max Trainer M3 on floor for in-store only purchase. This initiative will expose Max Trainer to new consumers, and further increase awareness of this key product platform. We're monitoring this effort closely. And while the results during peak fitness season are the most important, we are already impressed with the partnership shown by Dick's Sporting Goods team, and the representation of our products in store.

In summary, while we're encouraged by our year-to-date accomplishments across all channels, and very thankful for the efforts of our team around the world, we remain mindful of the near-term challenges in direct, and potential softness for consumer markets in general. The integration of Octane Fitness continues to meet our expectations, and confirms our belief that our businesses are highly complementary.

Our overall performance this quarter is a validation of our strategy to diversify our revenue streams to better position the Company for future profitable growth. Our team continues to leverage our strong portfolio of brands, and we will continue our regular cadence of product launches for all business segments. And with that, I'd like to turn the call back over to Bruce for his final comments. Bruce?

Bruce Cazenave - *Nautilus Inc - CEO*

Thank you, Bill. I would like to make a few final comments, before we open up the call for questions. Both Bill's and Sid's comments illustrate that we continue to execute well on the key areas of focus that have enabled us to achieve significant top and bottom line growth over the past few years.

This is evidenced first, by the launch of a truly innovative new products. Some are shipping now, and with more in the pipeline to be launched the first half of next year. Recently introduced products also reaffirm our commitment to further broaden our portfolio, and to drive the business for long-term profitable growth be it industry-leading design and innovation, including in areas where we previously were absent.

Secondly, we made a major positive move towards expanding and diversifying our product portfolio with the acquisition of Octane Fitness earlier this year. As Bill mentioned, we are very pleased with how the integration of that business is progressing, and the potential opportunities this acquisition will afford us in the future. Thirdly, international markets continue to be a vast, untapped opportunity, and we are now tracking along in an accelerated growth path in most of these markets. Finally, our focus on gross margins and improving operating margins is institutionalized within the Company, and our team is continuously challenging itself to operate more efficiently, and further leverage our strengths and infrastructure.

All said, we are confident that the strategic initiatives and priorities we have in place are working well, and are the right ones going forward. Looking ahead, we are very carefully navigating through the same challenges that emerged in Q3 related to the media conditions and general consumer response. While there are clear external factors creating uncertainty in the general consumer market, and are hopeful that things will stabilize soon, we are proactively planning to operate in this environment well into 2017.

I'm proud of our team's ability to quickly adapt to the changing conditions, and adjust our media spending and other expenses accordingly, in order to maintain healthy margins and profitability. We are maintaining our long-range annual run rate targets for revenue growth and operating income improvement, but given the Q3 performance, we anticipate slightly underperforming the long range run rate target for organic growth -- of revenue growth of 10% to 12% in 2016.



Also, the EPS accretion from the Octane acquisition will likely be in the \$0.07 to \$0.10 range this year, which is lower than previously expected range of \$0.10 to \$0.15 due to market softness in one of Octane channels of distribution. This range includes a \$0.06 of amortization expense for intangible assets, as well as additional integration expense. The financial health of our Company remains strong, and we will continue to execute on strategies that are designed to maximize long-term shareholder value.

Finally, I'd like to take this opportunity to thank our dedicated team of employees around the world for all their hard work, and to deliver the desired results, and to create a positive momentum we have in every corner of our Company. That concludes our prepared remarks. Now I would like to open it up call for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Mike Swartz, SunTrust.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Good afternoon, guys.

Bruce Cazenave - *Nautilus Inc - CEO*

Hey, Mike.

Bill McMahon - *Nautilus Inc - COO*

Hey, Mike.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

I just wanted to maybe talk about the direct business. I think you had some commentary around -- I guess, you kind of call it consumer response, versus conversion rates. Could you just help flesh that out a little more, maybe ties those two -- the factors together? And then, I guess, in terms of how you're thinking about 4Q, I mean, should still be expecting kind of a down 20 rate -- 20% rate in revenue growth in that business? It sounds like things in October got a little better, but just trying to get a sense of magnitude there?

