WESTERN ASSET/CLAYMORE INFLATION-LINKED SECURITIES & INCOME FUND
Form N-CSRS
August 25, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED

MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-21403

Western Asset/Claymore Inflation-Linked Securities & Income Fund

(Exact name of registrant as specified in charter)

385 East Colorado Boulevard, Pasadena, CA 91101

(Address of principal executive offices) (Zip code)

Robert I. Frenkel, Esq.

Legg Mason & Co., LLC

100 First Stamford Place

Stamford, CT 06902

(Name and address of agent for service)

Registrant s telephone number, including area code: (888) 777-0102

Date of fiscal year end: December 31

Date of reporting period: June 30, 2014

ITEM 1. REPORT TO STOCKHOLDERS.

The **Semi-Annual** Report to Stockholders is filed herewith.

Semi-Annual Report

June 30, 2014

WESTERN

ASSET/CLAYMORE

INFLATION-LINKED SECURITIES & INCOME FUND (WIA)

INVESTMENT PRODUCTS: NOT FDIC INSURED   NO BANK GUARANTEE   MAY LOSE VALUE

What s inside

Letter to shareholders	II
Investment commentary	V
Fund at a glance	1
Spread duration	2
Effective duration	3
Schedule of investments	4
Statement of assets and liabilities	10
Statement of operations	11
Statements of changes in net assets	12
Statement of cash flows	13
Financial highlights	14
Notes to financial statements	15
Additional shareholder information	31
Dividend reinvestment plan	32

Investment objectives

The Fund s primary investment objective is to provide current income. Capital appreciation, when consistent with current income, is a secondary investment objective.

Letter to shareholders

Dear Shareholder,

We thank you for your investment in Western Asset/Claymore Inflation-Linked Securities & Income Fund (the Fund). As investment adviser for the Fund, we are pleased to submit the Fund s semi-annual shareholder report for the six-month reporting period ended June 30, 2014.

For the six-month period ended June 30, 2014, the Fund returned 6.30% based on its net asset value (NAV[i]) and 8.83% based on its New York Stock Exchange (NYSE) market price per share. The Fund s unmanaged benchmarks, the Barclays U.S. Government Inflation-Linked 1-10 Year Index[ii] and the Barclays U.S. Government Inflation-Linked All Maturities Index[iii], returned 3.99% and 6.35%, respectively, for the same period. All Fund returns cited whether based on NAV or market price assume the reinvestment of all distributions. Past performance does not guarantee future results. The market price of the Fund s shares fluctuates from time to time, and it may be higher or lower than the Fund s NAV. Details of Fund fees and expenses appear elsewhere in this report.

A number of adjustments were made to the Fund during the reporting period. We reduced the Fund s investment grade corporate bond exposure, largely in the Financial sector. We increased the Fund s allocation to inflation-linked bonds (linkers) in Mexico and Brazil. We also reduced the Fund s exposure to emerging market nominal government bonds. In particular, we trimmed our exposure in Brazil. However, we increased the Fund s nominal government bond exposure in Mexico. Elsewhere, we initiated several investment grade bond relative value trades during the six-month period.

During the reporting period, we tactically utilized leverage in the Fund. We ended the period with liabilities as a percentage of gross assets, of approximately 16%, relatively unchanged during the six months ended June 30, 2014. The use of leverage was additive for results during the reporting period.

The largest contributors to the Fund s absolute performance during the reporting period were our allocations to emerging market quasi-sovereign and nominal government bonds, as well as our emerging market linkers.

The Fund s allocation to developed market investment grade bonds was also rewarded. They were supported by generally positive corporate earnings, declining interest rates and low defaults. Elsewhere, our developed country linkers were additive to the Fund s absolute performance.

The largest detractors from the Fund s absolute performance for the period were derivative instruments, in particular, U.S Treasury futures and options on U.S Treasury futures, as well as Euro-Dollar futures and options, which were utilized to manage the Fund s yield curve[iv] positioning and duration[v]. Currency forwards, which were used to manage the Fund s currency exposures, were also negative for results.

As of June 30, 2014, the Fund s market price of $12.23 per share represented a discount of 11.18% to its NAV of $13.77 per share. In each month of the period, the Fund provided its investors with a distribution of $0.032 per share. The most recent distribution represents an annualized distribution rate of 3.14% based on the Fund s last closing market price of $12.23 as of June 30, 2014.

The Fund s investment objective is to provide current income. Capital appreciation, when consistent with current income, is a secondary objective. Under normal market conditions, the Fund will invest:

At least 80% of its total managed assets[vi] in inflation-linked securities

At least 60% of its total managed assets in U.S. Treasury Inflation Protected Securities (TIPS[vii])

No more than 40% of its total managed assets in non-U.S. dollar investments, which gives the Fund the flexibility to invest up to 40% of its total managed assets in non-U.S. dollar inflation-linked securities (no more than 20% of its non-U.S. dollar exposure may be unhedged)

Each of the foregoing policies is a non-fundamental policy that may be changed without shareholder approval. The Fund has also adopted the following non-fundamental policy, which, to the extent required by applicable law, may only be changed after notice to shareholders: under normal market conditions, the Fund will invest at least 80% of its total managed assets in inflation-protected securities and non-inflation-protected securities and instruments with the potential to enhance the Fund s income. The Fund will not invest in bonds that are below investment grade quality at the time of purchase. Up to 20% of the Fund s portfolio securities may represent corporate debt securities of investment grade quality at the time of their purchase that are not inflation-linked securities. To the extent permitted by the foregoing policies, the Fund may invest in emerging market debt securities. Reverse repurchase agreements and other forms of leverage will not exceed 38% of the Fund s total managed assets. The Fund currently expects that the average effective duration[viii] of its portfolio will range between zero and fifteen years, although this target duration may change from time to time. The Fund may enter into credit default swap contracts for investment purposes, to manage its credit risk or to add leverage. The Fund may enter into total return swap contracts for investment purposes.

Shareholders have the opportunity to reinvest their dividends from the Fund through the Dividend Reinvestment Plan (DRIP), which is described in detail on page 30 of this report. In general, if shares

Letter to shareholders (cont d)

are trading at a discount to NAV, the DRIP takes advantage of the discount by reinvesting the monthly dividend distribution in common shares of the Fund purchased in the market at a price less than NAV. Conversely, when the market price of the Fund s common shares is at a premium above NAV, the DRIP reinvests participants dividends in newly-issued common shares at NAV, subject to an IRS limitation that the purchase price cannot be more than 5% below the market price per share. The DRIP provides a cost-effective means to accumulate addi tional shares.

We appreciate your investment and look forward to serving your investment needs in the future. For the most up-to-date information on your investment, please visit the Fund s website at www.guggenheiminvestments.com/wia.

Sincerely,

Western Asset Management Company

July 31, 2014

[i] Net asset value (NAV) is calculated by subtracting total liabilities, including liabilities associated with financial leverage (if any) from the closing value of all securities held by the Fund (plus all other assets) and dividing the result (total net assets) by the total number of the common shares outstanding. The NAV fluctuates with changes in the market prices of securities in which the Fund has invested. However, the price at which an investor may buy or sell shares of the Fund is the Fund s market price as determined by supply of and demand for the Fund s shares.

[ii] The Barclays U.S. Government Inflation-Linked 1-10 Year Index measures the performance of the intermediate U.S. TIPS market.

[iii] The Barclays U.S. Government Inflation-Linked All Maturities Index measures the performance of the U.S. TIPS market. The Index includes TIPS with one or more years remaining maturity with total outstanding issue size of $500 million or more.

[iv] The yield curve is the graphical depiction of the relationship between the yield on bonds of the same credit quality but different maturities.

[v] Duration is the measure of the price sensitivity of a fixed-income security to an interest rate change of 100 basis points. Calculation is based on the weighted average of the present values for all cash flows.

[vi] Total managed assets equals the total assets of the Fund (including any assets attributable to leverage) minus accrued liabilities (other than liabilities representing leverage).

[vii] U.S. Treasury Inflation Protected Securities (TIPS) are inflation-indexed securities issued by the U.S. Treasury in five-year, ten-year and twenty-year maturities. The principal is adjusted to the Consumer Price Index, the commonly used measure of inflation. The coupon rate is constant, but generates a different amount of interest when multiplied by the inflation-adjusted principal.

[viii] Effective duration measures the expected sensitivity of market price to changes in interest rates, taking into account the effects of structural complexities. (For example, some bonds can be prepaid by the issuer.)

Investment commentary

Economic review

Since the end of the Great Recession, the U.S. economy has expanded at a slower than usual pace, compared to recent history. U.S. gross domestic product (GDP)[i] growth, as reported by the U.S. Department of Commerce s revised figures, was 4.5% during the third quarter of 2013, its best reading since the fourth quarter of 2011. At the beginning of the six months ended June 30, 2014 (the reporting period), the severe winter weather of January and February played a key role in a sharp reversal in the economy, a 2.1% contraction during the first quarter of 2014. This was the first negative GDP report in three years. Negative contributions were widespread: private inventory investment, exports, state and local government spending, nonresidential and residential fixed investment. Thankfully, this setback was very brief, as the initial reading for second quarter GDP growth, released after the reporting period ended, was 4.0%, suggesting the recovery has some resilience and continues to recover from the severe consequences of the Great Recession. The second quarter rebound in GDP growth was driven by several factors, including increased private inventory investment and exports, as well as an acceleration in personal consumption expenditures and an upturn in state and local government spending.

The U.S. manufacturing sector continued to support the economy during the reporting period. Based on figures for the Institute for Supply Management s Purchasing Managers Index (PMI)[ii], U.S. manufacturing expanded during all six months of the reporting period (a reading below 50 indicates a contraction, whereas a reading above 50 indicates an expansion). After a reading of 56.5 in December 2013, the PMI fell to 51.3 in January 2014, its weakest reading since May 2013. However, the PMI moved up the next four months and was 55.4 in May 2014, and slipped to 55.3 in June, with fifteen of the eighteen industries within the PMI expanding.

The U.S. job market improved during the reporting period. When the period began, unemployment, as reported by the U.S. Department of Labor, was 6.6%. Unemployment then ticked up to 6.7% in February and held steady in March 2014. Unemployment then fell to 6.3% in April and was unchanged in May. The labor market then gathered additional momentum in June, as the unemployment rate fell to 6.1%, the lowest level since September 2008. However, falling unemployment during the period was partially due to a decline in the workforce participation rate, which was 62.8% from May through June 2014, matching the lowest level since 1978. The number of longer-term unemployed, however, declined, as 32.8% of the 9.5 million Americans looking for work in June 2014 had been out of work for more than six months. In contrast, 37.7% of the 10.4 million Americans looking for work in December 2013 had been out of work for more than six months.

Investment commentary (cont d)

Market review

Q. How did the Federal Reserve Board (Fed[iii]) respond to the economic environment?

A. The Fed took a number of actions as it sought to meet its dual mandate of fostering maximum employment and price stability. As has been the case since December 2008, the Fed kept the federal funds rate[iv] at a historically low range between zero and 0.25%. At its meeting in December 2012, prior to the beginning of the reporting period, the Fed announced that it would continue purchasing $40 billion per month of agency mortgage-backed securities (MBS), as well as initially purchasing $45 billion per month of longer-term Treasuries. Following the meeting that concluded on December 18, 2013, the Fed announced that it would begin tapering its monthly asset purchases, saying Beginning in January 2014, the Committee will add to its holdings of agency MBS at a pace of $35 billion per month rather than $40 billion per month, and will add to its holdings of longer-term Treasury securities at a pace of $40 billion per month rather than $45 billion per month.

At each of the Fed s next four meetings (January, March, April and June 2014), it announced further $10 billion tapering of its asset purchases. Finally, at its meeting that ended on July 30, 2014, after the reporting period ended, the Fed again cut its monthly asset purchases. Beginning in August, it will buy a total of $25 billion per month ($10 billion per month of agency MBS and $15 billion per month of longer-term Treasuries).

Q. Did Treasury yields trend higher or lower during the six months ended June 30, 2014?

A. Short-term Treasury yields moved higher, whereas long-term Treasury yields declined during the reporting period. When the reporting period began, the yield on the two-year Treasury was 0.38%. It fell as low as 0.30% in early February 2014, and was as high as 0.51% on June 17, 2014, before ending the period at 0.47%. The yield on the ten-year Treasury began the period at 3.04%, its peak for the period. The ten-year Treasury fell as low as 2.44% on May 28, 2014 and ended the period at 2.53%.

Q. What was the inflationary environment during the reporting period?

A. While inflation ticked up, it remained relatively modest during the reporting period. For the six months ended June 30, 2014, the seasonally unadjusted rate of inflation, as measured by the Consumer Price Index for All Urban Consumers (CPI-U[v],) was 2.27%. The CPI-U less food and energy was 1.34% over the same period. Inflation-protected securities generated strong results during the reporting period due to falling interest rates and expectations for rising inflation. During the six months ended June 30, 2014, the Barclays U.S. TIPS Index[vi] gained 5.83%.

Q. What factors impacted the spread sectors (non-Treasuries) during the reporting period?

A. The spread sectors generated positive results during the reporting period, rallying in January and February 2014, as investor demand was solid overall. The majority of spread sectors then modestly declined in March as interest rates moved higher.

However, the reporting period ended on an upbeat note as the spread sectors generated positive results from April through June. The overall bond market, as measured by the Barclays U.S. Aggregate Index[vii], gained 3.93% during the six months ended June 30, 2014.

