RIGEL PHARMACEUTICALS INC
Form DEF 14A
April 12, 2010

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SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934

Filed by the Registrant ý

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement

o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

ý Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material Pursuant to § 240.14a-12

RIGEL PHARMACEUTICALS, INC.
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box)

ý No fee required.

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1. Title of each class of securities to which transaction applies:

2. Aggregate number of securities to which transaction applies:

3. Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

4. Proposed maximum aggregate value of transaction:

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6. Amount Previously Paid:

7. Form, Schedule or Registration Statement No.:

8. Filing Party:

9. Date Filed:

RIGEL PHARMACEUTICALS, INC.

1180 Veterans Boulevard
South San Francisco, California 94080

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held On May 27, 2010

DEAR STOCKHOLDER:

Notice is hereby given that the Annual Meeting of Stockholders of **RIGEL PHARMACEUTICALS, INC.**, a Delaware corporation (the "Company" or "Rigel"), will be held on Thursday, May 27, 2010 at 10:00 a.m. local time at our executive offices, located at 1180 Veterans Boulevard, South San Francisco, California 94080, for the following purposes:

1. To elect the three nominees for director named herein to the Board of Directors of the Company (the "Board") to hold office until the 2013 Annual Meeting of Stockholders.

2. To approve amendments to the Company's 2000 Equity Incentive Plan, as amended (the "EIP"), to (i) increase the aggregate number of shares of common stock authorized for issuance under the EIP by 1,250,000 shares and (ii) increase the maximum number of shares eligible to be granted pursuant to an option in any calendar year from 166,667 shares to 1,500,000 shares for purposes of Section 162(m) of the Internal Revenue Code.

3. To approve an amendment to the Company's 2000 Non-Employee Directors' Stock Option Plan, as amended (the "Directors' Plan"), to increase the aggregate number of shares of common stock authorized for issuance under the Directors' Plan by 350,000 shares.

4. To ratify the selection of Ernst & Young LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2010.

5. To conduct any other business properly brought before the meeting or any adjournment or postponement of the meeting.

These items of business are more fully described in the Proxy Statement accompanying this Notice.

The record date for the Annual Meeting is April 6, 2010. Only stockholders of record at the close of business on that date may vote at the meeting or any continuation, postponement or adjournment thereof. We appreciate your continued confidence in Rigel and look forward to seeing you at the meeting on May 27th.

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE STOCKHOLDERS' MEETING TO BE HELD ON MAY 27, 2010

THIS COMMUNICATION PRESENTS ONLY AN OVERVIEW OF THE MORE COMPLETE PROXY MATERIALS THAT ARE AVAILABLE TO YOU ON THE INTERNET. WE ENCOURAGE YOU TO ACCESS AND REVIEW ALL OF THE IMPORTANT INFORMATION CONTAINED IN THE PROXY MATERIALS BEFORE VOTING. THE PROXY STATEMENT IS AVAILABLE AT HTTP://WWW.PROXYVOTE.COM.