Bill McMahon - *Nautilus Inc - COO*

Hi, Mike. Bill, here, great question. The first things we look at in direct whenever we encounter something like this is, the raw response or the top of the funnel, is that funnel getting filled with enough calls and web visits? And then once you have the traffic, is it converting and at an expected rate? It's kind of two different types of problems to look at.

Clearly, in this case, we know that is raw response, is what we're trying to address. We have seen some improvement in October. No, I would not anticipate at this time that direct would be down to the same level. But I would say, we have some work to do to get back to positive, and we're taking those steps right now.



Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Okay. And then, just the next question on Octane. I mean, it sounds like Octane was up 20%-plus in the quarter. It sounds like more a back half loaded year. Just maybe, just the drivers of that, how much of that would be any kind of stabilization improvement in the specialty channel, maybe versus the initial shipments of the commercial Zero Runner?

Bill McMahon - *Nautilus Inc - COO*

I'd say most of the improvement is the new product which does help across the channels in effect. We're still looking to see improvement in the specialty channel, but the new product is helping us to gain share.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Okay. And then, just maybe just a little more granularity on the international business in the quarter. Just maybe a sense of -- was that up double-digits organically,?

Bill McMahon - *Nautilus Inc - COO*

Yes, we can say it was up double digits organically and via Octane.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Okay. Thanks, guys.

Bill McMahon - *Nautilus Inc - COO*

Thanks, Mike.

Operator

Andrew Burns, D.A. Davidson.

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

Thanks. Good afternoon. I understand the cautionary commentary, given the uncertainty, but the fact that conversions remains strong and credit approval rates are healthy, it seems like there's a good chance the largest factor here, is the election noise. In that scenario, what happens come November 9? Do you steadily ramp media spend back up, or do you press the gas and go back to the previous media game plan, in terms of spending?

Bill McMahon - *Nautilus Inc - COO*

Andrew, Bill again. I think generally, it'd would be prudent for us to ramp up on a controlled manner. Usually stepped increases on a large scale could be a little risky. And I think while we're also helpful that the election is the primary driver here, we have to be mindful of keeping an eye on all factors, as we go through the quarter. The good news is, as we noted in the remarks, the quarter is heavily back loaded normally on a historical basis, so we do have some run way to continue to show improvement.



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

And how material of changes could you make, in terms of switching between networks, if you're seeing better returns on different channels?

Bill McMahon - *Nautilus Inc - COO*

We can dramatically change our media profile and adjustment as needed. And in fact, we've done some of that since the middle of Q3.

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

Thanks. And then, in terms of Octane, and the timing of product, new products has created some lumpy results year to date, in addition to the specialty. Should we be thinking about fourth quarter is being sort of a good natural run rate for the business? Or is there still going to be some new product timing that influences the fourth quarter? And just trying to gauge when we can take a look at the underlying business to think about it, as we move into 2017? Thanks.

Bill McMahon - *Nautilus Inc - COO*

Yes, thanks, Andrew. We do anticipate continued growth over time in Octane, thanks to the new products that we're launching. Q4 specifically though, we would caution, last year there were two new product launches in that quarter that were of magnitude; we're not comping those same launches this year. So in the short-term, Q4 might be a little challenging on a comp basis for Octane.

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

Thanks, and good luck.

Bruce Cazenave - *Nautilus Inc - CEO*

Thanks, Andrew.

Operator

Frank Camma, Sidoti.

Frank Camma - *Sidoti & Company - Analyst*

Good afternoon, guys.

Bruce Cazenave - *Nautilus Inc - CEO*

Hey, Frank.



Frank Camma - *Sidoti & Company - Analyst*

Hey, would it be possible for you guys just to call out the Octane numbers, since you're going to have to report it anyway, I assume in your Q, I mean, I think it would help maybe in this case? Just trying to get -- I mean, we back into it, but would you be willing to state those numbers, the revenue number at least? (multiple speakers)

Bill McMahon - *Nautilus Inc - COO*

Yes, it was \$16.2 million for this quarter, Q3.

Frank Camma - *Sidoti & Company - Analyst*

Okay. Yes, that's what I thought. Now so and given Bill's comments there, about Octane, fourth quarter difficult comp, I mean, it sounds like year over year for Octane, you're going to see revenue decline. I mean, is that a fair statement, given like the number you gave out at the beginning of the year? I mean, I don't know if you can comment about that or not, but that kind of back on the envelope, that's what it looks you're projecting now?