Q. How did the emerging markets debt asset class perform over the reporting period?

A. The asset class was volatile but generated extremely strong results during the six months ended June 30, 2014. The asset class weakened in January 2014, given renewed concerns about China s economy and depreciating emerging market currencies. However, the asset class rallied sharply from February through June 2014 as investor demand was generally robust. Overall, the JPMorgan Emerging Markets Bond Index Global (EMBI Global[viii])gained 9.10% during the six months ended June 30, 2014.

Performance review

For the six months ended June 30, 2014, Western Asset/Claymore Inflation-Linked Securities & Income Fund returned 6.30% based on its net asset value (NAV[ix])and 8.83% based on its New York Stock Exchange (NYSE) market price per share. The Fund s unmanaged benchmarks, the Barclays U.S. Government Inflation-Linked 1-10 Year Index[x] and the Barclays U.S. Government Inflation-Linked All Maturities Index[xi], returned 3.99% and 6.35%, respectively, for the same period. The Barclays World Government Inflation-Linked All Maturities Index[xii] and the Fund s Custom Benchmark[xiii] returned 6.44% and 6.29%, respectively, over the same time frame.

During this six-month period, the Fund made distributions to shareholders totaling $0.19 per share. As of June 30, 2014, the Fund estimates that 68.07% of the distributions were sourced from net investment income and 31.93% constitute realized capital gains.* The performance table shows the Fund s six-month total return based on its NAV and market price as of June 30, 2014. **Past performance is no guarantee of future results.**

Performance Snapshot as of June 30, 2014
(unaudited)

Price Per Share	6-Month Total Return*
$13.77 (NAV)	6.30%
$12.23 (Market Price)	8.83%

All figures represent past performance and are not a guarantee of future results.

*** Total returns are based on changes in NAV or market price, respectively. Returns reflect the deduction of all Fund expenses, including management fees, operating expenses, and other Fund expenses. Returns do not reflect the deduction of brokerage commissions or taxes that investors may pay on distributions or the sale of shares.**

Total return assumes the reinvestment of all distributions, including returns of capital, if any, at NAV.

Total return assumes the reinvestment of all distributions, including returns of capital, if any, in additional shares in accordance with the Fund s Dividend Reinvestment Plan.

* These estimates are not for tax purposes. The Fund will issue a Form 1099 with final composition of the distributions for tax purposes after year end. A return of capital is not taxable and results in a reduction in the tax basis of a shareholder s investment. For more information about a distribution s composition, please refer to the Fund s distribution press release or, if applicable, the Section 19 notice located in the press release section of our website, www.guggenheiminvestments.com/WIA.

Investment commentary (cont d)

Thank you for your investment in Western Asset/Claymore Inflation-Linked Securities & Income Fund. As always, we appreciate that you have chosen us to manage your assets and we remain focused on achieving the Fund s investment goals.

Sincerely,

Western Asset Management Company

July 31, 2014

RISKS: Bonds are subject to a variety of risks, including interest rate, credit and inflation risks. As interest rates rise, bond prices fall, reducing the value of a fixed-income investment s price. The Fund is subject to the additional risks associated with inflation protected securities, including liquidity risk, prepayment risk, extension risk and deflation risk. Investments in foreign companies, including emerging markets, involve risks beyond those inherent solely in domestic investments. Leverage may cause a fund to be more volatile than if the fund had not been leveraged, which may increase the risk of investment loss. To the extent that the Fund invests in asset-backed, mortgage-backed or mortgage-related securities, its exposure to prepayment and extension risks may be greater than investments in other fixed-income securities. International investments are subject to currency fluctuations, as well as social, economic and political risks. These risks are magnified in emerging markets.

All investments are subject to risk including the possible loss of principal. Past performance is no guarantee of future results. All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

The information provided is not intended to be a forecast of future events, a guarantee of future results or investment advice. Views expressed may differ from those of the firm as a whole.

[i] Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.

[ii] The Institute for Supply Management s PMI is based on a survey of purchasing executives who buy the raw materials for manufacturing at more than 350 companies. It offers an early reading on the health of the U.S. manufacturing sector.

[iii] The Federal Reserve Board (Fed) is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices and a sustainable pattern of international trade and payments.

[iv] The federal funds rate is the rate charged by one depository institution on an overnight sale of immediately available funds (balances at the Federal Reserve) to another depository institution; the rate may vary from depository institution to depository institution and from day to day.

[v] The Consumer Price Index for All Urban Consumers (CPI-U) is a measure of the average change in prices over time of goods and services purchased by households, which covers approximately 87% of the total population and includes, in addition to wage earners and clerical worker households, groups such as professional, managerial and technical workers, the self-employed, short-term workers, the unemployed and retirees and others not in the labor force.

[vi] The Barclays U.S. TIPS Index represents an unmanaged market index made up of U.S. Treasury Inflation-Linked Index securities.

[vii] The Barclays U.S. Aggregate Index is a broad-based bond index comprised of government, corporate, mortgage- and asset-backed issues, rated investment grade or higher, and having at least one year to maturity.

[viii] The JPMorgan Emerging Markets Bond Index Global (EMBI Global) tracks total returns for U.S. dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady bonds, loans, Eurobonds and local market instruments.

[ix] Net asset value (NAV) is calculated by subtracting total liabilities, including liabilities associated with financial leverage (if any) from the closing value of all securities held by the Fund (plus all other assets) and dividing the result (total net assets) by the total number of the common shares outstanding. The NAV fluctuates with changes in the market prices of securities in which the Fund has invested. However, the price at which an investor may buy or sell shares of the Fund is the Fund s market price as determined by supply of and demand for the Fund s shares.

[x] The Barclays U.S. Government Inflation-Linked 1-10 Year Index measures the performance of the intermediate U.S. TIPS market.

[xi] The Barclays U.S. Government Inflation-Linked All Maturities Index measures the performance of the U.S. TIPS market. The index includes TIPS with one or more years remaining maturity with total outstanding issue size of $500 million or more.

[xii] The Barclays World Government Inflation-Linked All Maturities Index measures the performance of the major government inflation-linked bond markets.

[xiii] The Custom Benchmark is comprised of 90% Barclays U.S. Government Inflation-Linked All Maturities Index and 10% Barclays U.S. Credit Index. The Barclays U.S. Credit Index is an index composed of corporate and non-corporate debt issues that are investment grade (rated Baa3/BBB- or higher).

Fund at a glance (unaudited)

Investment breakdown (%) as a percent of total investments

The bar graph above represents the composition of the Fund s investments as of June 30, 2014 and December 31, 2013 and does not include derivatives such as forward foreign currency contracts, futures contracts, written options and swap contracts. The Fund is actively managed. As a result, the composition of the Fund s investments is subject to change at any time.

Represents less than 0.1%.

Spread duration (unaudited)

Economic exposure June 30, 2014

Spread duration measures the sensitivity to changes in spreads. The spread over Treasuries is the annual risk-premium demanded by investors to hold non-Treasury securities. Spread duration is quantified as the % change in price resulting from a 100 basis points change in spreads. For a security with positive spread duration, an increase in spreads would result in a price decline and a decline in spreads would result in a price increase. This chart highlights the market sector exposure of the Fund s sectors relative to the selected benchmark sectors as of the end of the reporting period.

Benchmark	Barclays U.S. Government Inflation-Linked All Maturities Index
EM	Emerging Markets
IG Credit	Investment Grade Credit
MBS	Mortgage-Backed Securities
WIA	Western Asset/Claymore Inflation-Linked Securities & Income Fund

Effective duration (unaudited)

Interest rate exposure June 30, 2014

Effective duration measures the sensitivity to changes in relevant interest rates. Effective duration is quantified as the % change in price resulting from a 100 basis points change in interest rates. For a security with positive effective duration, an increase in interest rates would result in a price decline and a decline in interest rates would result in a price increase. This chart highlights the interest rate exposure of the Fund s sectors relative to the selected benchmark sectors as of the end of the reporting period.

Benchmark	Barclays U.S. Government Inflation-Linked All Maturities Index
EM	Emerging Markets
IG Credit	Investment Grade Credit
MBS	Mortgage-Backed Securities
WIA	Western Asset/Claymore Inflation-Linked Securities & Income Fund

Schedule of investments (unaudited)

June 30, 2014

Western Asset/Claymore Inflation-Linked Securities & Income Fund

Security	Rate	Maturity Date	Face Amount	Value
U.S. Treasury Inflation Protected Securities 82.0%				
U.S. Treasury Bonds, Inflation Indexed	2.375%	1/15/25	5,042,816	$ 6,109,291
U.S. Treasury Bonds, Inflation Indexed	2.000%	1/15/26	489,671	576,932
U.S. Treasury Bonds, Inflation Indexed	1.750%	1/15/28	32,949,280	37,932,859
U.S. Treasury Bonds, Inflation Indexed	3.625%	4/15/28	11,724,800	16,466,016
U.S. Treasury Bonds, Inflation Indexed	2.500%	1/15/29	1,004,713	1,267,665
U.S. Treasury Bonds, Inflation Indexed	3.875%	4/15/29	3,849,980	5,628,189
U.S. Treasury Bonds, Inflation Indexed	2.125%	2/15/40	625,136	795,339
U.S. Treasury Bonds, Inflation Indexed	2.125%	2/15/41	12,989,400	16,656,879
U.S. Treasury Bonds, Inflation Indexed	0.750%	2/15/42	19,199,896	18,073,400
U.S. Treasury Bonds, Inflation Indexed	0.625%	2/15/43	5,196,391	4,717,346
U.S. Treasury Bonds, Inflation Indexed	1.375%	2/15/44	4,882,128	5,369,579
U.S. Treasury Notes, Inflation Indexed	0.500%	4/15/15	18,748,246	19,019,215
U.S. Treasury Notes, Inflation Indexed	2.000%	1/15/16	41,908,689	44,184,205 [a]
U.S. Treasury Notes, Inflation Indexed	0.125%	4/15/16	794,701	815,562
U.S. Treasury Notes, Inflation Indexed	2.500%	7/15/16	669,055	726,029
U.S. Treasury Notes, Inflation Indexed	2.375%	1/15/17	14,704,880	16,086,903 [a]
U.S. Treasury Notes, Inflation Indexed	0.125%	4/15/17	4,174,600	4,318,102
U.S. Treasury Notes, Inflation Indexed	2.625%	7/15/17	16,435,400	18,398,658
U.S. Treasury Notes, Inflation Indexed	1.625%	1/15/18	848,625	925,598
U.S. Treasury Notes, Inflation Indexed	0.125%	4/15/18	13,013,087	13,442,116
U.S. Treasury Notes, Inflation Indexed	1.375%	7/15/18	7,376,102	8,059,542
U.S. Treasury Notes, Inflation Indexed	2.125%	1/15/19	3,091,424	3,481,716
U.S. Treasury Notes, Inflation Indexed	1.250%	7/15/20	7,317,280	8,018,707
U.S. Treasury Notes, Inflation Indexed	0.625%	7/15/21	13,788,311	14,524,042
U.S. Treasury Notes, Inflation Indexed	0.125%	1/15/22	25,502,242	25,671,602
U.S. Treasury Notes, Inflation Indexed	0.125%	7/15/22	10,256,460	10,326,173
U.S. Treasury Notes, Inflation Indexed	0.125%	1/15/23	21,771,552	21,696,701
U.S. Treasury Notes, Inflation Indexed	0.375%	7/15/23	4,441,096	4,527,142
U.S. Treasury Notes, Inflation Indexed	0.625%	1/15/24	1,306,473	1,353,833
Total U.S. Treasury Inflation Protected Securities (Cost $325,541,067)				**329,169,341**
Asset-Backed Securities 0.1%				
Amresco Residential Securities Mortgage Loan Trust, 1997-3 M1A	0.707%	9/25/27	989	944 [b]
Asset-Backed Funding Certificates, 2004-OPT2 M1	0.977%	8/25/33	25,432	24,506 [b]
EMC Mortgage Loan Trust, 2004-C A1	0.702%	3/25/31	11,576	11,282 [b][c]
Structured Asset Securities Corp., 2002-AL1 A3	3.450%	2/25/32	166,583	164,497
Total Asset-Backed Securities (Cost $112,837)				**201,229**

See Notes to Financial Statements.