By Order of the Board of Directors,

Dolly A. Vance
Secretary

South San Francisco, California
April 12, 2010

YOUR VOTE IS IMPORTANT. WHETHER OR NOT YOU EXPECT TO ATTEND THE MEETING IN PERSON, PLEASE VOTE YOUR PROXY PROMPTLY SO YOUR SHARES CAN BE REPRESENTED AT THE MEETING. YOU CAN VOTE BY INTERNET, BY TELEPHONE, OR BY REQUESTING A PRINTED OR ELECTRONIC COPY OF A FULL SET OF THE PROXY MATERIALS AND COMPLETING, SIGNING AND RETURNING THE PROXY CARD AS INSTRUCTED IN THE MATERIALS. INSTRUCTIONS ON HOW TO ACCESS THE PROXY MATERIALS OVER THE INTERNET, OR TO REQUEST THAT A PAPER OR ELECTRONIC COPY OF THE FULL SET OF PROXY MATERIALS BE SENT TO YOUR SPECIFIED POSTAL OR EMAIL ADDRESS, MAY BE FOUND IN THE NOTICE OF INTERNET AVAILABILITY OF PROXY MATERIALS MAILED TO STOCKHOLDERS ON APRIL 12, 2010. ANY PROXY THAT WILL NOT BE DELIVERED IN PERSON TO THE ANNUAL MEETING MUST BE RECEIVED BY US NO LATER THAN 11:59 P.M. PACIFIC TIME ON WEDNESDAY, MAY 26, 2010. EVEN IF YOU HAVE VOTED BY PROXY, YOU MAY STILL VOTE IN PERSON IF YOU ATTEND THE MEETING. PLEASE NOTE, HOWEVER, THAT IF YOUR SHARES ARE HELD OF RECORD BY A BROKER, BANK OR OTHER NOMINEE AND YOU WISH TO VOTE IN PERSON AT THE MEETING, YOU MUST BRING WITH YOU A PROXY ISSUED IN YOUR NAME FROM THAT RECORD HOLDER THAT CONFIRMS THAT YOU ARE THE BENEFICIAL OWNER OF THOSE SHARES.

RIGEL PHARMACEUTICALS, INC.

1180 Veterans Boulevard
South San Francisco, California 94080

PROXY STATEMENT

FOR THE 2010 ANNUAL MEETING OF STOCKHOLDERS

May 27, 2010

QUESTIONS AND ANSWERS ABOUT THESE PROXY MATERIALS AND VOTING

WHY DID I RECEIVE A NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS ON THE INTERNET?

Pursuant to rules adopted by the Securities and Exchange Commission (the "SEC"), we have decided to provide access to our proxy materials to our stockholders via the internet. Accordingly, we are sending a Notice of Internet Availability of Proxy Materials (the "Notice") to our stockholders of record and posting our proxy materials online at www.proxyvote.com. The Notice contains only an overview of the complete proxy materials available. Stockholders are encouraged to access and review all the proxy materials on the website or request a paper or electronic copy of the full set of proxy materials for review prior to voting. Instructions on how to access the proxy materials over the internet or to request a paper or electronic copy of the full set of the proxy materials may be found in the Notice.

We intend to mail the Notice on or about April 12, 2010 to all stockholders of record as of April 6, 2010 who are entitled to vote at the Annual Meeting.

WILL I RECEIVE ANY PROXY MATERIALS BY MAIL OTHER THAN THE NOTICE?

No, you will not receive any other proxy materials by mail unless you request a paper or electronic copy of proxy materials. To request that a full set of the proxy materials be sent to your specified postal address, please go to www.proxyvote.com or call 1-800-579-1639. Please have your proxy card in hand when you access the website or call and follow the instructions provided.

HOW DO I ATTEND THE ANNUAL MEETING?

The meeting will be held on Thursday, May 27, 2010 at 10:00 a.m. local time at our executive offices, located at 1180 Veterans Boulevard, South San Francisco, California 94080. Directions to the annual meeting may be found online at http://www.rigel.com/rigel/contact. Information on how to vote in person at the annual meeting is discussed below.

WHO CAN VOTE AT THE ANNUAL MEETING?

Only stockholders of record at the close of business on April 6, 2010 are entitled to vote at the Annual Meeting. On this record date, there were 51,969,119 shares of common stock outstanding and entitled to vote.

Stockholder of Record: Shares Registered in Your Name

If on April 6, 2010 your shares were registered directly in your name with our transfer agent, Wells Fargo Bank, N.A., then you are a stockholder of record. As a stockholder of record, you may vote in person at the meeting or vote by proxy. Whether or not you plan to attend the Annual Meeting, we urge you to fill out and return the proxy card or vote by proxy over the telephone or on the internet as instructed below, to ensure your vote is counted. We must receive any proxy cards that will not be delivered in person at the Annual Meeting, or proxies submitted telephonically or over the internet, no later than 11:59 p.m. Pacific Time on Wednesday, May 26, 2010.

