NAUTILUS, INC.
Form 10-K
March 16, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

[x] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011
OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO
Commission file number: 001-31321

NAUTILUS, INC.
(Exact name of Registrant as specified in its charter)

Washington (State or other jurisdiction of incorporation or organization)	94-3002667 (I.R.S. Employer Identification No.)

16400 S.E. Nautilus Drive
Vancouver, Washington 98683
(Address of principal executive offices, including zip code)
(360) 859-2900
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, no par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None.
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [x]
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [ ] No [x]
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [x] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [x] No [ ]
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of “accelerated filer, large accelerated filer and smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [x]
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes [ ] No [x]
The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the last sales price ($2.00) as reported on the New York Stock Exchange as of the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2011) was $61,493,672.
The number of shares outstanding of the registrant's common stock as of February 29, 2012 was 30,746,836 shares.
Documents Incorporated by Reference
The registrant has incorporated by reference into Part III of this Form 10-K portions of its Proxy Statement for its 2012 Annual Meeting of Shareholders.

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2011 FORM 10-K ANNUAL REPORT

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PART I

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "plan," "expect," "aim," "believe," "project," "intend," "estimate," "will," "should," "could," and other terms of similar meaning typically identify forward-looking statements. The forward-looking statements in this report include, without limitation, the anticipated opportunity for growth in sales of cardio products; plans to continue to be a large direct marketer of strength products; potential continuance of or improvement in consumer credit financing approval rates; the continuance of certain advertising strategies and the impact of such programs on product sales; our new product development strategies; expectations for increased research and development expenses and our plans and expectations regarding borrowing agreements. Forward-looking statements also include any statements related to our expectations regarding future business and financial performance or conditions, anticipated sales growth across markets, distribution channels and product categories, expenses and gross margins, profits or losses, losses from discontinued operation, settlements of warranty obligations, new product introductions, financing and working capital requirements and resources. These forward-looking statements, and others we make from time-to-time, are subject to a number of risks and uncertainties. Many factors could cause actual results to differ materially from those projected in forward-looking statements, including the risks described in Part I, Item 1A of this report. We do not undertake any duty to update forward-looking statements after the date they are made or conform them to actual results or to changes in circumstances or expectations.

Item 1. Business

Unless the context otherwise requires, “Nautilus,” “Company,” “we,” “us,” and “our” refer to Nautilus, Inc. and its subsidiaries. All references to 2011, 2010 and 2009 in this report refer to our fiscal years ended on December 31, 2011, 2010 and 2009, respectively.

OVERVIEW

Founded in 1986, Nautilus is a consumer fitness products company headquartered in Vancouver, Washington and incorporated in the State of Washington in January 1993. We are committed to providing innovative, quality solutions to help people achieve a fit and healthy lifestyle. Our principal business activities include designing, developing, sourcing and marketing high-quality cardio and strength fitness products and related accessories for consumer use, primarily in the United States and Canada. Our products are sold under some of the most-recognized brand names in the fitness industry: Nautilus®, Bowflex®, Schwinn®, Schwinn Fitness™ and Universal®

We market our products through two distinct distribution channels, Direct and Retail, which we consider to be separate business segments. Our Direct business offers products directly to consumers through television advertising, catalogs and the Internet. Our Retail business offers our products through a network of independent retail companies with stores and websites located in the United States and internationally.

During the third quarter of 2009, we committed to a plan for the complete divestiture of our Commercial business with the expectation that the plan's successful completion would improve our overall operating results. Our former Commercial business, now classified as a discontinued operation, offered products to health clubs, schools, hospitals and other organizations. We completed the disposal of the assets of our former Commercial business in April 2011.

BUSINESS STRATEGY

We are focused on developing and marketing consumer fitness equipment and related products to help people enjoy healthier lives. Our products are targeted to meet the needs of a broad range of consumers, including fitness enthusiasts and individuals who are seeking the benefits of regular exercise. We have diversified our business by expanding our portfolio of high-quality fitness equipment into multiple product lines utilizing our well-recognized brand names. Our business strategy focuses exclusively on consumer products, markets and distribution channels.

Our strategies incorporate the individual characteristics of our Direct and Retail businesses. Our Direct business focuses on (i) the development of, or acquisition of rights to, unique products; (ii) the application of creative, cost-effective ways to communicate the benefits of their use; and (iii) making various payment options available to our customers. We are particularly attentive to Direct business metrics that provide feedback regarding the effectiveness of our media marketing programs and attractiveness of third-party consumer financing programs.

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In our Retail business, we strive to develop long-term relationships with key retailers of sports or fitness equipment. The primary objectives of our Retail business are (i) to offer a selection of products at key price-points; and (ii) to utilize the strength of our brands and long-standing customer relationships to secure more floor space with our Retail customers for our products.

Our long-term strategy involves:

- creatively marketing our equipment, both directly to consumers and through our Retail customers, while leveraging our well-known brand names;
- enhancing our product lines by designing fitness equipment that meets or exceeds the high expectations of our customers;
- utilizing our strengths in product engineering to reduce product costs;
- continuing our investment in research and development activities aimed at acquiring or creating new technologies; and
- increasing our international Retail sales and distribution.

PRODUCTS

We market quality cardiovascular and strength fitness products that cover a broad range of price points and features. Our products are designed for home use by individuals with varying exercise needs. From the person who works out occasionally to the serious athlete, we have products that will help them achieve their fitness objectives.

- Our Nautilus brand includes a complete line of cardio equipment, including treadmills, specialized cardio, exercise bikes and ellipticals. In late 2011 we launched the CoreBody Reformer™, a new product aimed at the yoga/pilates market, in our Direct channel. Our Nautilus E514 elliptical, launched in 2010, continues to receive high rankings from leading consumer products rating organizations.

- Our Bowflex brand represents a highly-regarded line of fitness equipment comprised of both cardio and strength products, including TreadClimber® specialized cardio machines, treadmills, PowerRod® and Revolution® home gyms, and SelectTech® dumbbells. In late 2011 we launched updated models in our popular TreadClimber line.

- Our Schwinn brand is known for its popular line of exercise bikes, including the Airdyne®, ellipticals and treadmills. In 2011 we introduced a new indoor cycling bike and a new Airdyne model.

- Our Universal brand, one of the oldest and most recognized names in the fitness industry, currently offers a line of kettlebell weights and weight benches. In 2011 we launched a new line of selectorized dumbbells under the Universal brand.

While we offer our full product assortment to our Direct customers through our Internet websites and our catalogs, we generally differentiate the product models offered in our Direct and Retail sales channels. Currently, our Bowflex TreadClimber product line is offered for sale primarily through our Direct sales channel.

Approximately 68% of our revenue in 2011 was derived from sales of consumer cardio products. While we continue to be a leader in the consumer strength product category, we believe the much larger market for cardio products offers us greater opportunity for growth.

BUSINESS SEGMENTS

We conduct our business in two segments, Direct and Retail. For further information, see Note 14, Segment Information, to our consolidated financial statements in Part II, Item 8 of this report.

SALES AND MARKETING

Direct

In our Direct business, we market and sell our products, principally Bowflex cardio and strength products, directly to consumers. While we are, and plan to continue to be, a large direct marketer of strength products in the United States, our advertising emphasis has shifted toward cardio products, especially the Bowflex TreadClimber, as cardio products represent the largest component of the fitness equipment market and a growing part of our business. Sales of cardio products represented 71% of our Direct channel revenues in 2011, compared to 56% in 2010 and 46% in 2009.

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Our marketing efforts are based on an integrated combination of media and direct consumer contact. In addition to television advertising, which ranges in length from 30 seconds to as long as five minutes, we utilize extended 30-minute television infomercials, Internet advertising, product websites, inquiry-response mailings, catalogs and inbound/outbound call centers. Marketing and media effectiveness is measured continuously based on sales inquiries generated, cost-per-lead, conversion rates, return on investment and other performance metrics. Almost all of our Direct customer orders are received either on our Internet websites or through company-owned and third-party call centers.

We committed an increased portion of our television advertising budget to our Bowflex TreadClimber product line during 2011. Currently, our Bowflex TreadClimber product line is sold primarily through our Direct sales channel. We emphasized lower-cost Internet-based advertising for our Bowflex rod-based home gyms during 2011, which is able to capitalize on the extensive consumer product awareness that already exists.

In September 2010, we completed our transition to a new consumer credit program with a new primary third-party financing provider, GE Capital Retail Bank, formerly GE Money Bank ("GE"). The relationship with GE has expanded the ability of our customers to obtain third-party consumer financing for buying our products. In addition, we added one secondary third-party consumer credit financing provider during the third quarter of 2010 and another in early 2011, both of which offer credit to certain qualified consumers whose credit applications have been declined by GE. As a result, combined consumer credit approvals by our primary and secondary U.S. third-party financing providers increased from 15% in 2010 to 25% in 2011.