Security	Rate	Maturity Date	Face Amount	Value
Collateralized Mortgage Obligations 2.0%				
Banc of America Mortgage Securities Inc., 2003-D	2.622%	5/25/33	43,621	$ 43,895 (b)
Bear Stearns Adjustable Rate Mortgage Trust, 2004-9 24A1	5.163%	11/25/34	82,703	80,971 (b)
Chase Mortgage Finance Corp., 2007-A1 2A3	2.498%	2/25/37	22,781	22,833 (b)
Countrywide Alternative Loan Trust, 2004-J1	6.000%	2/25/34	4,345	4,435
Federal Home Loan Mortgage Corp. (FHLMC), 4013 AI, IO	4.000%	2/15/39	5,352,996	986,392
Federal Home Loan Mortgage Corp. (FHLMC), 4057 UI, IO	3.000%	5/15/27	2,602,662	286,128
Federal Home Loan Mortgage Corp. (FHLMC), 4085, IO	3.000%	6/15/27	2,451,092	304,833
Government National Mortgage Association (GNMA), 2010-159 IO, IO	0.784%	8/16/50	24,405,427	838,131 (b)
Government National Mortgage Association (GNMA), 2011-121 IO, IO	1.046%	6/16/43	13,580,378	585,301 (b)
Government National Mortgage Association (GNMA), 2011-142 IO, IO	0.947%	9/16/46	12,617,184	636,562 (b)
Government National Mortgage Association (GNMA), 2011-152 IO, IO	1.339%	8/16/51	9,892,013	555,813 (b)
Government National Mortgage Association (GNMA), 2012-044 IO, IO	0.981%	3/16/49	6,086,403	375,482 (b)
Government National Mortgage Association (GNMA), 2012-112 IO, IO	0.859%	2/16/53	9,458,628	629,093 (b)
Government National Mortgage Association (GNMA), 2012-114 IO, IO	1.037%	1/16/53	2,729,758	241,726 (b)
Government National Mortgage Association (GNMA), 2012-125 IO, IO	0.859%	2/16/53	4,338,616	301,330 (b)
Government National Mortgage Association (GNMA), 2013-145 IO, IO	1.124%	9/16/44	3,971,956	304,591 (b)
Government National Mortgage Association (GNMA), 2014-016 IO, IO	1.038%	6/16/55	6,891,027	486,734 (b)
Government National Mortgage Association (GNMA), 2014-047 IA, IO	1.384%	2/16/48	4,333,552	357,561 (b)
Government National Mortgage Association (GNMA), 2014-050 IO, IO	1.040%	9/16/55	4,257,220	321,637 (b)
GSR Mortgage Loan Trust, 2004-11 1A1	2.696%	9/25/34	190,903	181,434 (b)
JPMorgan Mortgage Trust, 2003-A1 1A1	2.026%	10/25/33	43,485	43,859 (b)
JPMorgan Mortgage Trust, 2004-A1 1A1	1.990%	2/25/34	9,062	9,085 (b)
JPMorgan Mortgage Trust, 2006-A2 5A1	2.547%	11/25/33	8,800	8,862 (b)
Merrill Lynch Mortgage Investors Inc., 2003-H A3	1.938%	1/25/29	5,346	5,281 (b)
Merrill Lynch Mortgage Investors Trust, 2004-A1 2A1	2.381%	2/25/34	20,484	20,694 (b)
Residential Asset Mortgage Products Inc., 2004-SL2 A4	8.500%	10/25/31	13,351	15,028
Residential Asset Mortgage Products Inc., 2004-SL4 A5	7.500%	7/25/32	90,971	86,445
Sequoia Mortgage Trust, 2003-8 A1	0.793%	1/20/34	21,018	20,242 (b)
WaMu Mortgage Pass-Through Certificates, 2003-AR8 A	2.414%	8/25/33	19,476	19,738 (b)

See Notes to Financial Statements.

Schedule of investments (unaudited) (cont d)

June 30, 2014

Western Asset/Claymore Inflation-Linked Securities & Income Fund

Security	Rate	Maturity Date	Face Amount	Value
Collateralized Mortgage Obligations continued				
WaMu Mortgage Pass-Through Certificates, 2007-HY1 1A1	2.193%	2/25/37	212,950	$ 176,202 (b)
Washington Mutual Inc., MSC Pass-Through Certificates, 2004-RA1 2A	7.000%	3/25/34	20,876	22,089
Total Collateralized Mortgage Obligations (Cost $7,398,222)				**7,972,407**
Corporate Bonds & Notes 9.1%				
Consumer Staples 0.9%				
Tobacco 0.9%				
Altria Group Inc., Senior Notes	2.850%	8/9/22	850,000	817,943
Altria Group Inc., Senior Notes	9.950%	11/10/38	1,000,000	1,665,839
Reynolds American Inc., Senior Notes	4.750%	11/1/42	1,000,000	953,583
Total Consumer Staples				**3,437,365**
Energy 0.6%				
Oil, Gas & Consumable Fuels 0.6%				
Petrobras International Finance Co., Senior Notes	6.750%	1/27/41	1,123,000	1,156,690
Petroleos Mexicanos, Senior Notes	5.500%	6/27/44	1,277,000	1,329,357
Total Energy				**2,486,047**
Financials 6.1%				
Banks 4.4%				
Bank of America Corp., Senior Notes	4.500%	4/1/15	940,000	968,039
Bank of America Corp., Senior Notes	6.500%	8/1/16	970,000	1,075,137
Bank of America Corp., Senior Notes	4.100%	7/24/23	750,000	778,400
Bank of America Corp., Senior Notes	5.000%	1/21/44	810,000	859,364
Barclays Bank PLC, Subordinated Notes	7.625%	11/21/22	2,160,000	2,465,640
Citigroup Inc., Senior Notes	6.010%	1/15/15	1,273,000	1,311,376
Citigroup Inc., Subordinated Notes	6.675%	9/13/43	1,500,000	1,867,371
HSBC USA Inc., Senior Notes	2.375%	2/13/15	800,000	809,954
JPMorgan Chase & Co., Junior Subordinated Bonds	5.150%	5/1/23	2,250,000	2,157,187 (b)(d)
JPMorgan Chase & Co., Subordinated Notes	5.625%	8/16/43	1,080,000	1,220,813
Wachovia Capital Trust III, Junior Subordinated Bonds	5.570%	8/11/14	2,700,000	2,619,000 (b)(d)
Wells Fargo & Co., Subordinated Notes	5.375%	11/2/43	1,300,000	1,430,051
Total Banks				*17,562,332*
Capital Markets 0.3%				
Goldman Sachs Group Inc., Senior Notes	6.250%	9/1/17	1,000,000	*1,138,456*
Consumer Finance 0.4%				
American Express Co., Subordinated Debentures	6.800%	9/1/66	730,000	803,000 (b)
HSBC Finance Corp., Senior Notes	6.676%	1/15/21	700,000	837,131
Total Consumer Finance				*1,640,131*

See Notes to Financial Statements.

Security	Rate	Maturity Date	Face Amount	Value
Diversified Financial Services 1.0%				
General Electric Capital Corp., Junior Subordinated Bonds	6.250%	12/15/22	2,000,000	$ 2,225,000 (b)(d)
General Electric Capital Corp., Senior Notes	6.875%	1/10/39	1,500,000	2,014,917
Total Diversified Financial Services				*4,239,917*
Total Financials				**24,580,836**
Industrials 0.3%				
Airlines 0.3%				
Air Canada, Pass-Through Trust, Secured Notes	4.125%	5/15/25	976,153	**988,355** (c)
Materials 0.3%				
Metals & Mining 0.3%				
Vale SA, Senior Notes	5.625%	9/11/42	1,362,000	**1,334,351**
Telecommunication Services 0.6%				
Diversified Telecommunication Services 0.6%				
Verizon Communications Inc., Senior Notes	6.550%	9/15/43	1,920,000	**2,416,207**
Utilities 0.3%				
Electric Utilities 0.3%				
FirstEnergy Corp., Notes	7.375%	11/15/31	1,000,000	**1,181,841**
Total Corporate Bonds & Notes (Cost $34,073,446)				**36,425,002**
Non-U.S. Treasury Inflation Protected Securities 12.6%				
Australia 1.0%				
Australia Government Bond, Senior Bonds	2.500%	9/20/30	3,400,000 AUD	*4,112,053* (c)
Brazil 7.1%				
Federative Republic of Brazil, Notes	6.000%	8/15/22	54,911,646 BRL	25,312,687
Federative Republic of Brazil, Notes	6.000%	8/15/50	7,164,197 BRL	3,210,709
Total Brazil				*28,523,396*
Canada 1.3%				
Government of Canada, Bonds	4.250%	12/1/26	3,706,040 CAD	*5,123,161*
Japan 0.7%				
Japanese Government CPI Linked Bond, Senior Bonds	0.100%	9/10/23	280,506,600 JPY	*3,004,152*
Mexico 0.5%				
United Mexican States, Senior Bonds	4.500%	12/4/25	21,534,206 MXN	*2,021,012*
New Zealand 1.0%				
New Zealand Government Bond, Senior Bonds	2.000%	9/20/25	4,760,000 NZD	*4,039,423*
Sweden 1.0%				
Kingdom of Sweden, Bonds	0.250%	6/1/22	26,230,000 SEK	*3,982,109*
Total Non-U.S. Treasury Inflation Protected Securities (Cost $49,812,764)				**50,805,306**

See Notes to Financial Statements.

Schedule of investments (unaudited) (cont d)

June 30, 2014

Western Asset/Claymore Inflation-Linked Securities & Income Fund

			563		
Stock repurchased	(1,033)	(5,320)			(5,320)
Stock option income tax deficiencies		(1,174)			(1,174)
Balances at December 31, 2008	30,614	3,207	94,433	6,045	103,685
Net loss			(53,297)		(53,297)
Foreign currency translation adjustment, net of income taxes of $43				888	888
Comprehensive loss					(52,409)
Stock-based compensation expense		1,207			1,207
Shares issued for vested stock awards	130				
Balances at December 31, 2009	30,744	$ 4,414	$ 41,136	$ 6,933	$ 52,483

(1) Foreign currency translation adjustments are the sole component of Accumulated Other Comprehensive Income.

See accompanying notes to consolidated financial statements.

NAUTILUS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	2009	2008
Cash flows from operating activities:		
Loss from continuing operations	$ (18,610)	$ (52,597)
Loss from discontinued operations	(34,687)	(37,991)
Net loss	(53,297)	(90,588)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	10,739	16,832
Allowance for doubtful accounts	1,315	4,761
Inventory lower-of-cost-or-market adjustments	1,562	5,952
Stock-based compensation expense	1,207	4,792
Loss on asset disposals	10,250	755
Asset impairments	9,067	30,855
Writeoff of abandoned leasehold improvements and other assets	9,922	
Deferred income taxes, net of valuation allowances	1,025	14,106
Other		816
Changes in operating assets and liabilities:		
Trade receivables	23,458	22,475
Inventories	11,003	10,917
Prepaids and other current assets	2,299	4,971
Income taxes	(1,018)	(2,137)
Trade payables	(1,252)	(10,277)
Accrued liabilities, including warranty obligations	(11,498)	(8,660)
Net cash provided by operating activities	14,782	5,570
Cash flows from investing activities:		
Proceeds from sale of discontinued operations	7,397	58,435
Proceeds from other asset sales	211	1,379
Refunds of escrow deposits	4,024	5,000
Purchases of equipment and intangible assets	(2,000)	(4,824)
Net increase in restricted cash	(4,933)	
Payments received on note receivable		2,364
Net cash provided by investing activities	4,699	62,354
Cash flows from financing activities:		
Decrease in short-term borrowings	(17,944)	(61,230)
Debt issuance costs	(75)	(1,954)
Stock repurchases		(5,320)
Proceeds from exercises of stock options		563
Other		(1,174)
Net cash used in financing activities	(18,019)	(69,115)
Net effect of currency exchange rate changes	280	(1,173)

Net increase (decrease) in cash and cash equivalents	1,742	(2,364)
Cash and cash equivalents, beginning of year	5,547	7,911
Cash and cash equivalents, end of year	$ 7,289	$ 5,547
Supplemental disclosure of cash flow information:		
Cash refunded for income taxes	$ 11,105	$ 9,025
Cash paid for interest	$ 227	$ 2,677

See accompanying notes to consolidated financial statements.

NAUTILUS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) SIGNIFICANT ACCOUNTING POLICIES

Organization and Business Nautilus is a leading designer, developer and marketer of fitness products sold under such well-known brand names as Nautilus, Bowflex, Schwinn Fitness and Universal. As used herein, the term Nautilus or Company refers to Nautilus, Inc. and subsidiaries, unless the context indicates otherwise. The Company s goal is to develop and market fitness equipment and related products to help people enjoy healthier lives. Nautilus was founded in 1986 and incorporated in the state of Washington in 1993. The Company s headquarters are located in Vancouver, Washington.

We market our products through two business segments: Direct and Retail, each representing a distinct marketing distribution channel. Our direct business offers products directly to consumers through direct advertising, catalogs and the Internet. Our retail business offers our products through a network of independent retail companies located in the United States and Canada, as well as Internet-based merchants. Our commercial business, formerly an operating segment and reported as a discontinued operation beginning in 2009, offered products to health clubs, schools, hospitals and other organizations.

On April 18, 2008, the Company completed the sale of its former fitness apparel business, DashAmerica, Inc. d/b/a Pearl Izumi (Pearl Izumi). Accordingly, results of operations associated with the fitness apparel business have been presented in the consolidated financial statements as discontinued operations for all periods presented.

On September 25, 2009 the Company committed to a plan for the complete divestiture of its commercial business. Accordingly, results of operations and certain assets associated with the commercial business have been presented in the consolidated financial statements as discontinued operations for all periods presented.

Basis of presentation The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and relate to Nautilus, Inc. and its subsidiaries, all of which are wholly-owned, directly or indirectly. Intercompany transactions and balances have been eliminated in consolidation.

Year-end The Company s fiscal year ends on December 31.

Reclassifications The Company has reclassified certain 2008 amounts related to the cash flows of its fitness apparel division discontinued operation, as permitted by accounting guidance, which previously were reported separately, to conform to the current period presentation. Net cash flows were not impacted by this reclassification.

The results of the commercial business, including related costs previously included in restructuring expense, have been reclassified as discontinued operations in the Company s financial statements for all periods presented.

Accrued warranty obligations, previously included in accrued liabilities, have been reclassified as a separate component of current liabilities in the Company s consolidated balance sheets.

Use of estimates The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses and the disclosure of contingent assets and liabilities in the financial statements. Actual results could differ from those estimates.