Beneficial Owner: Shares Registered in the Name of a Broker or Bank

If on April 6, 2010 your shares were not held in your name, but rather in an account at a brokerage firm, bank, dealer, or other similar organization, then you are the beneficial owner of shares held in "street name" and the Notice is being forwarded to you by that organization. The organization holding your account is considered to be the stockholder of record for purposes of voting at the Annual Meeting. As a beneficial owner, you have the right to direct your broker or other agent regarding how to vote the shares in your account. You are also invited to attend the Annual Meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the meeting unless you request and obtain a valid proxy from your broker or other agent and bring this proxy with you to the Annual Meeting.

WHAT AM I VOTING ON?

There are four matters scheduled for a vote at the Annual Meeting:

- Election to the Board of the three nominees for director named herein to hold office until the 2013 Annual Meeting of Stockholders;

- Approval of amendments to the 2000 Equity Incentive Plan, as amended (the "EIP" or "2000 Plan") to (i) increase the number of shares authorized for issuance under the 2000 Plan by 1,250,000 shares of common stock and (ii) increase the maximum number of shares eligible to be granted pursuant to an option in any calendar year from 166,667 shares to 1,500,000 shares for purposes of Section 162(m) of the Internal Revenue Code;

- Approval of an amendment to the 2000 Non-Employee Directors' Stock Option Plan, as amended (the "Directors' Plan") to increase the number of shares authorized for issuance under the Directors' Plan by 350,000 shares of common stock; and

- Ratification of the selection of Ernst & Young LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2010.

WHAT IF ANOTHER MATTER IS PROPERLY BROUGHT BEFORE THE MEETING?

The Board knows of no other matters that will be presented for consideration at the Annual Meeting. If any other matters are properly brought before the meeting, it is the intention of the persons named in the accompanying proxy to vote on those matters in accordance with their best judgment.

HOW DO I VOTE?

You may either vote "For" all the nominees to the Board or you may "Withhold" your vote for any nominee you specify. For the other matter to be voted on, you may vote "For" or "Against" or abstain from voting. The procedures for voting are fairly simple:

Stockholder of Record: Shares Registered in Your Name

If you are a stockholder of record, you may vote using one of the following methods:

In Person: To vote in person, come to the Annual Meeting and bring your proxy card or request a ballot in order to vote your shares.

Internet: To vote via the internet, go to www.proxyvote.com. You can use the internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Pacific Time on May 26, 2010. Please have your proxy card in hand when you access the website and follow the instructions provided.

Telephone: To vote by telephone, call 1-800-690-6903. You can use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Pacific Time on May 26, 2010. Please have your proxy card in hand when you call and follow the instructions provided.

Mail: To vote by mail, you must first request a paper or electronic copy of the proxy materials. To request that a full set of the proxy materials be sent to your specified postal or email address, please go to www.proxyvote.com or call 1-800-579-1639. Please have your proxy card in hand when you access the website or call and follow the instructions. Upon receipt of the materials, mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Rigel Pharmaceuticals, Inc., c/o Vote Processing, 51 Mercedes Way, Edgewood, NY 11717.

Whether or not you plan to attend the Annual Meeting and vote in person, we urge you to vote by proxy to ensure your vote is counted. You may still attend the meeting and vote in person even if you have already voted by proxy.

Beneficial Owner: Shares Registered in the Name of Broker or Bank

If you are a beneficial owner of shares registered in the name of your broker, bank, or other agent, you should have received the Notice containing voting instructions from that organization rather than from Rigel. Simply follow the voting instructions in the Notice to ensure that your vote is counted. Alternatively, you may vote by telephone or over the internet as instructed by your broker or bank. To vote in person at the Annual Meeting, you must obtain a valid proxy from your broker, bank, or other agent and bring this proxy with you to the Annual Meeting. Follow the instructions from your broker or bank included with the Notice, or contact your broker or bank to request a proxy form.

Please see the Notice or the information from your bank, broker, or other holder of record provided you for more information on these proxy voting options.