Retail

In our Retail business, we market and sell a comprehensive line of consumer fitness equipment under the Nautilus, Schwinn, Universal and Bowflex brands. Our products are marketed through a network of retail companies, consisting of sporting goods stores, Internet retailers, large-format and warehouse stores, and, to a lesser extent, smaller specialty retailers and independent bike dealers.

We offer programs that provide price discounts to our Retail customers for ordering container-sized shipments or placing orders early enough in the season to allow for more efficient manufacturing by our Asian suppliers. These programs are designed to reduce our shipping and handling costs, with much of the savings being passed on to our customers. In addition, our Retail customers generally are eligible for other types of sales incentives, including volume discounts and various forms of rebates or allowances, which generally are intended to increase product exposure and availability for consumers, reduce transportation costs, and encourage marketing and promotion of our brands or specific products.

PRODUCT DESIGN AND INNOVATION

Innovation is a vital part of our business, and we continue to expand and diversify our product offerings by leveraging our research and development capabilities. We constantly search for new technologies and innovations that will help us grow our business, either through higher sales or increased production efficiencies. To accomplish this objective, we seek out ideas and concepts both within our company and from outside inventors. In 2011, we introduced 16 new or updated product models.

We rely on financial and engineering models to assist us in assessing the potential operational and economic impacts of adopting new technologies and innovations. If we determine that a third-party technology or innovation concept meets certain technical and financial criteria, we may enter into a licensing arrangement to utilize the technology or, in certain circumstances, purchase the technology for our own use. Our product design and engineering teams also invest considerable effort to improve product design and quality. As a consumer-driven company, we invest from time-to-time in qualitative and quantitative consumer research to help us assess new product concepts, optimal

features and anticipated consumer adoption.

Our research and development expenses were $3.2 million and $2.9 million in 2011 and 2010, respectively, as we increased our investment in new product development resources and capabilities in 2011. We expect our research and development expenses to increase in 2012 as we continue to increase our investment in new product development.

SEASONALITY

We expect our sales to vary seasonally. Sales are typically strongest in the first and fourth quarters, followed by the third quarter, and are generally weakest in the second quarter. We believe that various factors, such as the broadcast of network season finales and seasonal weather patterns, influence television viewers and cause our advertising on cable television stations to be less effective in the second quarter than in other periods. In addition, during the spring and summer months, consumers tend to be involved in outdoor activities, including outdoor exercise, which impacts sales of indoor fitness equipment. This seasonality can have a significant effect on our inventory levels, working capital needs and resource utilization.

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MERCHANDISE SOURCING

All of our products are produced by third-party manufacturers, most of whom are the sole source for particular products and substantially all of whom are located in Asia. Lead times for inventory purchases from our Asian suppliers, from order placement to receipt of goods, generally range from approximately two to three months, of which transit time represents three-to-four weeks. The length of our lead times requires us to place advance manufacturing orders based on management forecasts of future demand for our products. We attempt to compensate for our long replenishment lead times by maintaining adequate levels of inventory at our warehousing facilities.

We monitor our suppliers' ability to meet our product needs and we participate in quality assurance activities to reduce the risk of marketing substandard products. Our third-party manufacturing contracts are generally of annual or shorter duration, or manufactured products are sourced on the basis of individual purchase orders. Our manufacturing relationships are non-exclusive, and we are permitted to procure our products from other sources at our discretion. None of our manufacturing contracts include production volume or purchase commitments on the part of either party. Our third-party manufacturers are responsible for the sourcing of raw materials.

LOGISTICS

Our warehousing and distribution facilities are located in Portland, Oregon and Winnipeg, Manitoba. In our Direct business, we strive to maintain inventory levels that will allow us to ship our products shortly after receiving a customer's order. We use common carriers for substantially all of our merchandise shipments to Direct customers.

In our Retail business, we manage our inventory levels to accommodate anticipated seasonal changes in demand. Generally, we maintain higher inventory levels at the ends of the third and fourth quarters to satisfy relatively higher consumer demand in the fourth and first quarters of each year. Many of our Retail customers place orders well in advance of peak periods of consumer demand to ensure an adequate supply for the anticipated selling season. We use various commercial truck lines for our merchandise shipments to Retail customers.

In 2011 approximately one-quarter of our Retail inventory replenishment orders were shipped by our contract manufacturers in Asia directly to our Retail customer locations, typically in large containers. The use of such direct shipments allows us to maintain lower levels of inventory in our warehouses, resulting in lower storage, handling, freight, insurance and other costs.

COMPETITION

The markets for all of our products are highly competitive. We believe the principal competitive factors affecting our business are quality, brand recognition, innovation and pricing. We believe we are well-positioned to compete in markets in which we can take advantage of our strong brand names.

Our products compete directly with those offered by a large number of companies that market consumer fitness equipment and fitness programs. As the use of Internet websites for product sales by traditional retailers has increased, our competitors have become increasingly similar across our Direct and Retail sales channels. Our principal competitors include: Fitness Quest, marketer of Total Fitness®-branded products; ICON Health & Fitness, marketer of ProForm®- and NordicTrack®-branded products; Johnson Health Tech, marketer of Horizon®-branded products; Beach Body, marketer of the P90X® fitness program; and American Telecast, marketer of Total Gym®-branded products. Among our other competitors are marketers of computer- based physical activity products, such as the Nintendo Wii® and Microsoft Xbox® Kinect®, and weight management companies, such as Weight Watchers, each of which offers alternative solutions for a fit and healthy lifestyle.

EMPLOYEES

As of February 29, 2012, we had approximately 320 employees, substantially all of whom were full-time. None of our employees are subject to collective bargaining agreements. We have not experienced a material interruption of our operations due to labor disputes.

INTELLECTUAL PROPERTY

Trademarks, patents and other forms of intellectual property are vital to the success of our business and are an essential factor in maintaining our competitive position in the health and fitness industry.

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Trademarks

We own many trademarks including Nautilus®, Bowflex®, PowerRod®, Revolution®, TreadClimber®, SelectTech®, Trimline®, Airdyne®, CoreBody Reformer™ and Universal®. Nautilus is the exclusive licensee under the mark Schwinn® for fitness products. We believe that having distinctive trademarks that are readily identifiable by consumers is an important factor in creating a market for our products, maintaining a strong company identity and developing brand loyalty among our customers. In addition, we have granted licenses to certain third-parties to use the Nautilus, Schwinn and TreadClimber tradenames on commercial fitness products, for which we receive royalty income and expanded consumer awareness of our brands.

Each federally registered trademark is renewable indefinitely if the trademark is still in use at the time of renewal. We are not aware of any material claims of infringement or other challenges to our trademark rights in our major markets.

Patents

We own numerous patents, both issued and pending, and have licenses for the use of patents owned by others, which relate to our products. These patents cover a variety of technologies, some of which are utilized in the following products: TreadClimber specialized cardio machines; variable stride ellipticals; selectorized dumbbells; and recumbent exercise bikes. Nautilus is the exclusive licensee of patents that cover the Bowflex Revolution home gyms. Patent protection for these technologies extends as far as 2020. Expiration of these and other patents could trigger the introduction of similar products by our competitors. None of our material patents expire in 2012.

Building our intellectual property portfolio is an important factor in maintaining our competitive position in the health and fitness equipment industry. We have followed a policy of filing applications for U.S. and non-U.S. patents on utility and design inventions that we deem valuable to our business. We protect our proprietary rights vigorously and take prompt, reasonable actions to prevent counterfeit products and other infringement on our intellectual property.

BACKLOG

Historically, our backlog has not been a significant factor in our business. Our customer order backlog as of December 31, 2011 and 2010 was approximately $0.6 million and $3.2 million, respectively.

SIGNIFICANT CUSTOMERS

In 2011 Amazon.com accounted for more than 10 percent of our consolidated net sales. No individual customer accounted for 10 percent or more of our consolidated net sales in 2010.

ENVIRONMENTAL AND OTHER REGULATORY MATTERS

Our operations are subject to various laws and regulations both domestically and abroad. In the United States, federal, state and local regulations impose standards on our workplace and our relationship with the environment. For example, the U.S. Environmental Protection Agency, Occupational Safety and Health Administration and other federal agencies have the authority to promulgate regulations that may impact our operations. In particular, we are subject to legislation placing restrictions on our generation, emission, treatment, storage and disposal of materials, substances and wastes. Such legislation includes: the Toxic Substances Control Act; the Resource Conservation and Recovery Act; the Clean Air Act; the Clean Water Act; the Safe Drinking Water Act; and the Comprehensive Environmental Response and the Compensation and Liability Act (also known as Superfund). We are also subject to the requirements of the Consumer Product Safety Commission and the Federal Trade Commission, in addition to regulations concerning employee health and safety matters.

Our operations and certain disposed components of our former Commercial business expose us to claims related to environmental matters. Although compliance with federal, state, local and international environmental legislation has not had a material adverse effect on our financial condition or results of operations in the past, there can be no assurance that material costs or liabilities will not be incurred in connection with such environmental matters in the future.