Concentrations of risk Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash held in bank accounts that exceed federally insured limits and trade receivables.

Trade receivables are generally unsecured and therefore collection is affected by the economic conditions in each of our principal markets. Collection of receivables due from customers outside the U.S. may also be negatively impacted by the nature and extent of our business presence in a particular country and any rights or protections afforded to our customers under a country s legal system.

Nautilus relies on third-party contract manufacturers in Asia for substantially all of its products and for certain product engineering support. Business operations could be disrupted by natural disasters, difficulties in transporting our products from foreign suppliers, as well as political, social or economic instability in the countries where our contract manufacturers or their vendors and customers conduct business. While any of the Company s manufacturing arrangements could be replaced over time, the temporary loss of the services of any primary contract manufacturer could cause a significant disruption in operations and delay product shipments.

Cash, cash equivalents and restricted cash All highly liquid investments with remaining maturities of three months or less at purchase are considered to be cash equivalents. Restricted cash consists of bank accounts pledged as collateral for outstanding letters of credit, which are long-term.

Inventories Inventories are stated at the lower of cost or market, with cost determined based on the first-in, first-out method. Any abnormal amounts of freight, handling costs and spoilage are recognized as current period charges. The Company establishes inventory allowances for excess, slow-moving and obsolete inventory based on inventory levels, expected product life cycles and forecasted sales demand. Inventories are written down to market value, based on historical demand, competitive factors, changes in technology and product lifecycles.

Property, plant and equipment Property, plant and equipment is stated at cost, net of accumulated depreciation. Improvements or betterments which add new functionality or significantly extend the life of an asset are capitalized. Expenditures for maintenance and repairs are expensed as incurred. The cost of assets retired, or otherwise disposed of, and the related accumulated depreciation, are removed from the accounts in the year of disposal. Gains and losses resulting from asset sales and dispositions are recognized in our consolidated statement of operations in the period in which assets are disposed.

Depreciation is recognized, using the straight-line method, over the lesser of the estimated useful lives of the assets or, in the case of leasehold improvements, the lease term including renewal periods if the Company expects to exercise its renewal options. Depreciation on furniture, equipment and information systems is determined based on estimated useful lives, which generally range from three to five years.

Goodwill and intangible assets Goodwill consists of the excess of acquisition costs over the fair values of net assets acquired in business combinations. Indefinite-life intangible assets consist of acquired trademarks. Goodwill and other indefinite-life intangible assets are stated at cost and are not amortized; instead, they are tested for impairment at least annually.

Nautilus reviews goodwill and other indefinite-life intangible assets for impairment in the fourth quarter of each year, or more frequently when events or changes in circumstances indicate that the assets may be impaired. With respect to goodwill, the Company compares the carrying value of the related reporting unit to an estimate of the reporting unit s fair value. If the carrying value of the reporting unit exceeds its estimated fair value, the estimated fair values of all of the reporting unit s assets and liabilities are determined to establish the amount of the impairment, if any. For further information regarding goodwill, refer to Note 7, Goodwill. For further information regarding other intangible assets, refer to Note 8, Other Intangible Assets.

In 2009, in connection with its annual impairment review, Nautilus determined that an indefinite-life trademark was impaired and recognized an impairment charge of $2.3 million. In 2008, in connection with its annual impairment review, Nautilus determined that goodwill of its retail segment was impaired and recognized an impairment charge of $29.8 million.

Table of Contents

Finite-lived intangible assets, primarily acquired patents and patent rights, are stated at cost, net of accumulated amortization. The Company recognizes amortization expense for its finite-lived intangible assets on a straight-line basis over the estimated useful lives, which generally range from one to 16 years.

Impairment of long-lived assets Long-lived assets, including property, plant and equipment, and finite-lived intangible assets, including patents and patent rights, are evaluated for impairment when events or circumstances indicate the carrying value may be impaired. When such an event or condition occurs, Nautilus estimates the future undiscounted cash flows to be derived from the use and eventual disposition of the asset to determine whether a potential impairment exists. If the carrying value exceeds estimated future undiscounted cash flows, the Company records impairment expense to reduce the carrying value of the asset to its estimated fair value.

In connection with changes in long-term product development plans resulting from strategic decisions made by management in the fourth quarter, Nautilus recognized an impairment charge of $3.6 million in 2009 related to certain patent rights which the Company previously expected to be utilized in its retail products.

Revenue recognition Product sales and shipping revenues, net of promotional discounts, rebates and return allowances, are recorded when products are shipped and title passes to customers. Retail sales to customers are made pursuant to a sales contract that provides for transfer of both title and risk of loss upon our delivery to the carrier.

Taxes collected from customers and remitted to governmental authorities are recorded on a net basis, and excluded from revenue. Shipping and handling fees billed to customers are recorded gross and included in both revenue and cost of sales. Many direct business customers finance their purchases through a third-party credit provider, for which Nautilus pays a commission or financing fee to the credit provider. Revenue for these transactions is recognized based on the sales prices charged to the customer and the commission or financing fee is included in selling and marketing expense.

Revenue is recognized net of applicable sales incentives, such as promotional discounts, rebates and return allowances. Nautilus estimates the revenue impact of incentive programs, based on the planned duration of the program and historical experience. If the amount of sales incentives is reasonably estimable, the impact of such incentives is recorded at the later of the time the customer is notified of the sales incentive or the time of the sale.

Nautilus estimates liability for product returns based on historical experience and records the expected obligation as a reduction in revenue. If actual return costs differ from previous estimates, the amount of the liability and corresponding revenue are adjusted in the period such costs occur.

Cost of sales Cost of sales is primarily comprised of: inventory purchase costs; royalties; salaries, wages and other employee-related costs; occupancy charges, including depreciation of warehouse and distribution facility improvements and equipment; transportation expenses; costs of product warranties and related services; distribution information systems costs; and allocated expenses for shared administrative functions.

Product warranty obligations The Company s products carry limited defined warranties for defects in materials or workmanship, which require Nautilus to pay for replacement parts, costs for shipping the parts to customers and, in certain instances, service labor costs. Nautilus records a liability, at the time of sale, for the estimated costs of responding to future warranty claims. Estimated warranty costs are recorded as a component of cost of sales, based on historical warranty claim experience and available product quality data. If necessary, Nautilus adjusts its liability for specific warranty matters when they become known and are reasonably estimable. Warranty expenses are affected by the performance of new products, significant manufacturing or design defects not discovered until after the product is delivered to the customer, product failure rates, and higher or lower than expected repair costs. If warranty costs differ from previous estimates, or if circumstances change such that the assumptions inherent in our previous estimates are no longer valid, the amount of warranty reserve is adjusted accordingly.

Table of Contents

The following reflects the activity related to our reserves for warranty obligations for the two-year period ended December 31, 2009:

(In thousands)	Balance at Beginning of Year	Charged to Costs and Expenses	Deductions*	Balance at End of Year
Warranty reserves:				
2009	$ 17,837	$ 3,073	$ (12,531)	$ 8,379
2008	25,185	9,122	(16,470)	17,837

* Deductions represent warranty claims paid out in the form of service costs and/or product replacements.

Warranty reserves at December 31, 2009 and 2008 include $1.3 million and $2.5 million, respectively, in estimated long-term obligations.

Litigation and Loss Contingencies From time to time, the Company may be involved in various claims, lawsuits and other proceedings. Such litigation involves uncertainty as to the eventual outcomes and losses which may be realized when one or more future events occur or fail to occur. Nautilus records expenses for litigation and loss contingencies when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The Company estimates the probability of such losses based on the advice of internal and external counsel, the outcomes from similar litigation, the status of the lawsuits (including settlement initiatives), legislative developments and other factors. Due to the numerous variables associated with these judgments and assumptions, both the precision and reliability of the resulting estimates of the related loss contingencies are subject to substantial uncertainties. The Company regularly monitors its estimated exposure to these contingencies and, as additional information becomes known, may change its estimates accordingly.

Advertising and promotion Nautilus expenses its advertising and promotion costs as incurred. Production costs of television advertising commercials are recorded as prepaid expenses until the initial broadcast, at which time such costs are expensed. Advertising and promotion costs are included in selling and marketing expenses.

Total advertising and promotion expenses were $48.3 million and $67.0 million for the years ended December 31, 2009 and 2008, respectively. Prepaid advertising and promotion costs totaled $0.9 million at December 31, 2009 and December 31, 2008.

Research and development Internal research and development costs, which primarily consist of salaries and wages, employee benefits, expenditures for materials, and fees to use licensed technologies, are expensed as incurred. Third party research and development costs for products under development or being researched, if any, are expensed as the contracted work is performed.

Income taxes Nautilus accounts for income taxes based on the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates expected to be in effect when the temporary differences are expected to be included, as income or expense, in the applicable tax return. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in the period of the enactment. Valuation allowances are provided against deferred income tax assets if we determine it is more likely than not that such assets will not be realized.

The Company recognizes a tax benefit from an uncertain tax position when it is more likely than not that the position will be sustained based on the technical merits of the position upon examination, including resolutions of any related appeals or litigation.

Foreign currency translation Nautilus translates the accounts of its foreign subsidiaries into U.S. dollars, using the current rate method, whereby: revenues, expenses, gains and losses are translated at weighted-average exchange rates during the year; and assets and liabilities are translated at the exchange rate on the balance sheet date. Translation gains and losses are reported in the Company s consolidated balance sheets as a component of accumulated other comprehensive income (loss) in stockholders equity.

Gains and losses arising from foreign currency transactions, including transactions between the Company and its foreign subsidiaries, are recorded as a component of other income (expense) in our consolidated statements of operations.

Fair value of financial instruments Financial instruments include cash, cash equivalents, restricted cash, trade receivables, short-term borrowings, accounts payable, letters of credit and guarantees entered into in the ordinary course of our business. The carrying amounts reflected in our consolidated balance sheets approximate fair value due to their market rates of interest and/or short-term maturities.

Stock-based compensation Nautilus recognizes stock-based compensation, on a straight-line basis, over the applicable vesting period, based on the grant-date fair value of the award. To the extent a stock-based award is subject to performance conditions, the amount of expense recorded in a given period, if any, reflects our assessment of the probability of achieving the performance targets.

Fair value of stock options is estimated using the Black-Scholes-Merton option valuation model; fair value of restricted stock awards is based on the closing market price on the day preceding the grant. Assumptions used in calculating the fair value of stock-option grants are as follows:

	2009	**2008**
Dividend yield	0.0%	0.0%
Risk-free interest rate	2.5%	3.2%
Expected life (years)	4.75	4.59
Expected volatility	88%	52%

Expected dividend yield is based on our current expectation that no dividend payments will be made in future periods.

Risk-free interest rate is based on the implied yield available on U.S. Treasury zero coupon issues with a remaining term approximating the expected life of the options.

Expected life is calculated using the simplified method, equal to the sum of the vesting term and the original contractual term, divided by two.

Expected volatility is determined based on the daily historical volatility of the Company s common stock over a period commensurate with the expected life of the stock option.

The Company estimates future forfeitures, at the time of grant and in subsequent periods, based on historical turnover rates, previous forfeiture experience and changes in the business or key personnel that would suggest future forfeitures may differ from historical data. The Company recognizes compensation expense for only those stock options and stock-based awards that are expected to vest. The Company reevaluates estimated forfeitures each quarter and, if applicable, recognizes a cumulative effect adjustment in the period of the change if the revised estimate of the impact of forfeitures differs significantly from the previous estimate.

Related party transactions The Company s largest shareholder, Sherborne Investors LP (Sherborne) undertook a successful action to replace four of the Company s directors with Sherborne nominees in a December 2007 special meeting of shareholders. In May 2008, shareholders approved the reimbursement of up to $0.6 million of expenses incurred by Sherborne in connection with the shareholder action. Payment requires the approval of the disinterested members of the Company s Board and is not anticipated until some time after the Company returns to profitability. The obligation to reimburse Sherborne s expenses is included as a long-term liability in the Company s consolidated balance sheets at December 31, 2009 and 2008.

In February 2009, the disinterested members of the Company s Board of Directors approved a separate agreement with Sherborne Investors Management (Sherborne Investors) under which the Company is obligated to reimburse Sherborne Investors, $20,000 per month, for the use of Sherborne s New York office space and administrative, information technology and communications services to support the Company s Chief Executive Officer. In 2009, Nautilus paid Sherborne Investors $220,000 in reimbursements under this agreement.

New accounting pronouncements No new accounting pronouncements had, or are reasonably likely to have, a material impact on the Company s consolidated financial position, results of operations or cash flows.

(2) DISCONTINUED OPERATIONS

Discontinued operations consist of the Company s commercial business and its former fitness apparel business.

Commercial Business

In light of continuing operating losses in its commercial business and in order to focus exclusively on management of its direct and retail consumer businesses, on September 25, 2009 the Company committed to a plan for the complete divestiture of its commercial business segment. As a result of this action, the Company reported its commercial business as a discontinued operation, which qualified for held-for-sale accounting treatment, in the third quarter of 2009. The results of the commercial business have been reclassified as discontinued operations in the Company s financial statements for all periods presented.

In 2009, in light of continuing declines in commercial real property values and changes in management s expectations regarding revenue, the Company tested the long-lived assets of its commercial business segment for impairment. As a result, the Company recognized pre-tax impairment charges in the third quarter of 2009 related to real property and other intangible assets of $1.4 million and $1.6 million, respectively. In addition, the Company recognized an estimated pre-tax disposal loss of $18.3 million in the third quarter of 2009 in connection with its planned sale of the commercial business.