WE PROVIDE INTERNET PROXY VOTING TO ALLOW YOU TO VOTE YOUR SHARES ONLINE, WITH PROCEDURES DESIGNED TO ENSURE THE AUTHENTICITY AND CORRECTNESS OF YOUR PROXY VOTE INSTRUCTIONS. HOWEVER, PLEASE BE AWARE THAT YOU MUST BEAR ANY COSTS ASSOCIATED WITH YOUR INTERNET ACCESS, SUCH AS USAGE CHARGES FROM INTERNET ACCESS PROVIDERS AND TELEPHONE COMPANIES.

HOW MANY VOTES DO I HAVE?

On each matter to be voted upon, you have one vote for each share of common stock you owned as of April 6, 2010.

WHAT IF I RETURN A PROXY CARD BUT DO NOT MAKE SPECIFIC CHOICES?

If you return a signed and dated proxy card without marking any voting selections, your shares will be voted: (a) "For" the election of the three nominees for director named herein to the Board to hold office until the 2013 Annual Meeting of Stockholders; (b) "For" approval of amendments to the 2000 Plan to (i) increase the number of shares authorized for issuance under the 2000 Plan by 1,250,000 shares of common stock and (ii) increase the maximum number of shares eligible to be granted pursuant to an option in any calendar year from 166,667 shares to 1,500,000 shares for purposes of Section 162(m) of the Internal Revenue Code; (c) "For" approval of an amendment to the Directors' Plan to increase the number of shares authorized for issuance under the Directors' Plan by 350,000 shares of common stock; and (d) "For" ratification of the selection by the Audit Committee of the Board of Ernst & Young LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2010. If any other matter is properly presented at the meeting, your proxyholder (one of the individuals named on your proxy card) will vote your shares using his or her best judgment. However, if you are a beneficial owner of shares registered in the name of your broker, bank or other agent, please see "How are the votes counted?" and "What are "Broker Non-Votes?" below.

WHO IS PAYING FOR THIS PROXY SOLICITATION?

We will pay for the entire cost of soliciting proxies. In addition to these proxy materials, our directors and employees may also solicit proxies in person, by telephone, or by other means of communication. We will also reimburse brokerage firms, banks and other agents for the cost of forwarding proxy materials to beneficial owners. Directors and employees will not be paid any additional compensation for soliciting proxies.

WHAT DOES IT MEAN IF I RECEIVE MORE THAN ONE NOTICE?

If you receive more than one Notice, your shares are registered in more than one name or are registered in different accounts. Please follow the voting instructions for each Notice that you receive to ensure that all of your shares are voted.

CAN I CHANGE OR REVOKE MY VOTE AFTER SUBMITTING MY PROXY?

Yes. You can change or revoke your proxy at any time before the final vote at the Annual Meeting. If you are the record holder of your shares, you may change or revoke your proxy in any one of three ways:

- You may submit another properly completed proxy card with a later date by mail, or grant a subsequent proxy via the internet or by telephone. Your most current proxy card or telephone or internet proxy is the one that is counted and must be received before 11:59 P.M. Pacific Time on May 26, 2010. All other proxies previously submitted will be automatically revoked.

- You may send a timely written notice that you are revoking your proxy to Rigel Pharmaceuticals, Inc., c/o Vote Processing, 51 Mercedes Way, Edgewood, NY 11717.

- You may attend the Annual Meeting and vote in person. However, simply attending the meeting will not, by itself, revoke your proxy.

If your shares are held by your broker or bank as a nominee or agent, you should follow the instructions provided by your broker or bank.

HOW ARE VOTES COUNTED?

Votes will be counted by the inspector of election appointed for the meeting, who will separately count "For" and "Withhold" and, with respect to proposals other than the election of directors, "Against" votes, abstentions and broker non-votes. Abstentions and broker non-votes will be treated as shares present for the purpose of determining the presence of a quorum for the transaction of business at the Annual Meeting. Abstentions will be counted towards the vote total for each proposal, and will have the same effect as "Against" votes for each proposal. Broker non-votes have no effect and will not be counted towards the vote total for any proposal.

WHAT ARE "BROKER NON-VOTES"?