AVAILABLE INFORMATION

Our common stock is listed on the New York Stock Exchange and trades under the symbol “NLS.” Our principal executive offices are located at 16400 SE Nautilus Drive, Vancouver, Washington 98683, and our telephone number is (360) 859-2900. The Internet address of our corporate website is http://www.nautilusinc.com.

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We file annual reports, quarterly reports, current reports, proxy statements and other information with the Securities and Exchange Commission (the “SEC”) under the Securities Exchange Act of 1934, as amended. You can inspect and obtain a copy of our reports, proxy statements and other information filed with the SEC at the offices of the SEC's Public Reference Room at 100 F Street N.E., Washington, D.C. 20549, on official business days during the hours of 10 a.m. to 3 p.m. EST. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. The SEC maintains an Internet website at http://www.sec.gov where you can access copies of most of our SEC filings.

We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, available free of charge on our corporate website. In addition, our Code of Business Conduct and Ethics, corporate governance policies, and the charters of our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee are available on our corporate website. The information presented on our corporate website is not part of this report.

Item 1A. Risk Factors

Nautilus operates in an environment that involves a number of risks and uncertainties. The risks and uncertainties described in this Annual Report on Form 10-K are not the only risks and uncertainties that we face. Additional risks and uncertainties that presently are not considered material or are not known to us, and therefore are not mentioned herein, may impair our business operations. If any of the risks described in this Annual Report on Form 10-K actually occur, our business, operating results and financial position could be adversely affected.

Our revenues and profitability can fluctuate from period to period and are often difficult to predict due to factors beyond our control.

Our results of operations in any particular period may not be indicative of results to be expected in future periods, and have historically been, and are expected to continue to be, subject to periodic fluctuations arising from a number of factors, including:

- Introduction and market acceptance of new products;
- Variations in product selling prices and costs and the mix of products sold;
- Size and timing of Retail customer orders, which, in turn, often depend upon the success of our customers' businesses or specific products;
- Changes in the market conditions for consumer fitness equipment;
- Changes in macroeconomic factors;
- Availability of consumer credit;
- Timing and availability of products coming from our offshore contract manufacturing suppliers;
- Seasonality of markets, which vary from quarter-to-quarter and are influenced by outside factors such as overall consumer confidence and the availability and cost of television advertising time;
- Effectiveness of our media and advertising programs;
- Customer consolidation in our Retail segment, or the bankruptcy of any of our larger Retail customers;
- Restructuring charges;
- Goodwill and other intangible asset impairment charges; and
- Legal and contract settlement charges.

These trends and factors could adversely affect our business, operating results, financial position and cash flows in any particular period.

Intense competition or loss of one or more of our large Retail customers could negatively impact our sales and operating results.

Our products are sold in highly competitive markets with limited barriers to entry. As a result, introduction by competitors of lower-priced or more innovative products could result in a significant decline in our revenues and have a material adverse effect on our operating results, financial position and cash flows.

Additionally, we derive a significant portion of our revenue from a small number of Retail customers. A loss of business from one or more of these large customers, if not replaced with new business, could negatively affect our operating results and cash flow.

We may not be able to obtain sufficient debt financing.

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Prior to December 31, 2011, we extended the expiration date of the Loan and Security Agreement with Bank of the West, thereby extending the maturity date of our Increasing Rate Senior Discount Notes to May 2, 2013. We expect to obtain other debt financing prior to the maturity date of the notes and use the proceeds or a portion thereof to pay off the notes. There is no guarantee that we will be able to borrow funds on favorable terms, if at all, or that any amount raised will be sufficient to meet our cash requirements. If we are not able to obtain sufficient debt financing, it could have a material adverse affect on our operating results, financial position and cash flows. For more information regarding our borrowing arrangements, refer to Note 10, Borrowings, to our consolidated financial statements in Part II, Item 8 of this report.

Further decline or weaker than expected recovery in consumer spending likely would negatively affect our product revenues and earnings.

Success of each of our products depends substantially on the amount of discretionary funds available to our customers. Global credit and financial markets have experienced extreme disruptions in the recent past, including severely diminished liquidity and credit availability, declines in consumer confidence, declines in economic growth, increases in unemployment rates and uncertainty about economic stability. There can be no assurance that there will not be further deterioration in these conditions. Further decline or weaker than expected recovery in general economic conditions could further depress consumer spending, especially spending for discretionary consumer products such as ours. Poor economic conditions could in turn lead to substantial decreases in our net sales or have a material adverse effect on our operating results, financial position and cash flows.

Portions of our operating expenses and costs of goods sold are relatively fixed, and we may have limited ability to reduce expenses sufficiently in response to any revenue shortfalls.

Many of our operating expenses are relatively fixed. We may not be able to adjust our operating expenses or other costs sufficiently to adequately respond to any revenue shortfalls. If we are unable to reduce operating expenses or other costs quickly in response to any revenue shortfall, it would negatively impact our operating results, financial condition and cash flows.

If we are unable to anticipate consumer preferences or to effectively develop, market and sell future products, our future revenues and operating results could be adversely affected.

Our future success depends on our ability to effectively develop, market and sell new products that respond to new and evolving consumer preferences. Accordingly, our revenues and operating results may be adversely affected if we are unable to develop or acquire rights to new products that satisfy consumer preferences. In addition, any new products that we market may not generate sufficient revenues to recoup their acquisition, development, production, marketing, selling and other costs.

Our business is affected by seasonality which results in fluctuations in our operating results.

We experience moderate fluctuations in aggregate sales volume during the year. Sales are typically strongest in the first and fourth quarters, followed by the third quarter, and are generally weakest in the second quarter. However, the mix of product sales may vary considerably from time to time as a result of changes in seasonal and geographic demand for particular types of fitness equipment. In addition, our customers may cancel orders, change delivery schedules or change the mix of products ordered with minimal notice. As a result, we may not be able to accurately predict our quarterly sales. Accordingly, our results of operations are likely to fluctuate significantly from period to period.

Government regulatory actions could disrupt our marketing efforts and product sales.

Various international and U.S. federal, state and local governmental authorities, including the Federal Trade Commission and the Consumer Product Safety Commission, regulate our product marketing efforts. Our sales and profitability could be significantly harmed if any of these authorities commence a regulatory enforcement action that interrupts our marketing efforts, results in a product recall or negative publicity, or requires changes in product design.

A significant decline in availability of media time or substantially higher advertising rates may hinder our ability to effectively market our products and may reduce profitability.

We depend on television advertising to market certain products sold directly to consumers. Consequently, a marked increase in the price we must pay for our preferred media time and/or a reduction in its availability may adversely impact our financial performance.

Our revenues could decline due to changes in credit markets and decisions made by credit providers.

Historically, a significant portion of our Direct sales have been financed for our customers under various programs offered by third- party consumer credit financing sources. Reductions in consumer lending and the availability of consumer credit could limit the number of customers with the financial means to purchase our products. Higher interest rates could increase monthly payments for consumer products financed through one of our monthly payment plans or through other sources of consumer financing. In the past, we have partnered with financial service companies to assist our customers in obtaining financing to purchase our products. Our present agreements with our third party consumer credit financing providers enable certain customers to obtain financing if they qualify for the provider's private label revolving credit card. We cannot be assured that our third party financing providers will continue to provide consumers with access to credit or that credit limits under such arrangements will not be reduced. Such restrictions or reductions in the availability of consumer credit could have a material adverse impact on our results of operations, financial position and cash flows.

If our contract manufacturers experience any delay, disruption or quality control problems in their operations, we could lose market share and revenues, and our reputation may be harmed.

We have outsourced the production of all of our products to third-party manufacturers. We rely on our contract manufacturers to procure components and provide spare parts in support of our warranty and customer service obligations. We generally commit the manufacturing of each product to a single contract manufacturer.

Our reliance on contract manufacturers exposes us to the following risks over which we may have limited control:

- Unexpected increases in manufacturing and repair costs;
- Interruptions in shipments if our contract manufacturer is unable to complete production;
- Inability to completely control the quality of finished products;
- Inability to completely control delivery schedules;
- Changes in our contract manufacturer's business models or operations;
- Potential increases in our negotiated product costs as a result of fluctuations in currency exchange rates;
- Impact of the global market and economic conditions on the financial stability of our contract manufacturers and their ability to operate without requesting earlier payment terms or letters of credit;
- Potential lack of adequate capacity to manufacture all or a part of the products we require; and
- Potential unauthorized reproduction or counterfeiting of our products.

Substantially all of our contract manufacturers are located in Asia, primarily China, and may be subject to disruption by natural disasters, as well as political, social or economic instability. The temporary or permanent loss of the services of any of our primary contract manufacturers could cause a significant disruption in our product supply chain and operations and delays in product shipments.