Subsequently, in the fourth quarter of 2009, management determined that the Company might realize greater value by selling its commercial business in multiple asset groups involving several buyers, rather than as a single disposal group as originally was planned. In the quarter ended December 31, 2009 the Company completed the sale of its StairMaster and Schwinn Fitness commercial product lines and recorded an $8.8 million adjustment to reduce the estimated pre-tax disposal loss related to the commercial business.

Following is the adjustment to previously reported amount of estimated pre-tax disposal loss, reflecting management s decision in the fourth quarter of 2009 to dispose of the business in multiple asset groups involving several buyers, rather than as a single disposal group as originally was planned:

(In thousands, before income taxes)	**2009**
Estimated loss on sale of commercial discontinued operation, as of September 30, 2009	$ (18,331)
Adjustment to expected proceeds	8,840
Estimated loss on sale of commercial discontinued operation, as of December 31, 2009	$ (9,491)

The amount of estimated loss recognized by the Company in connection with the disposal of commercial business assets reflects the carrying values of the assets expected to be sold in excess of the estimated amount of anticipated cash proceeds, net of sale transaction costs. The estimated loss amount may be adjusted in future periods, depending on changes that may occur in the underlying facts and circumstances and finalization of the related sale transactions, and the amount of the adjustment may be material.

Operating results of the commercial business discontinued operation are as follows:

(In thousands)	**Year ended December 31,** **2009**	 **2008**
Revenue	$ 74,644	$ 127,466
Loss before income taxes	$ (24,909)	$ (30,194)
Estimated loss on sale of commercial discontinued operation	(9,491)	
Income tax expense (benefit)	(90)	10,208
Loss from discontinued operation commercial business	$ (34,310)	$ (40,402)

The income tax expense in 2008 results from valuation allowances provided against certain deferred income tax assets related to the commercial business discontinued operation. Commercial business discontinued operation assets held-for-sale and related disposal loss impairments as of December 31, 2009 are as follows:

(In thousands)	**Inventories**	**Property, Plant & Equipment**	**Totals**
Assets of discontinued operation held-for-sale, before impairment adjustments	$ 14,164	$ 6,883	$ 21,047
Impairment adjustments included in loss from discontinued operations:			
Estimated loss on remaining commercial business assets held-for-sale at December 31, 2009	(3,897)	(6,369)	(10,266)
Assets of discontinued operation held-for-sale, as adjusted	$ 10,267	$ 514	$ 10,781

Currently, the Company expects to incur additional cash charges related to its planned divestiture, including estimated employee termination severance payments of approximately $1.6 million and estimated termination charges for leases and other commercial contract obligations of approximately $1.8 million, which are not reflected in 2009 operating results because such liabilities were not incurred as of year-end. The estimated amounts of additional costs may be adjusted in future periods, depending on changes that may occur in the underlying facts and circumstances, and the amount of adjustment may be material.

Cash flows of the commercial business after completion of the sale transactions may include settlements of then outstanding accounts receivable, trade payables and contractual obligations, settlements of sales agreement contingencies and receipts of passive royalties, all of which, according to accounting guidance, are not considered to be direct cash flows of the disposed segment.

In 2008, the Company recognized a $3.8 million charge, included in discontinued operations, due to uncertainties regarding access to, and future recovery of, certain assets of its China sales operation. In 2009, the Company recovered a portion of these assets and, as a result of this and other changes in circumstances, reduced the previously accrued loss amount by $2.3 million. At December 31, 2009 the Company had an allowance of $1.5 million due to uncertainties regarding the future recovery of China trade receivables.

Table of Contents

Fitness Apparel Business

On April 18, 2008 the Company completed the sale of its fitness apparel business, Pearl iZumi. Operating results for Pearl iZumi, included in loss from discontinued operations, are as follows:

(In thousands)	**2009**	**2008**
Revenue		$ 27,616
Income (loss) before income taxes	$ (377)	$ 3,016
Income tax expense		605
Income (loss) from discontinued operation fitness apparel	$ (377)	$ 2,411

The Company had an escrow deposit of $4.4 million related to the sale of Pearl iZumi, of which $2.0 million was released in August, 2009. In the third quarter of 2009, the Company recorded a $0.4 million adjustment to the previously reported disposal of Pearl iZumi for additional amounts due to the buyer under terms of the purchase agreement. The remaining escrow deposit balance of $2.0 million was released to the Company in October 2009.

(3) RESTRUCTURING

During 2008, Nautilus implemented a number of initiatives to reduce operating costs and reorganize its operations, including measures to restructure its workforce and terminate an agreement pursuant to which it was to acquire a manufacturing operation in China. In 2009, the Company announced additional plans aimed at further reducing operating costs and improving the overall alignment of spending with anticipated revenue. The 2009 plan impacted all functions through reductions in personnel and other initiatives, including the abandonment of certain information technology software, the termination of certain leases and warehouse distribution services and the downsizing of the Company s leased corporate headquarters. Initiatives related to continuing operations are summarized below.

In 2009, the Company:

Restructured its workforce and reduced the number of employees to better match business requirements;

Conducted a thorough review of its information technology costs to better align computer systems and support services to our restructured business model, resulting in significant savings related to software purchases, maintenance agreements and licensing fees;

Terminated the lease for its corporate headquarters facility in Vancouver, Washington, and entered into a new lease for substantially less space in the same building; and

Terminated a warehouse distribution service agreement for U.S. service parts inventory, which will now be distributed from existing Company locations;

In 2008, the Company:

Restructured its workforce to better match the business requirements;

Reviewed its product lines, eliminating low volume or low profit products;

Consolidated its U.S. distribution centers and aligned products by business segment to allow for more efficient product handling;

Transferred Canadian call center activities to its Vancouver, Washington call center; and

Terminated an agreement pursuant to which it was to acquire a manufacturing operation in China.

Table of Contents

Following is a summary of expenses associated with the aforementioned restructuring activities, included in Restructuring in the Company s Consolidated Statements of Operations:

(In thousands)	2009	2008
Employee termination severance costs	$ 563	$ 4,813
Facility lease termination costs	2,101	240
Abandoned leasehold improvements	8,028	
Abandoned information technology software and related service agreements	1,799	
Abandoned creative media assets		470
Termination of agreement to acquire manufacturing operation in China		8,000
Contract termination costs	939	350
Other	721	65
	$ 14,151	$ 13,938

The following table summarizes liabilities for exit costs related to restructuring activities, included in Accrued liabilities and Other long-term liabilities in our consolidated balance sheets:

(In thousands)	Severance and Benefits	Facilities and other Leases	Total Liabilities
Balance as of January 1, 2008	$	$	$
Accruals	4,662	697	5,359
Payments	(2,978)	(697)	(3,675)
Balance as of December 31, 2008	1,684		1,684
Accruals	563	5,230	5,793
Payments	(1,884)	(3,530)	(5,414)
Balance as of December 31, 2009	$ 363	$ 1,700	$ 2,063

(4) TRADE RECEIVABLES

Activity related to our allowance for doubtful trade receivables is as follows:

(In thousands)	Balance at Beginning of Year	Charged to Costs and Expenses	Deductions*	Balance at End of Year
Allowance for doubtful accounts:				
2009	$ 6,602	$ 1,315	$ (3,757)	$ 4,160
2008	4,490	4,761	(2,649)	6,602

* Deductions consist of amounts written off against the allowance, net of recoveries.

(5) INVENTORIES

	December 31,	
(In thousands)	**2009**	**2008**
Finished goods	$ 11,850	$ 29,541
Work-in-process		1,147
Parts and components	1,269	5,834
Raw materials		7,280
	$ 13,119	$ 43,802

At December 31, 2009 and 2008, the Company recorded inventory valuation allowances of $0.7 million and $6.7 million, respectively, related to excess parts and finished goods inventories. The reduction in inventory valuation allowances primarily results from the reclassification of certain inventories to assets held-for-sale at December 31, 2009.

(6) PROPERTY, PLANT AND EQUIPMENT

	Estimated Useful Life	December 31,	
(In thousands)	**(in years)**	**2009**	**2008**
Land	N/A	$	$ 324
Buildings	5 to 20		7,017
Leasehold improvements	5 to 20	2,767	13,704
Computer equipment	2 to 5	41,225	42,623
Machinery and equipment	3 to 5	8,393	26,621
Furniture and fixtures	5	2,573	3,566
Construction in process	N/A	554	1,530
Total cost		55,512	95,385
Accumulated depreciation		(47,470)	(62,502)
		$ 8,042	$ 32,883

Depreciation expense was $7.1 million and $9.8 million in 2009 and 2008, respectively.

On June 30, 2009, the Company terminated the lease for its world headquarters facility located in Vancouver, Washington and entered into a new lease agreement to occupy substantially less space in the same building. As a result of the downsizing, the Company abandoned certain leasehold improvements and recorded a related charge of $8.0 million in 2009, included as a component of restructuring expense (see Note 3 Restructuring).

(7) GOODWILL

Nautilus applies a fair value-based impairment test to evaluate the carrying value of goodwill annually, at October 31, and more frequently if certain events or circumstances indicate that an impairment loss may have been incurred. The analysis of potential impairment of goodwill is a two-step process. The first step requires us to calculate an estimate of the fair value of the applicable reporting units. Reporting units are defined as operating segments or one level below an operating segment when that component constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. The Company has determined the reporting units relating to continuing operations are its direct and retail business segments.

Our estimates of reporting unit fair values are generally based on an analysis of discounted cash flows for the reporting unit and, when appropriate, an analysis of comparable market data. If under step one, the estimated fair value of the reporting unit is greater than its carrying amount, there is no impairment. If the reporting unit s carrying amount is greater than the estimated fair value, then a second step must be completed to measure the amount of impairment, if any.

The second step, if necessary, involves the allocation of the estimated fair value of the reporting unit to all of the identifiable assets and liabilities of the unit (including any unrecorded intangible assets). Any remaining, or unallocated, amounts reflect the implied fair value of the reporting unit s goodwill. To the extent the estimated implied fair value of the goodwill is less than its carrying value, an impairment loss is recognized for the difference.

The Company tested goodwill for impairment during both the third and fourth quarters of 2009, and no impairment was indicated. In determining the estimated future cash flows, current and future levels of income were considered as well as business trends and market conditions. In 2008, the Company recognized a $29.8 million impairment charge related to goodwill of its retail reporting unit. No goodwill impairment charges were recognized prior to 2008.

Activity related to goodwill for the years ended December 31, 2009 and 2008 was as follows (in thousands):

	Direct	Retail	Total
Balance as of January 1, 2008	$ 2,988	$ 29,755	$ 32,743
Impairment loss		(29,755)	(29,755)
Currency exchange rate adjustment	(590)		(590)
Balance as of December 31, 2008	2,398		2,398
Currency exchange rate adjustment	396		396
Balance as of December 31, 2009	$ 2,794	$	$ 2,794

(8) OTHER INTANGIBLE ASSETS

(In thousands)	Estimated Useful Life (in years)	December 31, 2009	December 31, 2008
Other intangible assets:			
Indefinite life trademarks	N/A	$ 9,052	$ 16,419
Patents	1 to 16	18,154	23,209
Total cost		27,206	39,628
Accumulated amortization:			
Patents		(6,368)	(5,225)
Total accumulated amortization		(6,368)	(5,225)
		$ 20,838	$ 34,403

In 2009, in light of various changes in long-term product strategies, the Company tested other intangible assets for impairment and recognized impairment charges of $5.9 million for intangible assets of its retail business segment.

Amortization expense for intangible assets for the years ended December 31, 2009 and 2008 was $2.5 million and $2.7 million, respectively. Amortization expense for intangible assets is expected to be approximately $2.1 million in each year from 2010 through 2013 and $2.0 million in 2014, with the remaining $1.5 million amortized over the six year period from 2015 through 2020.

(9) ACCRUED LIABILITIES

(In thousands)	December 31, 2009	December 31, 2008
Restructuring costs	$ 1,005	$ 1,535
Payroll and benefits	3,903	3,593

Royalties	970	1,957
Legal and professional fees	1,265	2,970
Other	3,601	5,073
	$ 10,744	$ 15,128

Table of Contents

(10) BORROWINGS

During 2009 and 2008, the Company partly relied on its Loan and Security Agreement (the Loan Agreement) with Bank of America N.A. (BofA) to meet its ongoing cash needs, particularly during seasonal periods of reduced cash flow. The Loan Agreement provided the Company with a revolving secured credit line to fund the Company s letters of credit, working capital needs and other business purposes. On December 29, 2009, pursuant to the sale of certain assets of its Stairmaster and Schwinn Fitness product lines, the Company satisfied all outstanding obligations under the Loan Agreement and it was terminated.

On December 29, 2009, the Company entered into a Letter of Credit Agreement (the Letter of Credit Agreement) with BofA. The Letter of Credit Agreement provides up to $6.0 million in standby letters of credit, and expires on December 31, 2010 (Expiration Date). During this agreement period, BofA will issue standby letters of credit, with a maximum maturity not to exceed 365 days beyond the Expiration Date. Letters of credit are secured by a cash collateral account held by BofA in an amount not less than 105% of the amount of the outstanding letters of credit, plus $0.3 million.

At December 31, 2009 the Company had $4.4 million in standby letters of credit, collateralized by $4.9 million in restricted cash, which is reported as such in the Company s consolidated balance sheet. There was no restricted cash requirement under the Loan Agreement in 2008. At December 31, 2008, the Company had $17.9 million in outstanding borrowings and $6.7 million in standby letters of credit. The weighted-average interest rate on the Company s outstanding borrowings at December 31, 2008 was 4.0%.