Broker non-votes occur when a beneficial owner of shares held in "street name" does not give instructions to the broker or nominee holding the shares as to how to vote on matters deemed "non-routine." Generally, if shares are held in street name, the beneficial owner of the shares is entitled to give voting instructions to the broker or nominee holding the shares. If the beneficial owner does not provide voting instructions, the broker or nominee can still vote the shares with respect to matters that are considered to be "routine," but not with respect to "non-routine" matters. Under the rules and interpretations of the New York Stock Exchange ("NYSE"), "non-routine" matters are matters that may substantially affect the rights or privileges of stockholders, such as mergers, stockholder proposals and, for the first time, under a new amendment to the NYSE rules, elections of directors, even if not contested.

HOW MANY VOTES ARE NEEDED TO APPROVE EACH PROPOSAL?

Nominees are elected by a majority vote for non-contested director elections. Because the number of nominees properly nominated for the Annual Meeting is the same as the number of directors to be elected, the election of directors at this Annual Meeting is non-contested. Each nominee presented in Proposal 1 must be elected by a majority of the votes cast. If the number of votes "For" a nominee exceeds the number of votes "Withheld" (among votes properly cast in person or by proxy), then the nominee will be elected. Broker non-votes will have no effect.

To be approved, Proposal 2, amendments to the 2000 Plan to (i) increase the number of shares authorized for issuance under the 2000 Plan by 1,250,000 shares of common stock and (ii) increase the maximum number of shares eligible to be granted pursuant to an option in any calendar year from 166,667 shares to 1,500,000 shares for purposes of Section 162(m) of the Internal Revenue Code, must receive "For" votes from the holders of a majority of shares present and entitled to vote either in person or by proxy. If you "Abstain" from voting, it will have the same effect as an "Against" vote. Broker non-votes will have no effect.

To be approved, Proposal 3, an amendment to the Directors' Plan to increase the number of shares authorized for issuance under the Directors' Plan by 350,000 shares of common stock, must receive "For" votes from the holders of a majority of shares present and entitled to vote either in person or by proxy. If you "Abstain" from voting, it will have the same effect as an "Against" vote. Broker non-votes will have no effect.

To be approved, Proposal 4, ratification of the selection of Ernst & Young LLP as the independent registered public accounting firm of Rigel for the fiscal year ending December 31, 2010, must receive "For" votes from the holders of a majority of shares present and entitled to vote either in person or by proxy. If you "Abstain" from voting, it will have the same effect as an "Against" vote. Broker non-votes will have no effect. Although stockholder ratification of the selection of Ernst & Young LLP as Rigel's independent registered public accounting firm is not required, the Board is submitting Proposal 4 to the stockholders for ratification as a matter of good corporate practice. See Proposal 4 for more information regarding stockholder ratification.

WHAT IS THE QUORUM REQUIREMENT?

A quorum of stockholders is necessary to hold a valid meeting. A quorum will be present if stockholders holding at least a majority of the outstanding shares are present at the meeting in person or represented by proxy. On the record date, there were 51,969,119 shares outstanding and entitled to vote. Thus, the holders of 25,984,560 shares must be present in person or represented by proxy at the meeting to have a quorum.

Your shares will be counted towards the quorum only if you submit a valid proxy (or one is submitted on your behalf by your broker, bank or other nominee) or if you vote in person at the meeting. Abstentions and broker non-votes will be counted towards the quorum requirement. If there is no quorum, the chairman or the holders of a majority of shares present at the meeting in person or represented by proxy may adjourn the meeting to another date.

HOW CAN I FIND OUT THE RESULTS OF THE VOTING AT THE ANNUAL MEETING?

Preliminary voting results will be announced at the Annual Meeting. In addition, final voting results will be published in a current report on Form 8-K that we expect to file within four business days after the Annual Meeting. If final voting results are not available to us in time to file a Form 8-K within four business days after the meeting, we intend to file a Form 8 K to publish preliminary results and, within four business days after the final results are known to us, file an additional Form 8-K to publish the final results.

WHEN ARE STOCKHOLDER PROPOSALS DUE FOR NEXT YEAR'S ANNUAL MEETING?