Our third-party manufacturing contracts are generally of annual or shorter duration, or manufactured products are sourced on the basis of individual purchase orders. There is no assurance that we will be able to maintain our current relationships with these parties or, if necessary, establish future arrangements with other third-party manufacturers on commercially reasonable terms. Further, we cannot assure that their manufacturing and quality control processes will be maintained at a level sufficient to meet our inventory needs or prevent the inadvertent sale of substandard products. While we believe that products manufactured by our current third-party manufacturers could generally be procured from alternative sources, temporary or permanent loss of services from a significant manufacturer could cause disruption in our supply chain and operations.

Our inventory purchases are subject to long lead times, which could negatively impact our sales, cash flows and liquidity.

All of our products are produced by third-party manufacturers, substantially all of which are located in Asia, primarily China. Lead times for inventory purchases from our Asian suppliers, from order placement to receipt of goods, generally range from approximately two to three months, of which transit time represents three-to-four weeks. The length of our lead times requires us to place advance manufacturing orders based on management forecasts of future demand for our products. Due to the length of our lead times, our sales and cash flows may be negatively impacted if we do not have sufficient inventory on hand to meet customer demand for such items. In addition, our liquidity and cash flows may be negatively affected, and inventory obsolescence may increase, if the quantity of products we order exceeds customer demand for such items.

A delay in getting non-U.S.-sourced products through customs in a timely manner could result in reduced sales, canceled sales orders and unanticipated inventory accumulation.

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Most of our imported products are subject to duties or tariffs that affect the cost and quantity of various types of goods imported into the U.S. or our other markets. The countries in which our products are produced or sold may adjust or impose new quotas, duties, tariffs or other restrictions. Further, our business depends on our ability to source and distribute products in a timely manner. As a result, we rely on the free flow of goods through open and operational ports worldwide. Labor disputes at various ports create significant risks for our business, particularly if these disputes result in work slowdowns, lockouts, strikes or other disruptions during our peak importing seasons. Any of these factors could result in reduced sales, canceled sales orders and unanticipated inventory accumulation and have a material adverse effect on our operating results, financial position and cash flows.

Unpredictable events and circumstances relating to our international operations, including our use of non-U.S. manufacturers, could have a material adverse effect on our business.

Substantially all of our products are manufactured outside of the U.S. and a portion of our revenue is derived from sales outside the U.S., primarily in Canada. Accordingly, our future results could be materially adversely affected by a variety of factors pertaining to international trade, including: changes in a specific country's or region's political or economic conditions; trade restrictions; import and export licensing requirements; changes in regulatory requirements; additional efforts to comply with a variety of foreign laws and regulations; and longer payment cycles in certain countries, thus requiring us to finance customer purchases over a longer period than those made in the U.S. In addition, we rely on the performance of our employees located in foreign countries. Our ability to control the actions of these employees may be limited by the laws and regulations in effect in each country. Changes in any of the above factors could have a material adverse effect on our operating results, financial position and cash flows.

Currency exchange rate fluctuations could result in higher costs and reduced margins.

Substantially all of our products are manufactured outside of the U.S. and, therefore, currency exchange rate fluctuations could result in higher costs for our products, or could disrupt the business of independent manufacturers that produce our products, by making their purchases of raw materials more expensive and more difficult to finance. Our future financial results could be significantly affected by the value of the U.S. dollar in relation to the foreign currencies in which we, our customers or our suppliers conduct business. Fluctuations in the Chinese Renminbi exchange rate caused our costs for certain products to increase in 2011, reducing our margins and cash flows. Such fluctuations and cost increases may continue to occur in the future. If we are unable to increase our selling prices to offset such cost increases, or if such increases have a negative impact on sales of our products, our revenues and margins would be reduced and our operating results and cash flows would be negatively impacted. In addition, a portion of our revenue is derived from sales outside the U.S., primarily in Canada. Currency rate fluctuations could make our products more expensive for foreign consumers and reduce our sales, which would negatively affect our operating results and cash flows.

Failure or inability to protect our intellectual property could significantly harm our competitive position.

Protecting our intellectual property is an essential factor in maintaining our competitive position in the health and fitness industry. If we do not, or are unable to, adequately protect our intellectual property, our sales and profitability may be adversely affected. We own numerous patents and trademarks worldwide. However, our efforts to protect our proprietary rights may be inadequate, and applicable laws provide only limited protection.

Trademark infringement or other intellectual property claims relating to our products could increase our costs.

Our industry is susceptible to litigation regarding trademark and patent infringement and other intellectual property rights. We could become a plaintiff or defendant in trademark and patent infringement claims or claims of breach of

license. The prosecution or defense of intellectual property litigation is both costly and disruptive of the time and resources of our management, even if the claim or defense against us is without merit. We could also be required to pay substantial damages or settlement costs to resolve intellectual property litigation or related matters.

We also may not be able to successfully acquire intellectual property rights, protect existing rights, or potentially prevent others from claiming that we have violated their proprietary rights when we launch new products. We could incur substantial costs in defending against such claims even if they are without basis, and we could become subject to judgments or settlements requiring us to pay substantial damages, royalties or other charges.

Future impairments of intangible assets could negatively impact our operating results.

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We had goodwill of $2.9 million and other intangible assets of $16.7 million as of December 31, 2011. Any future impairment charges, if significant, could materially and adversely affect our operating results. An unexpected decline in revenue, changes in market conditions, changes in competitive products or technologies or a change in management's intentions regarding utilization of intangible assets could lead to further impairment charges.

We are subject to periodic litigation, product liability risk and other regulatory proceedings which could result in unexpected expense of time and resources.

From time to time, we may be a defendant in lawsuits and regulatory actions relating to our business or the former operations of our discontinued Commercial business segment. Due to the inherent uncertainties of litigation and regulatory proceedings, we cannot accurately predict the ultimate outcome of any such proceedings. An unfavorable outcome could have a material adverse impact on our business, financial condition and results of operations. In addition, any significant litigation in the future, regardless of its merits, could divert management's attention from our operations and may result in substantial legal costs.

We are subject to warranty claims for our products which could result in unexpected expense.

Many of our products carry limited warranties for defects in quality and workmanship. We may experience significant expense as the result of product quality issues, product recalls or product liability claims which may have a material adverse effect on our business. We maintain a warranty reserve for estimated future warranty claims. However, the actual costs of servicing future warranty claims may exceed the reserve and have a material adverse effect on our results of operations, financial condition and cash flows. In addition, we remain contingently liable for product warranty obligations which were transferred to buyers of our Commercial business product lines, if the buyer is unable to fulfill such obligations.

Disruption to our information and communication systems could result in interruptions to our business.

Our business is reliant on information and communication technology, and a substantial portion of our revenues are generated with the support of information and communication systems. The success of our Direct business is heavily dependent on our ability to respond to customer sales inquiries and process sales transactions using our call center communication systems, Internet websites and similar data monitoring and communication systems provided and supported by third-parties. If such systems were to fail, or experience significant or lengthy interruptions in availability or service, our revenues could be materially affected. We also rely on information systems in all stages of our product cycle, from design to distribution, and we use such systems as a method of communication between employees, suppliers and customers. In addition, we use information systems to maintain our accounting records, assist in trade receivables collection and customer service efforts, and forecast operating results and cash flows.

System failures or service interruptions may occur as the result of a number of factors, including: computer viruses; hacking or other unlawful activities by third parties; disasters; equipment, hardware or software failures; cable outages, extended power failures, or our inability or failure to properly protect, repair or maintain our communication and information systems. To mitigate the risk of business interruption, we have in place a disaster recovery program that targets our most critical operational systems. If our disaster recovery system is ineffective, in whole or in part, or efforts conducted by us or third-parties to prevent or respond to system interruptions in a timely manner are ineffective, our ability to conduct operations would be significantly affected. If we do not consider the potential impact of critical decisions related to systems or process design and implementation, this could lead to operational challenges and increase costs. Any of the aforementioned factors could have a material adverse affect on our operating results, financial position and cash flows.

If we are unable to maintain compliance with the continued listing standards of the New York Stock Exchange, we may become subject to delisting proceedings.

Our common stock currently is traded on the New York Stock Exchange (the “NYSE”). The NYSE's continued listing standards require that listed companies maintain either an average global market capitalization of not less than $50 million over a consecutive 30 trading-day period, or total stockholders' equity of not less than $50 million. On September 23, 2010, we were notified by the NYSE that we were not in compliance with this requirement for continued listing. On December 3, 2010, we were notified that the NYSE had accepted our plan demonstrating our ability to regain compliance with the continued listing standards within an 18-month period that ends on March 23, 2012. As of February 29, 2012, our market capitalization over the preceding 30 trading-day period was approximately $75 million, which exceeds the NYSE requirement for continued listing.

If we are unable to maintain compliance with the NYSE continued listing standards, our common stock could be delisted by the NYSE. Delisting could negatively impact us by, among other factors, reducing the volume of trading in our common stock and the number of investors willing or able to hold or acquire our common stock, damaging our reputation and standing with

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suppliers, lenders, customers and sources of consumer financing programs.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Following is a summary of our principal properties as of December 31, 2011:

Location	Primary Function(s)	Owned or Leased
Washington	Corporate headquarters and customer call center	Leased
Oregon	Warehouse and distribution	Leased
Canada	Warehouse, distribution and showroom	Leased
China	Quality assurance office	Leased

Each of our principal properties is used by both our Direct segment and our Retail segment. Our properties generally are well-maintained, adequate and suitable for their intended purposes and we believe our existing properties will meet our operational needs for the foreseeable future. If we require additional warehouse or office space in the future, we believe we will be able to obtain such space on commercially reasonable terms.