On March 8, 2010 the Company entered into a new loan agreement (the New Loan Agreement) with Bank of the West, providing for a $15.0 million revolving secured credit line. The New Loan Agreement is available for working capital, standby letters of credit and general corporate purposes through September 2012, assuming Nautilus satisfies certain terms and conditions at the time borrowings are requested.

The interest rate on any future borrowings under the New Loan Agreement will be based on the bank s prime rate or LIBOR, based on our financial condition at the time Nautilus elects to borrow. The New Loan Agreement includes a fee for the unused portion of the credit facility, which fee will vary depending on the Company s borrowing base availability.

Borrowings under the New Loan Agreement are collateralized by substantially all of the Company s assets. The New Loan Agreement contains customary covenants, including, but not limited to, covenants relating to minimum current ratio, minimum liquidity, minimum EBITDA and limitations on capital expenditures, mergers and acquisitions, indebtedness, liens, dispositions, dividends, and investments. The New Loan Agreement also contains customary events of default.

(11) INCOME TAXES

Components of the Company s loss from continuing operations before income taxes were as follows:

(In thousands)	**2009**	**2008**
United States	$ (31,164)	$ (59,518)
Non-U.S.	1,674	1,003
	$ (29,490)	$ (58,515)

Table of Contents

Income tax (benefit) provision from continuing operations consisted of the following:

(In thousands)	**2009**	**2008**
Current:		
U.S. federal	$ (12,153)	$ (10,694)
U.S. state	(123)	(392)
Non-U.S.	341	373
Total current	(11,935)	(10,713)
Deferred:		
U.S. federal	397	3,429
U.S. state	403	1,410
Non-U.S	255	(44)
Total deferred	1,055	4,795
	$ (10,880)	$ (5,918)

The tax effect of deferred tax assets and liabilities arising from temporary differences and carry-forwards are as follows:

	December 31,	
(In thousands)	**2009**	**2008**
Deferred tax assets:		
Accrued liabilities	$ 4,762	$ 8,409
Allowance for doubtful accounts	119	1,424
Inventory valuation	893	1,717
Uniform capitalization	249	354
Share-based compensation expense	929	1,373
Net operating loss carryforward	24,216	15,178
Basis difference on subsidiary held for sale	1,951	5,163
Capital loss carryforward	4,319	
Basis difference on long lived assets	13,262	1,971
Undistributed earnings of subsidiaries		1,872
Other	4,149	3,102
	54,849	40,563
Less: Valuation Allowance	(53,712)	(40,536)
Total deferred tax assets	1,137	27
Deferred income tax liabilities:		
Prepaid advertising	(270)	(501)
Other prepaids	(368)	(787)
Basis difference on long-lived assets	(1,860)	
Undistributed earnings of foreign subsidiaries	(113)	
Total deferred tax liabilities	(2,611)	(1,288)
Net deferred tax liability	$ (1,474)	$ (1,261)

Table of Contents

The Company s net deferred tax liabilities as presented in its consolidated balance sheets are as follows:

	December 31,	
(In thousands)	**2009**	**2008**
Current deferred tax assets	$ 54	$ 266
Current deferred tax liability	(1,220)	(919)
Non-current deferred tax assets, included in Other assets	446	429
Non-current deferred tax liabilities	(754)	(1,037)
Net deferred tax liability	$ (1,474)	$ (1,261)

A reconciliation of the U.S. statutory federal income tax rate with the Company s effective income tax benefit rate from continuing operations is as follows:

(In percents)	**2009**	**2008**
U.S. statutory income tax rate	35.0%	35.0%
State tax, net of U.S. federal tax benefit	3.4	2.5
Nondeductible incentive stock option expense	(0.1)	(0.5)
Non-U.S. Taxes	(0.6)	2.4
Nondeductible operating expenses	(0.1)	(0.1)
Research and development credit	0.3	0.1
Change in deferred tax measurement rate	(0.2)	0.1
Change in tax contingency reserve	(0.6)	0.8
Valuation allowance	(42.5)	(28.8)
Release of valuation allowance	42.4	
Other	(0.1)	(1.4)
Effective tax benefit rate	36.9%	10.1%

The comparative increase in our effective income tax benefit rate primarily is due to the partial release of valuation allowance, resulting from the enactment of a new law in the fourth quarter of 2009. The effective tax benefit rate for discontinued operations of 0.3% in 2009 differs from the statutory rate due to the recognition of a valuation allowance against deferred tax assets. Nautilus must periodically evaluate the potential realization of its deferred income tax assets and, if necessary, record a valuation allowance to reduce the net carrying value of such assets to the amount expected to be realized. In 2008, Nautilus concluded that cumulative taxable losses in recent years indicated a full valuation allowance against its deferred income tax assets was required. If and when a review of objective evidence indicates that some or all of the Company s valuation allowance is no longer appropriate, release of the valuation allowance would be recognized as an income tax benefit to continuing operations in the period in which such assessment is made. The amount of valuation allowance offsetting the Company s deferred income tax assets was $53.7 million and $40.5 million as of December 31, 2009 and 2008, respectively.

In November 2009, the President signed into U.S. federal law a provision to allow taxpayers to carry back an applicable net operating loss for up to five years. Nautilus elected to carry back a portion of its 2008 net operating loss and a portion of the Company s valuation allowance was released. A corresponding income tax benefit of $12.5 million was included in results of continuing operations in the fourth quarter of 2009 and Nautilus received a $12.1 million refund of U.S. federal income taxes in the first quarter of 2010.

Nautilus has net operating loss and tax credit carryforwards in U.S. federal, state and non-U.S. jurisdictions. At December 31, 2009, U.S. federal net operating loss carryforwards were $45.1 million, which were fully offset by a valuation allowance and are available to offset future taxable income, if any, through 2030. The Company s net operating loss carryforwards in state jurisdictions are fully offset by a valuation allowance, and will expire between 2013 and 2030, if not utilized. In addition, Nautilus has $11.3 million of U.S. federal capital loss carryforwards, which were fully offset by a valuation allowance and expire in 2013, if not utilized.

Table of Contents

At December 31, 2009, Nautilus has $23.0 million of net operating loss carryforwards in non-U.S. jurisdictions, including $10.2 million, $6.4 million, $3.6 million and $2.8 million related to its subsidiaries in Germany, Switzerland, China and Italy, respectively. As of December 31, 2009, the Company s non-U.S. net operating loss carryforwards were fully offset by a valuation allowance. The net operating losses for Switzerland, China and Italy expire between 2013 and 2017. Net operating loss carryforwards for Germany may be used indefinitely.

The timing and manner in which the Company is permitted to utilize its net operating loss carryforwards may be limited by Internal Revenue Code Section 382, *Limitation on Net Operating Loss Carry-forwards and Certain Built-in-Losses Following Ownership Change*. At December 31, 2009, the Company had approximately $45.1 million in U.S. federal net operating loss carryforwards, and an undetermined amount of income tax credits and state net operating loss carry forwards, which are potentially subject to the Section 382 limitation.

Under accounting guidance, an uncertain tax position represents the Company s expected treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return, that has not been reflected in measuring income tax expense for financial reporting purposes. A reconciliation of the beginning and ending amount of gross unrecognized tax benefits from uncertain tax positions (excluding the impact of penalties and interest) is as follows:

(In thousands)	**2009**	**2008**
Balance, beginning of year	$ 2,165	$ 2,166
Increases due to tax positions taken in previous periods	522	28
Decreases due to tax positions taken in previous periods	(22)	(4)
Increases due to tax positions taken in the current period	884	729
Decreases due to settlements with taxing authorities		(63)
Decreases due to lapse of statute of limitations	(300)	(691)
Balance, end of year	$ 3,249	$ 2,165

Unrecognized tax benefits, if recognized, would affect the Company s effective tax rate.

The Company recognizes tax-related interest and penalties as a component of income tax expense. As of December 31, 2009, the Company recognized a cumulative liability for interest and penalties of $0.9 million. As of December 31, 2008, the Company recognized a cumulative liability for interests and penalties of $0.6 million.

The Company s U.S. federal income tax returns for 2003 through 2009 are open to review by the U.S. Internal Revenue Service. The Company s state income tax returns for 2003 through 2009 are open to review, depending on the respective statute of limitation in each state. In addition, the Company files income tax returns in numerous non-U.S. jurisdictions with varying statutes of limitation.

As of December 31, 2009, the Company believes it is reasonably likely that, within the next 12 months, $0.2 million of previously unrecognized tax benefits will be recognized, primarily as reductions in income tax expense, as statutes of limitation expire.

(12) STOCKHOLDERS EQUITY

Common Stock

As of December 31, 2009, the Company had 75.0 million authorized shares of common stock, no par value, of which 30.7 million shares were issued and outstanding and 1.4 million shares were reserved for future issuance upon exercise of stock options.

In May 2008, the Company s Board of Directors authorized the repurchase of up to $10.0 million of the Company s common stock. The repurchase program does not obligate the Company to acquire any specific number of shares or acquire shares over any specified period of time. The Company repurchased 1.0 million shares for $5.3 million during the year ended December 31, 2008. The Company does not intend to repurchase any additional shares at this time.

2005 Long-Term Incentive Plan

In 2005, Nautilus shareholders approved the 2005 Long-Term Incentive Plan (the 2005 Plan) to enhance the Company s ability to attract and retain highly qualified personnel and align the long-term interests of participants with those of the shareholders. The 2005 Plan, which is administered by the Company s Compensation Committee of the Board of Directors (Compensation Committee), authorizes the Company to grant various types of stock-based awards including: stock options, stock appreciation rights, restricted stock, stock units and performance stock grants. Stock options granted under the 2005 Plan shall not have an exercise price less than the fair market value of the Company s common shares on the date of the grant. The exercise price of an option or stock appreciation right may not be reduced without shareholder approval. Stock options generally vest over four years of continuous service, commencing on the date of grant. Stock options granted after the adoption of the 2005 Plan have a seven year contractual term. Stock options granted under the preceding plan expire after ten years.

Upon its adoption, there were approximately 4.0 million shares available for issuance under the 2005 Plan. The number of shares available for issuance is increased by any shares of common stock which were previously reserved for issuance under the Company s preceding stock option plan, and were not subject to grant on June 6, 2005, or as to which the stock based compensation award is forfeited on or after June 6, 2005. The number of shares available for issuance is reduced by (i) two shares for each share delivered in settlement of any stock appreciation rights, for each share of restricted stock, and for each stock unit or performance unit award, and (ii) one share for each share delivered in settlement of a stock option award. In no event shall more than 1.0 million aggregate shares of common stock subject to stock options, stock appreciation rights, restricted stock or performance unit awards be granted to any one participant in any one year under the 2005 Plan. At December 31, 2009, 4.6 million shares remained available for future grant under the 2005 Plan.

Stock Options

A summary of the Company s stock option activity is as follows:

(In thousands, except exercise price)	**Total Shares**	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Life (in years)**	**Aggregate Intrinsic Value ($000s)**
Outstanding at January 1, 2008	2,804	$ 13.54		
Granted	1,116	4.15		
Forfeited, cancelled or expired	(1,819)	11.27		
Exercised	(90)	6.26		
Outstanding at December 31, 2008	2,011	10.70	5.06	$
Vested and expected to vest at December 31, 2008	1,616	11.61	4.90	
Outstanding at December 31, 2008	2,011	10.70		
Granted	65	1.63		
Forfeited, cancelled or expired	(662)	10.24		
Exercised				
Outstanding at December 31, 2009	1,414	10.50	4.24	26
Vested and expected to vest at December 31, 2009.	1,266	11.18	4.10	16

Aggregate intrinsic value in the above table represents the aggregate amount, for all options, by which closing share prices exceed the exercise price of the stock options. This value will fluctuate in the future based on the fair market value of our common stock.

Stock option expense was $0.9 million and $4.6 million in 2009 and 2008, respectively, included in general and administrative expense. During 2008, the Company was contractually obligated to accelerate vesting of certain stock options upon the termination of former Company officers and recognized $1.0 million in related expense. These options subsequently expired unexercised.

The weighted average grant-date fair values of stock options granted during 2009 and 2008 were $1.03 and $1.91, respectively. As of December 31, 2009, the unamortized compensation expense for unvested stock options totaled approximately $1.5 million, which is expected to be recognized over a weighted average period of 2.0 years.

Following is a summary of stock options outstanding at December 31, 2009:

(In thousands, except life and exercise price)		Options Outstanding		Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number of Options Exercisable	Weighted-Average Exercise Price
$0.95 $3.40	163	6.06	$ 2.12	5	$ 2.69
$4.15 $4.15	397	4.78	4.15	149	4.15
$4.41 $15.12	283	3.23	8.84	213	9.24
$15.15 $16.10	350	3.65	15.66	256	15.61
$16.17 $27.72	221	4.20	22.00	206	22.35
$0.95 $27.72	1,414	4.24	10.50	829	13.50

Restricted Stock Awards

In 2007, the Company granted 297,000 shares of restricted stock, which vested over two years, to members of its management team as a means to retain key employees while the Company moved forward with its restructuring activities. A summary of the Company s restricted stock award activity is as follows:

(In thousands, except fair value amounts)	Number of Shares	Weighted Average Grant Date Fair Value per Share
Outstanding at January 1, 2008	266	$ 9.23
Forfeited	(122)	9.23
Outstanding at December 31, 2008	144	9.23
Vested	(130)	9.23
Forfeited	(14)	9.23
Outstanding at December 31, 2009		

Restricted stock compensation expense for the years ended December 31, 2009 and 2008 was $0.3 million and $0.2 million, respectively.