Sid Nayar - *Nautilus Inc - CFO*

Yes. It's projected to be flat or down a little bit, yes. (multiple speakers)

Bill McMahon - *Nautilus Inc - COO*

And that was mostly from the first half of the year. Certainly Q3, with a double-digit increases year over year helped, but not enough to make up, for what was the first half of the year, particularly because of the specialty channel.

Frank Camma - *Sidoti & Company - Analyst*

Okay. That's fine. I just wanted to make sure that I have that right. My only other question is just a little more color on the Dick's sell-in. Was that -- because I know they really haven't -- they're really trying to go hard there, I guess on Black Friday, right? But was the revenue in the quarter, in the September quarter, or because it shipped then, or was it more spill over into the October's? I'm just trying to figure that out.

Bill McMahon - *Nautilus Inc - COO*

Frank, it sort of spanned across both late September and early October.

Frank Camma - *Sidoti & Company - Analyst*

Okay. Okay. All right. Thanks, guys.

Bill McMahon - *Nautilus Inc - COO*

Thank you, Frank.



Operator

George Kelly, Imperial Capital.

George Kelly - Imperial Capital - Analyst

Hi, guys. Yes, a couple of questions from me. First on credit trends, it sounds like in the quarter, things were better than they were last year. Can you say anything about what you've seen since the quarter ended?

Bill McMahon - Nautilus Inc - COO

We continue to see favorable credit conditions for us, no changes. If anything, we've seen improvements in Tier 1 approvals overall, which is helpful to us from a cost perspective. So we're pretty pleased with the credit environment right now.

George Kelly - Imperial Capital - Analyst

Great. And then, on the direct segment, just listening to your commentary -- and it seems like on the previous call, you pointed out that the election and the Olympics, but this time it seems like you're less -- you're more noticing just a general kind of weakness in consumer. Have you done a lot of tests around what's driving the -- I think you went through some of them, but just wondering, how you can kind of determine where some of this is coming from, if it is the election or just general consumer sluggishness?

Bill McMahon - Nautilus Inc - COO

Yes, I think you are hitting on the most important question, George, and unfortunately, we do not have an exact way to answer that. We do hope that the election is the primary driver of distractions out there, and we wouldn't be the first ones to speculate that. But I will say, the team does a great job of sticking with the analytics, and saying this is what we see.

Our decision to reduce media spend was primarily based on just low response and lower viewership, for whatever the cause, we needed to get our balance back in place, so that we could deliver the profit that we were seeking. If those conditions change, or begin to lessen, then we can adapt to that as we go. I can say that as we noted in our remarks, things are looking a little bit better in October already.

George Kelly - Imperial Capital - Analyst

Okay. And in the quarter, was the impact on your key products at direct equal? Did you see one product fall off more than the other?

Bill McMahon - Nautilus Inc - COO

No, I'd say it is across the board weakness at the top end of that conversion funnel. The raw response was down on all product interests.

George Kelly - Imperial Capital - Analyst

Okay. Last question on Dick's. Do you expect in 2017, or is there anything that you can say about this sort of expanded relationship? Do you expect to bring more direct products through Dick's?



Bill McMahon - *Nautilus Inc - COO*

I would say that we intend to bring more products through Dick's, and we've gained additional share with that account this year. In terms of more direct products, it's a great question. We want to see how this test goes together, and I'm sure they want to see how it goes as well. And I will say early on, I'm pretty impressed with how easy they are to work with, and how well they're representing our products on the floor.

George Kelly - *Imperial Capital - Analyst*

Great. Thank you.

Bruce Cazenave - *Nautilus Inc - CEO*

Thanks, George.

Operator

(Operator Instructions)

And at this time, I would like to turn the conference back over to Bruce Cazenave for any additional or concluding remarks.

Bruce Cazenave - *Nautilus Inc - CEO*

Thank you all for joining our call today, and your interest in Nautilus. We look forward to updating you on our year-end results on our next call in February. Hope everyone has a great afternoon. Thank you.

Operator

And that does conclude today's presentation. We do thank everyone for your participation.

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