Item 3. Legal Proceedings

We are party to various legal proceedings and claims arising from normal business activities. In addition, our tax filings are subject to audit by authorities in the jurisdictions where we conduct business, which may result in assessments of additional taxes. Management believes the Company has adequately provided for obligations that would result from these legal and tax proceedings where it is probable the Company 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.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market for our Common Stock

Our common stock is listed on the New York Stock Exchange (the “NYSE”) and trades under the symbol “NLS.” On February 29, 2012, the closing sale price of our common stock was $2.78 per share, as reported on the NYSE. As of February 29, 2012, there were 57 holders of record of our common stock and approximately 29,000 beneficial shareholders. The following table sets forth the high and low sales prices and dividends paid per common share for each period presented:

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	High	Low	Dividends Paid
2011:			
Quarter 1	$3.30	$1.81	—
Quarter 2	3.45	1.58	—
Quarter 3	2.24	1.32	—
Quarter 4	2.20	1.39	—
2010:			
Quarter 1	4.35	1.96	—
Quarter 2	3.63	1.52	—
Quarter 3	2.02	1.27	—
Quarter 4	1.92	1.30	—

Currently, we have no plans to pay dividends on our common stock. Payment of any future dividends, when permitted under our borrowing arrangements, is at the discretion of our Board of Directors, which considers various factors such as our financial condition, operating results, current and anticipated cash needs and future expansion plans.

Equity Compensation Plans

The following table provides information about our equity compensation plans as of December 31, 2011:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	1,482,917	$ 8.72	4,080,000
Equity compensation plans not approved by security holders	—	—	—
Total	1,482,917	8.72	4,080,000

For further information regarding our equity compensation plans, refer to Note 12, Stockholders' Equity, to our consolidated financial statements in Part II, Item 8 of this report.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

The following discussion and analysis is based upon our financial statements as of the dates and for the periods presented in this section. You should read this discussion and analysis in conjunction with the financial statements and notes thereto found in Part II, Item 8 of this report. All references to the years 2011 and 2010 mean the twelve-month periods ended December 31, 2011 and 2010, respectively. Unless the context otherwise requires, "Nautilus," "we," "us" and "our" refer to Nautilus, Inc. and its subsidiaries. Unless indicated otherwise, all information regarding our operating results pertains to our continuing operations.

Our results of operations may vary significantly from period-to-period. Our revenues typically fluctuate due to the seasonality of our industry, customer buying patterns, product innovation, the nature and level of competition for health and fitness products, our ability to procure products to meet customer demand, the level of spending on, and effectiveness of, our media and advertising programs and our ability to attract new customers and maintain existing sales relationships. In addition, our revenues are highly susceptible to economic factors, including, among other things, the overall condition of the economy and the availability of consumer credit in both the United States and Canada. Our profit margins may vary in response to the aforementioned factors and our ability to manage product costs. Profit margins may also be affected by fluctuations in the costs or availability of materials used to manufacture our products, product warranty costs, higher or lower fuel prices, and changes in costs of other distribution or manufacturing-related services. Our operating profits or losses may also be affected by the efficiency and effectiveness of our organization. Historically, our operating expenses have been influenced by media costs to produce and air television advertisements of our products, facility costs, operating costs of our information and communications systems, product supply chain management, customer support and new product development activities. In addition, our operating expenses have been affected from time-to-time by asset impairment charges, restructuring charges and other significant unusual or infrequent expenses.

As a result of the above and other factors, our period-to-period operating results may not be indicative of future performance. You should not place undue reliance on our operating results and should consider our prospects in light of the risks, expenses and difficulties typically encountered by us and other companies, both within and outside our industry. We may not be able to successfully address these risks and difficulties and, consequently, we cannot assure you of any future growth or profitability. For more information, see our discussion of Risk Factors located at Part I, Item 1A of this report.

OVERVIEW

We are committed to providing innovative, quality solutions to help people achieve a fit and healthy lifestyle. Our principal business activities include designing, developing, sourcing and marketing high-quality cardiovascular and strength fitness products and related accessories for consumer home use, primarily in the United States and Canada. Our products are sold under some of the most recognized brand names in the fitness industry: Nautilus®, Bowflex®, Schwinn®, Schwinn Fitness™ and Universal®.

We market our products through two distinct distribution channels, Direct and Retail, which we consider to be separate business segments. Our Direct business offers products directly to consumers through television advertising, the Internet and catalogs. Our Retail business offers our products through a network of third-party retailers with stores and websites located in the United States and internationally.

Our net sales in 2011 were $180.4 million, an increase of $12.0 million, or 7.1%, compared to net sales of $168.5 million in 2010, largely due to the continued strong demand for our TreadClimber products. This increase was partially offset by comparably lower sales for home gyms and other strength products. Growth in TreadClimber sales continues to be driven by consumer acceptance, more effective media advertising and improving consumer credit

approval rates.

In September 2010, we completed our transition to a new consumer credit program with a new primary third-party financing provider, GE Capital Retail Bank, formerly GE Money Bank ("GE"). The relationship with GE has expanded the ability of our customers to obtain third-party consumer financing for buying our products. In addition, we added one secondary third-party consumer credit financing provider during the third quarter of 2010 and another in early 2011, both of which offer credit to certain qualified consumers whose credit applications have been declined by GE. As a result of these actions, combined consumer credit approvals by our primary and secondary U.S. third-party financing providers increased from 15% in 2010 to 25% in 2011.
Income from continuing operations was $2.5 million for 2011, compared to a loss from continuing operations of $9.8 million for 2010. Diluted income per share from continuing operations for 2011 was $0.08, compared to diluted loss per share of $(0.32) for 2010. The significant improvement in results of continuing operations for 2011 was largely attributable to

increased sales and a 13.3% reduction in operating expenses achieved primarily through more cost efficient media advertising expenditures. Selling and marketing expenses as a percent of net sales declined to 30.2% for 2011 from 38.0% for 2010.
During 2011, we allocated a larger portion of our media expenditures toward our TreadClimber product line, compared to 2010. In addition, we began implementing a lower cost Internet-based advertising strategy for our home gyms in 2011, which is designed to capitalize on the extensive product awareness that currently exists among consumers for our Bowflex rod-based home gyms. In 2012, we expect to dedicate the majority of our media advertising budget to TreadClimbers and a new product, CoreBody Reformer, which was launched in November 2011.
Net income, including loss from the discontinued Commercial operation, was $1.4 million for 2011, an improvement of $24.3 million over net loss of $22.8 million for 2010. Diluted net income per share for 2011 was $0.05, as compared to diluted net loss per share of $(0.74) for 2010.

RESULTS OF OPERATIONS

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements. An accounting estimate is considered to be critical if it meets both of the following criteria: (i) the estimate requires assumptions about matters that are highly uncertain at the time the accounting estimate is made, and (ii) different estimates reasonably could have been used, or changes in the estimate that are reasonably likely to occur from period to period may have a material impact on the presentation of our financial condition, changes in financial condition or results of operations.

Our critical accounting policies and estimates are discussed below. We have not made any material changes in the methodologies we use in our critical accounting estimates during the past three fiscal years and we do not believe there is a reasonable likelihood that there will be a material change in the future assumptions or estimates we use. However, if our assumptions or estimates change in future periods, the impact on our financial position and operating results could be material.

Sales Discounts and Allowances

Product sales and shipping revenues are reported net of promotional discounts and return allowances. We estimate the revenue impact of retail sales incentive programs based on the planned duration of the program and historical experience. If the amount of our retail sales incentives can be reasonably estimated, we record the impact of such incentives at the later of the time we notify our customer of the sales incentive, or the time of the sale. If actual amounts differ from our estimates, revenue is adjusted.

Our calculation of amounts owed for sales discounts and allowances contains uncertainties because it requires management to make assumptions in interim periods and to apply judgment regarding a number of factors, including estimated future customer inventory purchases and returns.

Goodwill and Intangible Asset Valuation

We evaluate our indefinite-lived intangible assets and goodwill for potential impairment annually or when events or circumstances indicate their carrying value may be impaired. Finite-lived intangible assets, including patents and patent rights, are evaluated for impairment when events or circumstances indicate the carrying value may be impaired. No goodwill or intangible asset impairment charges were recognized in 2011 or 2010.

Our impairment loss calculations contain uncertainties because they require management to make assumptions and to apply judgment in order to estimate future cash flows and asset fair values. Our judgments regarding potential impairment are based on a number of factors including: the timing and amount of anticipated cash flows; market conditions; relative levels of risk; the cost of capital; terminal values; royalty rates; and the allocation of revenues, expenses and assets and liabilities to business segments. Each of these factors can significantly affect the value of our goodwill or indefinite-lived intangible assets and, thereby, could have a material adverse affect on our financial position and results of operations.