Performance Stock Units

In December 2005, the Company granted 125,000 performance unit awards to key members of its executive team. The performance unit awards were to vest if the Company met earnings targets set by the Compensation Committee of the Board of Directors. The fair value of the performance units was based on the closing market

Table of Contents

price of the Company s common stock on the date preceding the grant and was to be recognized over the estimated requisite service period based on the number of performance unit awards ultimately expected to vest. Compensation expense was not recognized for the performance units during 2009 and 2008 as management concluded it was unlikely the performance targets that trigger vesting would be met.

A summary of the Company s performance stock unit activity is as follows:

(In thousands, except fair value amounts)	Performance Units	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2008	48	$ 15.68
Granted		
Forfeited or expired	(15)	15.86
Outstanding at December 31, 2008	33	15.60
Granted		
Forfeited or expired	(33)	15.60
Outstanding at December 31, 2009		

The Company receives income tax deductions as a result of the exercise of certain stock options and the vesting of restricted stock and performance stock units.

(13) LOSS PER SHARE

Loss per share is presented on both a basic and diluted basis. Basic loss per share is based on the weighted average number of common shares outstanding. Diluted loss per share reflects the potential dilution that could occur if outstanding obligations to issue common stock were exercised or converted into common stock. For the calculations of diluted loss per share, the basic weighted average number of shares is increased by the dilutive effect of stock options and restricted stock awards determined using the treasury stock method.

The following table sets forth the computation of basic and diluted loss per share as reported in the Company s statements of operations:

(In thousands, except per share amounts)	2009	2008
Numerator:		
Loss from continuing operations	$ (18,610)	$ (52,597)
Loss from discontinued operations, net of tax	(34,687)	(37,991)
Net loss	$ (53,297)	$ (90,588)
Denominator:		
Basic shares outstanding	30,664	31,117
Dilutive effect of stock options and restricted stock		
Diluted shares outstanding	30,664	31,117
Calculations:		
Loss per share from continuing operations:		
Basic and diluted	$ (0.61)	$ (1.69)
Loss per share from discontinued operations:		
Basic and diluted	$ (1.13)	$ (1.22)
Loss per share:		

Basic and diluted	$ (1.74)	$ (2.91)

Table of Contents

In 2009 and 2008, there were 1.4 million and 2.2 million shares, respectively, issuable upon exercise of stock options, restricted stock and performance units that were not included in the calculation of diluted earnings per share because the effect would have been anti-dilutive.

(14) EMPLOYEE BENEFIT PLAN

The Company adopted a 401(k) plan, the Nautilus, Inc. 401(k) Savings Plan (401(k) Plan), in 1999 covering substantially all regular employees over the age of 18. Each participant may contribute up to 75% of eligible compensation during any calendar year, subject to certain limitations. Subject to the approval of the Company s Board of Directors, the 401(k) Plan provides for Company matching contributions of 100% of the first 1% of eligible earnings contributed by the employee, and an additional 50% match for earnings contributed over 1% and up to 6%. Matching contributions vest at 25% after the first year of service, and are fully vested after the second year. On April 19, 2009, the Company suspended matching contributions. On April 18, 2009, all participating employees and all participating employees terminated between July 24, 2008 and April 18, 2009 became fully vested in their matching company contributions. Company s contributions to the 401(k) Plan were $0.3 million and $1.2 million in 2009 and 2008, respectively.

Table of Contents

(15) SEGMENT INFORMATION

The Company has two reportable segments Direct and Retail. The Company s commercial business discontinued operation is not a reportable segment. Contribution is the measure of profit or loss used by the Company s chief operating decision maker, and is defined as net sales, less product costs and direct expenses. Direct expenses include employment costs, selling and marketing costs, general and administrative expenses and research and development costs directly related to segment operations. Segment assets are those directly assigned to an operating segment s operations, primarily accounts receivable, inventories and intangible assets. Unallocated assets primarily include shared information technology infrastructure, distribution centers, corporate headquarters, prepaids, deferred taxes and other assets. Capital expenditures directly attributable to the Direct and Retail segments were not significant in 2009 or 2008.

(In thousands)	**2009**	**2008**
Net sales:		
Direct	$ 123,045	$ 185,704
Retail	63,597	94,498
Unallocated (royalty income)	2,618	3,510
Consolidated net sales	$ 189,260	$ 283,712
Contribution:		
Direct	$ (716)	$ 2,953
Retail	10,801	11,027
Unallocated	1,664	1,114
Consolidated contribution	$ 11,749	$ 15,094
Reconciliation of consolidated contribution to loss from continuing operations:		
Consolidated contribution	$ 11,749	$ 15,094
Less:		
Selling and marketing expenses	(804)	(1,806)
General and administrative expenses	(18,505)	(24,326)
Research and development expenses	(1,590)	(2,761)
Restructuring costs	(14,151)	(13,938)
Intangible asset impairment charges	(5,904)	
Goodwill impairment charges		(29,755)
Interest expense, net	(168)	(1,753)
Other income (expense), net	(117)	730
Income tax benefit	10,880	5,918
Loss from continuing operations	$ (18,610)	$ (52,597)
Assets:		
Direct	$ 21,402	$ 35,012
Retail	31,672	42,459
Unallocated	62,098	120,048
Total assets	$ 115,172	$ 197,519
Depreciation and amortization expense:		
Direct	$ 5,347	$ 6,276
Retail	1,428	1,703
Unallocated	3,075	5,900
Total depreciation and amortization expense	$ 9,850	$ 13,879

Net sales outside of the United States, primarily in Canada, represented approximately 10% and 9% of consolidated net sales in 2009 and 2008, respectively.

(16) COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company leases property and equipment under non-cancellable operating leases which, in the aggregate, extend through 2016. Many of these leases contain renewal options and provide for rent escalations and payment of real estate taxes, maintenance, insurance and certain other operating expenses of the properties. Rent expense under all operating leases was $4.5 million and $5.9 million in 2009 and 2008, respectively.

At December 31, 2009, future minimum lease payments under non-cancellable operating leases are as follows:

(In thousands)	
2010	$ 4,828
2011	4,440
2012	3,348
2013	3,059
2014	2,551
Thereafter	2,072
Minimum lease payments	$ 20,298

Guarantees, Commitments and Off-Balance Sheet Arrangements

At December 31, 2009 and 2008, the Company had approximately $4.3 million and $6.7 million, respectively, in standby letters of credit with vendors. The standby letters of credit have expiration dates through September 2011.

The Company has long lead times for inventory purchases and, therefore, must secure factory capacity from its vendors in advance. At December 31, 2009, the Company had approximately $18.0 million in non-cancellable market-based purchase obligations, all of which were for inventory purchases expected to be received in 2010.

At times, the Company becomes involved in third-party lease and financing arrangements which assist its customers in obtaining funds to purchase its products. While most of these financings are without recourse, in certain cases the Company may offer a guarantee or other recourse provisions. The Company s third-party financing company reviews consumer credit information in evaluating the risk of default prior to extending credit to customers. The Company relies on the quality of its third-party financing company s review and its own risk assessment in determining whether to proceed with a recourse transaction. At December 31, 2009 and 2008, the maximum contingent liability under all recourse provisions was approximately $1.4 million and $1.6 million, respectively.

In the ordinary course of business, the Company enters into agreements that require it to indemnify counterparties against third-party claims. These may include: agreements with vendors and suppliers, under which the Company may indemnify them against claims arising from use of their products or services; agreements with customers, under which the Company may indemnify them against claims arising from their use or sale of the Company s products; real estate and equipment leases, under which the Company may indemnify lessors against third-party claims relating to the use of their property; agreements with licensees or licensors, under which the Company may indemnify the licensee or licensor against claims arising from their use of the Company s intellectual property or the Company s use of their intellectual property; and agreements with parties to debt arrangements, under which the Company may indemnify them against claims relating to their participation in the transactions.

The nature and terms of these indemnifications vary from contract to contract, and generally a maximum obligation is not stated. The Company holds insurance policies that mitigate potential losses arising from certain types of indemnifications. Management does not deem these obligations to be significant to our consolidated financial position, results of operations or cash flows, and no related liabilities are recorded at December 31, 2009.

Issues Arising from China Sales Operation

In 2008, the Company recognized a $3.8 million charge, included in discontinued operations, due to uncertainties regarding access to, and future recovery of, certain assets of its China sales operation. In 2009, the Company recovered a portion of these assets and, as a result of this and other changes in circumstances, reduced the previously accrued loss amount by $2.3 million. At December 31, 2009 the Company had an allowance of $1.5 million due to uncertainties regarding the future recovery of China trade receivables.

Legal Matters

The Company is party to various legal proceedings arising from normal business activities. In addition, the Company s tax filings are subject to audit by authorities in the jurisdictions where it conducts business, which may result in assessments of additional taxes. Management believes it has adequately provided for obligations that would result from these legal and tax proceedings where it is probable it will pay some amounts and the amounts can be reasonably estimated. In some cases, however, it is too early to predict a final outcome. Management believes that the ultimate resolution of these matters will not have a material effect on the Company s financial position, results of operations or cash flows.

(17) SUBSEQUENT EVENTS

In November 2009, the President signed into U.S. federal law a provision allowing taxpayers to carry back applicable net operating losses for a period of up to five years. This new law allowed Nautilus to carry-back a portion of its 2008 net operating loss to prior years in which the Company had paid federal taxes and, as a result, we received a U.S. income tax refund of approximately $12.1 million in January 2010.

On February 19, 2010, the Company completed an agreement for the sale of certain assets of its Nautilus strength equipment product lines. The buyer also acquired rights to certain patents, technologies and other intellectual property, assumed certain outstanding warranty obligations related to the Company s North American commercial products and entered into a short-term lease of its Independence, Virginia manufacturing and warehousing facilities with an option to purchase such facilities.

On March 8, 2010, the Company entered into the New Loan Agreement with Bank of the West, providing for a $15.0 million revolving secured credit line. The New Loan Agreement is available for working capital, standby letters of credit and general corporate purposes through September 2012, assuming Nautilus satisfies certain terms and conditions at the time borrowings are requested.

(18) SUPPLEMENTARY INFORMATION QUARTERLY RESULTS OF OPERATIONS (unaudited)

The following table summarizes the Company s unaudited quarterly financial data for 2009 and 2008:

			QUARTER ENDED		
(In thousands, except per share amounts)	**March 31**	**June 30**	**September 30**	**December 31**	**Total**
2009:					
Net sales	$ 54,055	$ 40,102	$ 41,431	$ 53,672	$ 189,260
Gross profit	30,304	19,809	20,281	26,121	96,515
Operating loss	(3,715)	(14,922)	(2,822)	(7,746)	(29,205)
Income (loss) from continuing operations	(5,424)	(14,678)	(1,523)	3,015	(18,610)
Income (loss) from discontinued operations, net of tax	(8,395)	(6,093)	(22,895)	2,696	(34,687)
Net income (loss)	(13,819)	(20,771)	(24,418)	5,711	(53,297)
Income (loss) per share, basic and diluted	$ (0.45)	$ (0.68)	$ (0.80)	$ 0.19	$ (1.74)
2008:					
Net sales	$ 95,917	$ 61,236	$ 62,656	$ 63,903	$ 283,712
Gross profit	50,014	27,970	29,130	28,668	135,782
Operating loss	(5,744)	(10,574)	(5,672)	(35,502)	(57,492)
Loss from continuing operations	(4,578)	(6,665)	(22,221)	(19,133)	(52,597)
Loss from discontinued operations, net of tax	(1,782)	(2,211)	(11,897)	(22,101)	(37,991)
Net loss	(6,360)	(8,876)	(34,118)	(41,234)	(90,588)
Loss per share:					
Basic and diluted	$ (0.20)	$ (0.28)	$ (1.11)	$ (1.35)	$ (2.91)

The following table summarizes the impact of certain items included in the Company s quarterly results of continuing operations:

			Quarter Ended		
(In thousands)	**March 31**	**June 30**	**September 30**	**December 31**	**Total**
2009					
Operating Loss					
Restructuring charges	$ 2,049	$ 11,796	$ 201	$ 105	$ 14,151
Intangible asset impairment charges			2,101	3,803	5,904
Writeoff of deferred financing costs		223		406	629
Legal and contract settlement costs	(750)		(200)	200	(750)
	$ 1,299	$ 12,019	$ 2,102	$ 4,514	$ 19,934
2008					
Operating Loss					
Restructuring charges	$ 10,634	$ 2,436	$ 300	$ 568	$ 13,938
Goodwill impairment charge				29,755	29,755
Writeoff of deferred financing costs			1,055		1,055
Legal and contract settlement costs		1,125	106	1,300	2,531
Shareholder action costs		565			565
	$ 10,634	$ 4,126	$ 1,461	$ 31,623	$ 47,844

Table of Contents

In 2009, restructuring charges were $14.2 million, and included: $8.0 million in impairment charges of abandoned leasehold improvements related to the reorganization and consolidation of our Vancouver, Washington headquarters facility; $2.8 million in lease termination costs and accrued lease obligations associated with the reduction of leased space at our headquarters facility; $1.8 million in charges due to our abandonment of information technology software which was no longer necessary to support the business needs; $0.9 million fee to terminate a warehouse distribution service agreement as part of our distribution consolidation activities; and severance costs of $0.6 million. In addition to restructuring charges, we recognized $5.9 million in asset impairment charges related to intangible assets of our retail segment, $0.4 million in deferred financing costs related to the termination of our bank agreement and $0.2 million in legal and contract settlement costs, partially offset by a benefit for legal matters which were settled in 2009 for $1.0 million less than the Company previously had estimated in 2008.