Product Warranty Obligations

Our products carry limited defined warranties for defects in materials or workmanship. Our product warranties generally obligate us to pay for the cost of replacement parts, cost of shipping the parts to our customers and, in certain instances,

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service labor costs. At the time of sale, we record a liability for the estimated costs of fulfilling future warranty claims. The 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, we adjust our liability for specific warranty matters when they become known and are reasonably estimable. Our estimates of warranty expenses are based on significant judgment, and the frequency and cost of warranty claims are subject to variation. 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 variances in expected repair costs.

Uncertainties exist with respect to outstanding warranty obligations of our discontinued Commercial business, as units sold to customers approach end-of-life and settlements are reached with certain customers in connection with our exit from the Commercial business. As of December 31, 2011, our warranty liability included $0.6 million for future warranty costs of our former commercial business, which represents management's estimate of the probable amount.

Litigation and Loss Contingencies
From time to time, we may be involved in claims, lawsuits and other proceedings. Such matters involve uncertainty as to the eventual outcomes and any losses or gains we may ultimately realize when one or more future events occur or fail to occur. We record 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. We estimate the probability of such losses based on the advice of internal and external counsel, outcomes from similar litigation, 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. We regularly monitor our estimated exposure to these contingencies and, as additional information becomes known, we may change our estimates accordingly.

Deferred Tax Assets - Valuation Allowance
We account 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 and the tax basis of existing assets and liabilities. Deferred tax assets and liabilities are measured using the enacted tax rates that are 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 our deferred tax assets and liabilities is recognized in the period of the enactment. A tax benefit from an uncertain tax position may be recognized 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.

We have recorded a valuation allowance to reduce our deferred tax assets to the amount we believe is more likely than not to be realized. As we determined that it is more likely than not that the benefit from our deferred tax assets will not be realized, we have a valuation allowance against net deferred tax assets of $60.3 million. If our assumptions change and we determine we will be able to realize these deferred tax assets, the tax benefits related to any reversal of the valuation allowance will be accounted for in the period in which we make such determination. Likewise, should we determine that we would be able to realize our deferred tax assets in the future in excess of our recorded amount, an adjustment to the deferred tax assets would increase income in the period such determination was made.

Significant judgments are required in determining tax provisions and evaluating tax positions. Such judgments require us to interpret existing tax law and other published guidance as applied to our circumstances. In particular, our valuation allowance contains uncertainties because management is required to make assumptions and to apply judgment to estimate the future realization of net deferred tax assets. If our financial results or other relevant facts change, thereby impacting the likelihood of realizing the tax benefit of an uncertain tax position, significant judgment

would be applied in determining the effect of the change on our valuation allowance.

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COMPARISON OF THE YEARS ENDED DECEMBER 31, 2011 AND 2010

The discussion that follows should be read in conjunction with our consolidated financial statements and the related notes in this report. All comparisons to prior year results are in reference to continuing operations only in each period, unless otherwise indicated.

The following table compares selected financial information in our consolidated statements of operations for the years ended December 31, 2011 and 2010 (in thousands):

	Year Ended December 31,			
	2011	2010	Change	% Change
Net sales	$180,412	$168,450	$11,962	7.1 %
Cost of sales	101,953	91,704	10,249	11.2 %
Gross profit	78,459	76,746	1,713	2.2 %
Operating expenses:				
Selling and marketing	54,494	64,039	(9,545)	(14.9)%
General and administrative	17,143	19,371	(2,228)	(11.5)%
Research and development	3,223	2,905	318	10.9 %
Total operating expenses	74,860	86,315	(11,455)	(13.3)%
Operating income (loss)	3,599	(9,569)	13,168	
Other income (expense):				
Interest income	65	15	50	
Interest expense	(466)	(140)	(326)	
Other	(11)	464	(475)	
Total other income (expense)	(412)	339	(751)	
Income (loss) before income taxes	3,187	(9,230)	12,417	
Income tax expense	686	588	98	
Income (loss) from continuing operations	2,501	(9,818)	12,319	
Loss from discontinued operation, net of income taxes	(1,081)	(13,023)	11,942	
Net income (loss)	$1,420	$(22,841)	$24,261	

The following table compares the net sales and gross margins of our business segments for the years ended December 31, 2011 and 2010 (in thousands):

	Year Ended December 31,			
	2011	2010	Change	% Change
Net sales:				
Direct	$107,061	$96,668	$10,393	10.8 %
Retail	68,591	67,789	802	1.2 %
Royalty income	4,760	3,993	767	19.2 %
Total net sales	$180,412	$168,450	$11,962	7.1 %
Gross profit:				
Direct	$57,655	$54,041	$3,614	6.7 %
Retail	16,044	18,711	(2,667)	(14.3)%
Royalty income	4,760	3,994	766	19.2 %
Total gross profit	$78,459	$76,746	$1,713	2.2 %
Gross margin:				
Direct	53.9 %	55.9 %	(200) basis points	

Retail	23.4	%	27.6	%	(420	) basis points

The following table compares the net sales of our major product lines within each business segment for the years ended December 31, 2011 and 2010 (in thousands):

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	Year Ended December 31,			
	2011	2010	Change	% Change
Direct net sales:				
Cardio products[1]	$ 75,982	$ 54,409	$ 21,573	39.6 %
Strength products[2]	31,079	42,259	(11,180)	(26.5)%
Total Direct net sales	107,061	96,668	10,393	10.8 %
Retail net sales:				
Cardio products[1]	43,718	43,628	90	0.2 %
Strength products[2]	24,873	24,161	712	2.9 %
Total Retail net sales	68,591	67,789	802	1.2 %
Royalty income	4,760	3,993	767	19.2 %
Total net sales	$ 180,412	$ 168,450	$ 11,962	7.1 %

(1) Cardio products include treadclimbers, treadmills, exercise bikes and ellipticals.
(2) Strength products include home gyms, selectorized dumbbells, kettlebell weights, weight benches and CoreBody Reformer.

Direct

Net sales of our Direct business were $107.1 million in 2011, an increase of $10.4 million, or 10.8%, compared to Direct net sales of $96.7 million in 2010. Revenues of cardio products in our Direct channel increased by 39.6% in 2011, compared to 2010, primarily due to higher sales of Bowflex TreadClimber products. The increase in Direct sales of cardio products was partially offset by a 26.5% decline in Direct sales of strength products, primarily rod-based home gyms. The decline in sales of rod-based home gyms is attributable in part to the cessation of television advertising for these products, as television ad spending on this mature product category was generating unsatisfactory returns. We have marketed rod-based home gyms through more cost efficient online media since early 2011.

In September 2010, we completed our transition to a new consumer credit program with a new primary third-party financing provider, GE Capital Retail Bank, formerly GE Money Bank ("GE"). The relationship with GE has expanded the ability of our customers to obtain third-party consumer financing for buying our products. In addition, we added one secondary third-party consumer credit financing provider during the third quarter of 2010 and another in early 2011, both of which offer credit to certain qualified consumers whose credit applications have been declined by GE. As a result, combined consumer credit approvals by our primary and secondary U.S. third-party financing providers increased from 15% in 2010 to 25% in 2011. We expect that average consumer credit financing approval rates in 2012 will approximate the 2011 level or improve modestly as we continue to optimize our credit program offerings.
Gross margin of our Direct business was 53.9% in 2011, a decrease of 200 basis points compared to 2010. The comparative decrease in Direct gross margin was primarily attributable to relatively higher warranty costs associated with cardio products, as compared to strength products, increased costs of certain products, largely arising from changes in foreign currency exchange rates, and higher year-over-year sales of in-home assembly services, which are sold at low margins.

Retail

Net sales of our Retail business were $68.6 million in 2011, an increase of $0.8 million, or 1.2%, compared to Retail net sales of $67.8 million in 2010, primarily driven by growth among our e-commerce Retail customers. In 2011, Retail sales of strength products increased by 2.9%, primarily due to higher sales of home gyms, and sales of cardio products increased by 0.2%, compared to 2010.

Gross margin of our Retail business was 23.4% in 2011, a decrease of 420 basis points compared to 2010, primarily due to increased costs of certain products, largely arising from changes in foreign currency exchange rates, and higher supply chain costs, including freight.

Operating Expenses

Operating expenses were $74.9 million in 2011, a decrease of $11.5 million, or 13.3%, compared to operating expenses of $86.3 million in 2010. This reduction was achieved primarily through more effective media advertising, which enabled more

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efficient spending. In addition, general and administrative expenses decreased by $2.2 million in 2011, compared to 2010.