In 2008, restructuring charges were $14.0 million, and included: $8.0 million in charges related to the termination of an agreement to acquire a manufacturing operation in China; $4.8 million in employee termination benefits and other employee costs; $0.6 million in contract termination costs; and $0.5 million for the disposal of unused creative advertising resulting from a change in our product strategies. In addition to restructuring charges, we recognized a $29.8 million asset impairment charge related to goodwill of the retail segment, $1.1 million for writing off deferred financing costs associated with a former bank agreement; $2.5 million of legal and contract settlement costs; and $0.6 million in expenses related to the reimbursement of shareholder action costs.

Table of Contents

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Disclosure Controls and Procedures

As of December 31, 2009, we conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended (Exchange Act), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of December 31, 2009 that our disclosure controls and procedures were effective.

Management s Report On Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Rule 13a-15(f) under the Exchange Act. This rule defines internal control over financial reporting as a process designed by, or under the supervision of, the company s chief executive officer and chief financial officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP. Our internal control over financial reporting includes those policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management s Assessment

Nautilus management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our internal control over financial reporting based on the criteria established in *Internal Control Integrated Framework,* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2009.

This annual report does not include an attestation report of the company s registered public accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by the company s registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management s report in this annual report.

Changes In Internal Control Over Financial Reporting

There were no material changes in our internal control over financial reporting during the fourth quarter of 2009.

Item 9B. Other Information

Given the timing of the event, the following information is included in this Form 10-K pursuant to Item 1.01 of Form 8-K Entry into a Material Definitive Agreement in lieu of filing a Form 8-K.

On March 8, 2010 we entered into a new loan agreement (the New Loan Agreement) with Bank of the West, providing for a $15.0 million revolving secured credit line. The New Loan Agreement is available for working capital, standby letters of credit and general corporate purposes through September 2012, assuming we satisfy certain terms and conditions at the time borrowings are requested.

The interest rate on any future borrowings under the New Loan Agreement will be based on the bank s prime rate or LIBOR, based on our financial condition at the time we elect to borrow. The New Loan Agreement includes a fee for the unused portion of the credit facility, which fee will vary depending on our borrowing base availability. Borrowings under the New Loan Agreement are collateralized by substantially all of our assets pursuant to the terms of a Security Agreement and certain other agreements related to security in our intellectual property assets. The New Loan Agreement contains customary covenants, including, but not limited to, covenants relating to minimum current ratio, minimum liquidity, minimum EBITDA and limitations on capital expenditures, mergers and acquisitions, indebtedness, liens, dispositions, dividends, and investments. The New Loan Agreement includes customary events of default.

The above is only a summary of the New Loan Agreement and is qualified in its entirety by reference to the full text of the New Loan Agreement included filed as Exhibit 10.30 to this Form 10-K and to the Security Agreement filed as Exhibit 10.31 to this Form 10-K.

Table of Contents

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item is included under the captions *Election of Directors*, *Section 16(a) Beneficial Ownership Reporting Compliance, Executive Officers* and *Information Concerning the Board of Directors* in our Proxy Statement for our 2010 Annual Meeting of Shareholders and is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this item is included under the caption *Executive Compensation* in our Proxy Statement for our 2010 Annual Meeting of Shareholders and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item is included under the caption *Stock Ownership* in our Proxy Statement for our 2010 Annual Meeting of Stockholders and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is included under the caption *Information Concerning the Board of Directors* in our Proxy Statement for our 2010 Annual Meeting of Shareholders and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

The information required by this item is included under the caption *Appointment of Registered Independent Public Accounting Firm* for 2010 in our Proxy Statement for our 2010 Annual Meeting of Shareholders and is incorporated herein by reference.

Table of Contents

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) Financial Statements

See the Consolidated Financial Statements in Item 8.

(a)(2) Financial Statement Schedule

There are no financial statement schedules filed as part of this annual report, since the required information is included in the consolidated financial statements, including the notes thereto, or the circumstances requiring inclusion of such schedules are not present.

(a)(3) Exhibit Index

See the Exhibit Index beginning on page 66 for a description of the documents that are filed as Exhibits to this Annual Report on Form 10-K or incorporated herein by reference.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NAUTILUS, INC.

Date: March 8, 2010

By: /s/ EDWARD J. BRAMSON
Edward J. Bramson
Chairman and Chief Executive Officer

(Principal Executive Officer)

POWER OF ATTORNEY

Each person whose individual signature appears below hereby authorizes and appoints Edward J. Bramson and Kenneth L. Fish, and each of them, with full power of substitution and resubstitution and full power to act without the other, as his true and lawful attorney-in-fact and agent to act in his name, place and stead and to execute in the name and on behalf of each person, individually and in each capacity stated below, and to file any and all amendments to this report, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing, ratifying and confirming all that said attorneys-in-fact and agents or any of them or their or his substitute or substitutes may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 8, 2010.

Signature	Title
*	Chairman and Chief Executive Officer (Principal Executive Officer)
Edward J. Bramson	
/s/ KENNETH L. FISH	Chief Financial Officer
Kenneth L. Fish	(Principal Financial Officer and Principal Accounting Officer)
*	Director
Ronald P. Badie	
*	Director
Richard A. Horn	
*	Director
Craig L. McKibben	
*	Director
Marvin G. Siegert	

* **Michael A. Stein**	Director	
*By:	/s/ Wayne M. Bolio **Wayne M. Bolio** ***Attorney-In-Fact***	March 8, 2010

EXHIBIT INDEX

Exhibit No.	Description
2.1	Stock Purchase Agreement dated as of February 15, 2008 by and among the Company, DashAmerica, Inc. d/b/a/ Pearl Izumi USA, Inc. and Shimano American Corporation Incorporated by reference to Exhibit 2.1 to the Company s Current Report on Form 8-K, as filed with the Commission on February 22, 2008.
2.2	First Amendment to Stock Purchase Agreement dated as of April 18, 2008 by and among Nautilus, Inc., Shimano American Corporation and DashAmerica, Inc. D/B/A Pearl Izumi USA, Inc. Incorporated by reference to Exhibit 2.2 to the Company s Current Report on Form 8-K, as filed with the Commission on April 24, 2008.
3.1	Amended and Restated Articles of Incorporation Incorporated by reference to Exhibit A to the Company s Schedule 14A, as filed with the Commission on April 22, 2008.
3.5	Amended and Restated Bylaws Incorporated by reference to Exhibit 3.1 of the Company s Current Report on Form 8-K, as filed with the Commission on April 5, 2005.
3.6	Amendment to Amended and Restated Bylaws of the Company Incorporated by reference to Exhibit 3.1 the Company s Current Report on Form 8-K, as filed with the Commission on January 31, 2007.
10.1*	Company Stock Option Plan, as amended Incorporated by reference to Exhibit 10.1 to the Company s Registration Statement on Form S-1, as filed with the Commission on March 3, 1999.
10.2*	Amendment to Company Stock Option Plan Incorporated by reference to Exhibit 10 to the Company s Quarterly Report on Form 10-Q for the three months ended June 30, 2000, as filed with the Commission on August 10, 2000.
10.3*	Company 2005 Long-Term Incentive Plan Incorporated by reference to Exhibit 10.1 of the Company s Current Report on Form 8-K, as filed with the Commission on June 10, 2005.
10.4*	First Amendment to the Company 2005 Long-Term Incentive Plan Incorporated by reference to Exhibit 10.2 to the Company s Quarterly Report on Form 10-Q for the three months ended September 30, 2006, as filed with the Commission on November 9, 2006.
10.5*	Form of Employee Incentive Stock Option Agreement under the Company Stock Option Plan Incorporated by reference to Exhibit 10.3 to the Company s Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Commission on March 16, 2005.
10.6*	Form of Nonstatutory Stock Option Agreement under the Company Stock Option Plan Incorporated by reference to Exhibit 10.4 to the Company s Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Commission on March 16, 2005.
10.7*	Form of Nonstatutory Stock Option Agreement Incorporated by reference to Exhibit 10 of the Company s Current Report on Form 8-K, as filed with the Commission on July 29, 2005.
10.8*	Form of Non-Employee Director Nonstatutory Stock Option Agreement Incorporated by reference to Exhibit 10 of the Company s Current Report on Form 8-K, as filed with the Commission on August 19, 2005.
10.9*	Executive Employment Agreement, dated January 14, 2004, by and between the Company and Darryl Thomas Incorporated by reference to Exhibit 10.14 to the Company s Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Commission on March 16, 2005.
10.10*	Executive Employment Agreement, dated March 31, 2005, by and between the Company and William D. Meadowcroft Incorporated by reference to Exhibit 99.2 to the Company s amended Current Report on Form 8-K/A, as filed with the Commission on April 6, 2005.

Table of Contents

Exhibit No.	Description
10.11*	Employment Agreement dated May 6, 2008 between Nautilus, Inc. and Sebastien Goulet Incorporated by reference to Exhibit 10.6 of the Company s Form 10-Q for the three months ended March 31, 2008 as filed with the Commission on May 12, 2008.
10.12*	Executive Employment Agreement, dated October 17, 2007, by and between the Company and Robert S. Falcone. Incorporated by reference to the Company s Current Report of Form 8-K, as filed with the Commission on October 23, 2007.
10.14*	Form of Performance Unit Agreement Incorporated by reference to Exhibit 10.3 to the Company s Quarterly Report on Form 10-Q for the three months ended June 30, 2006, as filed with the Commission on August 9, 2006.
10.15*	Summary of Performance Unit Award Incorporated by reference to Exhibit 10.1 to the Company s Quarterly Report on Form 10-Q for the three months ended September 30, 2006, as filed with the Commission on November 9, 2006.
10.16	Trademark License Agreement, dated September 20, 2001, by and between Pacific Direct, LLC and the Company Incorporated by reference to Exhibit 2.1 of the Company s Quarterly Report on Form 10-Q for the three months ended September 30, 2001, as filed with the Commission on November 14, 2001.
10.17	License Agreement, dated April 26, 1999, as amended, between the Company and Gary D. Piaget Incorporated by reference to Exhibit 10.10 to the Company s Annual Report on Form 10-K for the year ended December 31, 2003, as filed with the Commission on March 15, 2004.
10.18	Office Lease Agreement, dated June 30, 2009, between Columbia Tech Center LLC and the Company Incorporated by reference to Exhibit 10.1 of the Company s Form 8-K, as filed with the Commission on July 7, 2009.
10.19	Credit Agreement, dated December 22, 2009, between Bank of America N.A and the Company Incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K, as filed with the Commission on January 5, 2010.
10.20	Fourth Amended and Restated Merchant Agreement dated as of October 27, 2008 by and between Nautilus, Inc. and HSBC Bank Nevada, N.A. (Confidential treatment has been requested with respect to a portion of this agreement.) Incorporated by reference to Exhibit 10.1 of the Company s Form 10-Q for the three months ended October 31, 2008 as filed with the Commission on November 10, 2008.
10.21	Supply Agreement dated as of May 2, 2008 by and among Nautilus, Inc., Land America Health and Fitness Co., Ltd. and Treuriver Investments Co. Limited Incorporated by reference to Exhibit 10.4 of the Company s Form 10-Q for the three months ended March 31, 2008 as filed with the Commission on May 12, 2008. [Confidential treatment has been granted with respect to a portion of this Exhibit]
10.22	Settlement Agreement dated as of May 5, 2008 by and among Nautilus, Inc. Land America Health and Fitness Co., Ltd., Treuriver Investments Co. Limited, Michael C. Bruno and Yang Lin Qing Incorporated by reference to Exhibit 10.5 of the Company s Form 10-Q for the three months ended March 31, 2008 as filed with the Commission on May 12, 2008.
10.23	Schwinn Asset Purchase Agreement dated as of December 5, 2009 between Nautilus, Inc. and Fit Dragon International, Inc.
10.24	License Agreement dated as of December 29, 2009 between Nautilus, Inc. and Fit Dragon International, Inc.
10.25	Stairmaster Asset Purchase Agreement dated as of December 5, 2009 between Nautilus, Inc. and Fit Dragon International, Inc.

Exhibit No.	Description
10.26	Technology Transfer and License Agreement dated as of December 29, 2009 between Nautilus, Inc. and Fit Dragon International, Inc.
10.27	Asset Purchase Agreement dated as of February 18, 2010 between Nautilus, Inc. and Med-Fit Systems, Inc.
10.28	Commercial License Agreement dated as of February 18, 2010 between Nautilus, Inc. and Med-Fit Systems, Inc.
10.29	Lease Agreement dated as of February 19, 2010 between Nautilus, Inc. and Med-Fit Systems, Inc.
10.30	Credit Agreement dated as of March 8, 2010 between Nautilus, Inc. and Bank of the West.
10.31	Security Agreement dated as of March 8, 2010 between Nautilus, Inc. and Bank of the West.
21	Subsidiaries of the Company.
23	Consent of Independent Registered Public Accounting Firm.
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Indicates management contract, compensatory agreement or arrangement, in which the Company s directors or executive officers may participate.