Selling and Marketing

Selling and marketing expenses were $54.5 million in 2011, a decrease of $9.5 million, or 14.9%, compared to 2010. Advertising expense of our Direct business, a component of selling and marketing expenses, in 2011 was $28.6 million, a decrease of $12.0 million, or 29.6%, compared to 2010. The comparative decrease in Direct advertising expenses was primarily attributable to management's decision in early 2011 to shift advertising away from the mature home-gym category and to increase the media investment in our TreadClimber product line. Since early 2011, we have marketed home gyms through more cost efficient online media. Lower comparable Direct advertising expenses were offset in part by higher consumer credit financing costs, as a result of sequentially improving consumer credit approval rates, and the availability of additional secondary consumer financing providers in 2011, as compared to 2010.

General and Administrative

General and administrative expenses were $17.1 million in 2011, a decrease of $2.2 million, or 11.5%, compared to 2010, primarily due to lower depreciation, personnel and occupancy expenses.

Research and Development

Research and development expenses were $3.2 million in 2011, an increase of $0.3 million, or 10.9%, compared to 2010, as we increased our investment in new product development resources and capabilities.

Other Income and Expense

Interest Expense

We incurred interest expense of $0.5 million in 2011 in connection with our long-term note payable, compared to $0.1 million in 2010. We have not borrowed under our current financing agreement with Bank of the West, other than to fund our outstanding letters of credit.

Other Expense

Other expense was less than $0.1 million in 2011, compared to $0.5 million in 2010, primarily due to changes in foreign currency exchange gains and losses.

11,093 $19,441

Sales for the first half of fiscal 2011 were $25,365,000 as compared to $19,441,000 for the first half of fiscal 2010, an increase of $5,924,000 or 30.5%. As the table indicates, significant increases were realized in the U.S. Government and Domestic markets offset in part in by a decline in International sales.

Domestic Sales

Domestic sales in the first half of fiscal 2011 were $5,336,000 as compared to $4,836,000 in the first half of fiscal 2010, an increase of $500,000 or 10.3%, reflecting a significant increase in the sterilizer product line (up $1,058,000) of our Control Systems Group, partially offset by declines in most other product areas. Domestic sales represented 21.0% of the Company s total sales in the first half of fiscal 2011, as compared to 24.9% for the first half of fiscal 2010.

U.S. Government Sales

U.S. Government sales in the first half of fiscal 2011 were $10,573,000 as compared to $3,512,000 in the first half of fiscal 2010, an increase of $7,061,000 or 201.1%, and represented 41.7% of total sales in the first half of fiscal 2011 versus 18.1% for the first half of fiscal 2010. This increase is the result of sales of the Company s Pilot Training Systems products under contracts from the U.S. Navy for a research disorientation trainer and the U.S. Air Force to provide a high performance training and research human centrifuge and a suite of altitude chambers.

International Sales

For the first half of fiscal 2011, international sales (which include sales made by the Company s foreign subsidiaries) were $9,456,000 as compared to $11,093,000 in the first half of fiscal 2010, a decrease of $1,637,000 or 14.8%, and represented 37.3% of total sales, as compared to 57.0% in the first half of fiscal 2010. International performance reflected lower simulation sales (down $2,492,000) primarily for a contract in the Middle East which was completed in fiscal 2010. For the first half of fiscal 2011, there were sales to the Korean government for $7,847,000**.** For the first half of fiscal 2010, there were sales to or relating to governments or commercial accounts in Saudi Arabia of $6,666,000.

Gross Profit

Gross profit for the first half of fiscal 2011 was $9,924,000 as compared to $9,383,000 in the first half of fiscal 2010, an increase of $541,000 or 5.8%. The improvement in gross profit was due to an increase in both governmental and domestic sales, and was partially offset by the reduction in higher margin international sales. As a percentage of sales, gross profit for the first half of fiscal 2011 was 39.1% compared to 48.3% for the same period a year ago. The 9.2 percentage point reduction in the gross margin rate as a percentage of sales primarily reflected reductions in the ATS and simulation product areas.

Selling and Marketing Expenses

Selling and marketing expenses for the first half of fiscal 2011 were $2,122,000 as compared to $2,524,000 in the first half of fiscal 2010, a decrease of $402,000 or 15.9%. This decrease primarily reflected reduced bid and proposal expenses and reduced commissions on the shift in sales mix in the first half of fiscal 2011 to U.S. Government sales.

General and Administrative Expenses

General and administrative expenses for the first half of fiscal 2011 were $3,086,000 as compared to $3,170,000 in the first half of fiscal 2010, a decrease of $84,000 or 2.6%.

Research and Development Expenses

Research and development expenses, which are charged to operations as incurred, were $564,000 for the first half of fiscal 2011 as compared to $455,000 for the first half of fiscal 2010. The first half of fiscal 2010 reflected higher grant funds from the Turkish Government. Most of the Company s research efforts, which were and continue to be a significant cost of its business, are included in cost of sales for applied research for specific contracts, as well as research for feasibility and technology updates.

Loss on Extinguishment of Debt

In the first half of fiscal 2010, the Company recorded a loss on extinguishment of debt (the Subordinated Note) of $224,000, which represented the unamortized portion of the debt discount that was recorded at the issuance of this instrument. This charge resulted from the exchange of subordinated debt for preferred stock under the Lenfest Financing Transaction which was completed in July 2009. See Note 6 Long-term Obligations and Credit Arrangements in the accompanying Notes to the Condensed Consolidated Financial Statements.

Interest Expense

Interest expense for the first half of fiscal 2011 was $417,000 as compared to $866,000 for the first half of fiscal 2010, representing a decrease of $449,000 or 51.9%, reflecting reduced bank borrowing and the July 2009 exchange of the Subordinated Note for preferred stock.

Other Expense, Net

Other expense, net, was $128,000 for the first half of fiscal 2011 versus $121,000 for the first half of fiscal 2010. These expenses consist primarily of bank and letter of credit fees as well as foreign currency exchange gains or losses.

Income Taxes

Due to the utilization of net operating loss carry forwards available the Company did not record a provision for income taxes in the first half of fiscal 2011 or 2010.

The Company has reviewed the components of its deferred tax asset and has determined, based upon all available information, that its current and expected future operating income will more likely than not result in the realization of a portion of its deferred tax assets relating primarily to its net operating loss carryforwards. As of August 27, 2010, the Company had approximately $34 million of federal net loss carry forwards available to offset future income tax liabilities, beginning to expire in 2025. In addition, the Company has the ability to offset deferred tax assets against deferred tax liabilities created for such items as depreciation and amortization.

Liquidity and Capital Resources

The Company s liquidity position and borrowing availability improved significantly during the first half of fiscal 2011. Cash flow from operating activities was $5,720,000. Working capital (current assets less current liabilities) was $15,991,000 and the Company s current ratio (current assets divided by current liabilities) was 2.20. The Company repaid over $1 million under its line of credit agreement and repurchased $1,500,000 of Series E Preferred Stock from Lenfest. This positive performance primarily reflected the net income in the period and milestone payment collections under long term contracts.

The Company believes that it will have adequate cash from operations and existing credit facilities, including the $20 million PNC Line of Credit and the $7.5 Lenfest Credit Facility, to allow it to effectively and efficiently execute the requirements of its contracts. As of August 27, 2010, the Company had not utilized any of the $7.5 million available funding under the Lenfest Credit Facility.

As of August 27, 2010, the Company s availability under the Amended and Restated PNC Credit Agreement was approximately $9,964,000. This reflected cash borrowings of $8,477,000 and outstanding letters of credit of approximately $1,559,000.

The schedule below presents the Company s available borrowings under its existing credit facilities (amounts in thousands):

Credit facility*	Total Facility	Amount Utilized	Amount Available	Total Facility	Amount Utilized	Amount Available
	As of August 27, 2010:			As of February 26, 2010:		
PNC line of credit	$ 20,000	$ 10,036	$ 9,964	$ 20,000	$ 11,128	$ 8,872
Lenfest credit line	7,500		7,500	7,500		7,500
Dedicated line of credit	5,422	5,422		5,422	5,422	
Total	$ 32,922	$ 15,458	$ 17,464	$ 32,922	$ 16,550	$ 16,372

* See Note 6 Long-tem Debt and Credit Arrangements in the accompanying Notes to the Condensed Consolidated Financial Statements.

Cash flows from operating activities:

Cash flow from operating activities is driven by income from sales of our products offset by the timing of receipts and payments in the ordinary course of business.

During the first half of fiscal 2011, we generated $5,720,000 of cash from operating activities versus $537,000 for the first half of fiscal 2010, an improvement of $5,183,000. Cash generated in the current period primarily reflected significantly improved operating results, customer progress payments under long-term POC contracts, and non-cash expenses of depreciation and amortization. These items were offset in part by a decrease in costs in excess of billings and a reduction in billings in excess of costs under long-term POC contracts as well as an increase in prepaid commissions resulting from payments received under POC contracts which have not been recognized as revenue.

Cash flows from investing activities:

Cash used for investing activities primarily relates to funds used for capital expenditures in property and equipment. These uses of cash are offset by sales and borrowings under our credit facilities. The Company s investing activities used $958,000 in the first half of fiscal 2011 and consisted primarily of costs for the continued construction activities and the manufacturing of demonstration simulators for our NASTAR Center coupled with higher software enhancements for our Advanced Tactical Fighter Systems technology.

Cash flows from financing activities:

The Company s financing activities used $6,681,000 of cash during the first half of fiscal 2011. This primarily reflected the repayments under the Company s bank line, the funding a secured letter of credit for a performance guarantee and the repurchase of $1,500,000 of Series E Preferred Stock from and payments of Series D and E Preferred Stock dividends to Lenfest.

Outlook

We expect to use our cash, cash equivalents and credit facilities for working capital and general corporate purposes, products, product rights, technologies, property, plant and equipment, the payment of contractual obligations (including scheduled interest payments on our credit facilities and dividends on our preferred stock), the potential acquisition of businesses, and/or the purchase, redemption or retirement of our credit facilities and preferred stock. We expect that net sales of our currently marketed products should allow us to continue to generate positive operating cash flow in fiscal 2011.

Backlog

Below is a breakdown of the Company s August 27, 2010 and February 26, 2010 sales backlog (amounts in thousands except percentages):

August 27, 2010	**Business segment:**			
Geographic area:	**TSG**	**CSG**	**Total**	**%**
Domestic	$ 993	$ 4,747	$ 5,740	4.7%
US Government	40,959	36,744	77,703	63.6
International	33,036	5,632	38,668	31.7
Total	**$ 74,988**	**$ 47,123**	**$ 122,111**	**100.0%**
% of total	**61.4%**	**38.6%**	**100.0%**	

February 26, 2010	**Business segment:**			
Geographic area:	**TSG**	**CSG**	**Total**	**%**
Domestic	$ 210	$ 3,772	$ 3,982	4.1%
US Government	49,111	48	49,159	50.8
International	36,244	7,579	43,823	45.1
Total	**$ 85,565**	**$ 11,399**	**$ 96,964**	**100.0%**
% of total	**88.2%**	**11.8%**	**100.0%**	

Our sales backlog at August 27, 2010 and February 26, 2010, for work to be performed and revenue to be recognized under written agreements after such dates, was $122,111,000 and $96,964,000**,** respectively. Of the August 27, 2010 sales backlog, approximately $29,640,000 represents one international contract for multiple aircrew training simulators. Approximately 98% of the U.S. Government backlog represents three contracts.

The Company s order flow does not follow any seasonal pattern as the Company receives orders in each fiscal quarter of its fiscal year.

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Item 4. Controls and Procedures

Following the submission of the Original Filing, ETC management determined that the Company s disclosure controls and procedures were ineffective and that material weaknesses in internal control over financial reporting existed as of August 27, 2010, the end of the period covered by the Original Filing.

Evaluation of Disclosure Control and Procedures

Subsequent to the end of the period covered by the Original Filing, our Chief Executive Officer and Chief Financial Officer evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed in the reports we file under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and (ii) is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosures. A controls system cannot provide absolute assurances, however, that the objectives of the controls systems are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. Based on that evaluation, and solely as a result of material weaknesses in internal controls over financial reporting described below, our Chief Executive Officer and Chief Financial Officer have concluded that ETC s disclosure controls and procedures were ineffective as of the end of the period covered by the Original Filing.

Material Weaknesses in Internal Control Over Financial Reporting

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of interim or annual financial statements will not be prevented or detected on a timely basis by the company s internal controls.

ETC management has concluded that the following two material weaknesses existed as of the end of the period covered by the Original Filing:

First, management performed and completed its annual report on internal control over financial reporting but failed to include the Annual Report in the Company s Form 10-K for the period ended February 26, 2010. The failure to include the annual report was the result of an administrative error made during the preparation and filing of the Form 10-K.

Second, management determined that certain errors were made relating to the calculation and presentation of the Company s earnings per share in accordance with United States generally accepted accounting principles. Specifically, the Company did not reflect the participating features of its Series D Preferred Stock and Series E Preferred Stock when calculating its earnings per share in financial statements for certain prior periods.

Remediation Efforts

ETC s remediation efforts, as outlined below, are designed to address the material weaknesses identified by management and to strengthen the Company s internal control over financial reporting.

Specifically, the Company has implemented the following procedural remediation steps to address the material weaknesses described above and to improve its internal control over financial reporting:

Company management will prepare, publish and enforce a detailed reporting schedule which will allow adequate time for proper review by a newly formed compliance disclosure committee. This committee will include Company accounting personnel, the Company s General Counsel and the Company s key operations personnel. The role of this committee will be to assure that all public filings have been reviewed for regulatory compliance and adequate disclosure and that all suggested revisions have been properly incorporated;

Company management will review all procedural controls to ensure that (1) all process participants clearly understand their respective individual roles and the overall control environment, and (2) downstream controls and other checks and balances in the control environment are functioning adequately; and

if appropriate, for specific non-routine complex accounting transactions, management will engage a separate accounting firm to support management in accounting for these transactions.

These material weaknesses were previously disclosed on January 11, 2011, in the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended November 26, 2010.

Changes in Internal Control over Financial Reporting

Except as noted above, there was no change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Mends International, Ltd.

On May 29, 2008, a Request for Arbitration was filed against the Company with the Secretariat of the International Court of Arbitration by Mends International Ltd. (Mends). Mends Request for Arbitration arose out of a February 3, 1999 contract between the Company and Mends wherein Mends purchased aeromedical equipment for sale to the Nigerian Air Force. On July 1, 2010, the International Court of Arbitration issued a Partial Final Award which was within the scope of the Company s reserve and which did not have a material adverse effect on the Company s financial condition or results of operations. Additionally, the International Court of Arbitration may make an additional award to allocate the costs of the arbitration (including attorneys fees) between the parties. It is not expected that any additional award, if any, will have a material adverse effect on the Company s financial position or results of operation.

Administrative Agreement with U.S. Navy

In 2007, the Company entered into a settlement agreement with the Department of the Navy to resolve litigation filed by the Company in May 2003 in connection with a contract for submarine rescue decompression chambers. As of May 14, 2008, the Company had made all payments required under this settlement agreement and had transferred the chambers to the Department of the Navy. From October 2, 2007 through December 12, 2007, the Company was suspended by the Department of the Navy from soliciting work for the federal government pursuant to the Federal Acquisition Regulation. However, effective December 12, 2007, the Department of the Navy lifted the Company s suspension pursuant to the execution by the Company and the Department of the Navy of an Administrative Agreement. In accordance with the Administrative Agreement, the Company has established and implemented a program of compliance reviews, audits, and reports.

Other Matters

Certain other claims, suits, and complaints arising in the ordinary course of business have been filed or are pending against us. In our opinion, after consultation with legal counsel handling these specific matters, all such matters are reserved for or adequately covered by insurance or, if not so covered, are without merit or are of such kind, or involve such amounts, as would not have a significant effect on our financial position or results of operations if disposed of unfavorably.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None.

Item 4. Removed and Reserved

Item 5. Other Information

None.

Item 6. Exhibits

Number	Item
3.1	Registrant s Articles of Incorporation, as amended, were filed as Exhibit 3.1 to Registrant s Form 10-K for the year ended February 28, 1997 and are incorporated herein by reference.
3.2	Registrant s amended and restated By-Laws were filed as Exhibit 3.2 to Registrant s Form 8-K dated July 6, 2009, and are incorporated herein by reference.
3.3	Registrant s amended and restated By-Laws were filed as Exhibit 3.1 to Registrant s Form 8-K dated July 28, 2010, and are incorporated herein by reference.
10.1	Amendment to Loan Documents dated as of May 7, 2010, between the Registrant, H.F. Lenfest and PNC Bank, National Association was filed on June 1, 2010 as Exhibit 1.1 to Form 8-K and is incorporated by reference.
10.2	Amendment to Loan Documents dated as of June 2, 2010 between the Registrant and PNC Bank, National Association was filed on July 12, 2010 as Exhibit 10.2 to Form 10-Q and is incorporated herein by reference.
10.3	Amendment to Loan Documents dated as of August 18, 2010 between the Registrant and PNC Bank, National Association was filed on August 20, 2010 as Exhibit 10.1 to Form 8-K and is incorporated herein by reference.
31.1	Certification dated March 15, 2011 pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 made by William F. Mitchell, Chief Executive Officer.
31.2	Certification dated March 15, 2011 pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 made by Duane D. Deaner, Chief Financial Officer.
32	Certification dated March 15, 2011 pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 made by William F. Mitchell, Chief Executive Officer, and Duane D. Deaner, Chief Financial Officer.

Signatures

Pursuant to the requirements 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.

ENVIRONMENTAL TECTONICS CORPORATION
(Registrant)

Date: March 15, 2011	By: /s/ William F. Mitchell William F. Mitchell President and Chief Executive Officer (Principal Executive Officer)
Date: March 15, 2011	By: /s/ Duane Deaner Duane Deaner, Chief Financial Officer (Principal Financial and Accounting Officer)