To be considered for inclusion in next year's proxy materials, your proposal must be submitted in writing and must comply with all requirements of Rule 14a-8 promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act") by December 13, 2010, to Rigel's Secretary at 1180 Veterans Boulevard, South San Francisco, California 94080. However, if Rigel's 2010 Annual Meeting of Stockholders is not held between April 27, 2011 and June 26, 2011, then the deadline will be a reasonable time prior to the time Rigel begins to print and mail its proxy materials. If you wish to submit a proposal or nominate a director, not to be included in next year's proxy materials, you must do so not later than the close of business on February 26, 2011 nor earlier than the close of business on January 27, 2011. However, if Rigel's 2010 Annual Meeting of Stockholders is not held between April 27, 2011 and June 26, 2011, to be timely, notice by the stockholder must be received not earlier than the close of business on the 120th day prior to the 2010 Annual Meeting of Stockholders and not later than the close of business on the later of the 90th day prior to the 2010 Annual Meeting of Stockholders or the 10th day following the day on which public announcement of the date of the 2010 Annual Meeting of Stockholders is first made. You are also advised to review our Bylaws, which contain additional requirements about advance notice of stockholder proposals and director nominations. The chair of the 2010 Annual Meeting of Stockholders may determine, if the facts warrant, that a matter has not been properly brought before the meeting and, therefore, may not be considered at the meeting. In addition, the proxy solicited by the Board for the 2010 Annual Meeting of Stockholders will confer discretionary voting authority with respect to (i) any proposal presented by a stockholder at that meeting for which Rigel has not been provided with timely notice and (ii) any proposal made in accordance with Rigel's Bylaws, if the 2010 proxy statement briefly describes the matter and how management's proxy holders intend to vote on it, if the stockholder does not comply with the requirements of Rule 14a-4(c)(2) promulgated under the Exchange Act.

PROPOSAL 1

ELECTION OF DIRECTORS

Rigel's Board of Directors is divided into three classes. Each class has a three-year term. Vacancies on the Board may be filled only by persons elected by a majority of the remaining directors. A director elected by the Board to fill a vacancy in a class, including vacancies created by an increase in the number of directors, shall serve for the remainder of the full term of that class and until the director's successor is elected and qualified.

The Board presently has nine members. There are three directors in the class whose term of office expires in 2010. Each of the nominees listed below is currently a director of the Company who was previously elected by the stockholders. If elected at the Annual Meeting, each of these nominees would serve until the 2013 Annual Meeting and until his successor is elected and has qualified, or sooner in the event of the director's death, resignation or removal. It is Rigel's policy to encourage directors and nominees for director to attend the Annual Meeting. A majority of our directors attended the 2009 Annual Meeting of Stockholders.

In a contested election, which is an election in which the number of nominees exceeds the number of directors to be elected, our directors will be elected by a plurality of the shares represented in person or by proxy and entitled to vote on the election of directors at that meeting. Our Bylaws now provide that, in a non-contested election involving incumbent directors, if the votes cast "For" an incumbent director nominee do not exceed the number of votes "Withheld", the incumbent director will promptly tender his resignation to the Board. Broker non-votes are counted towards a quorum, but are not counted for any purpose in determining whether an incumbent director has been elected. The Nominating and Corporate Governance Committee of the Board will review the circumstances surrounding the "Withheld" vote and promptly make a recommendation to the Board on whether to accept or reject the resignation or whether other action should be taken. In making its decision, the Board will evaluate the best interests of Rigel and our stockholders and will consider all factors and relevant information. The Board will act on the Nominating and Corporate Governance Committee's recommendation and publicly disclose its decision, as well as the rationale behind it, within 90 days from the date of certification of the stockholder vote. The director who tenders his resignation will not participate in the Board's or the Nominating and Corporate Governance Committee's decisions.

In the event that any nominee should become unavailable for election as a result of an unexpected occurrence, the proxies will be voted for the election of a substitute nominee or nominees proposed by the Nominating and Corporate Governance Committee of the board of directors. Each person nominated for election has agreed to serve if elected, and the Board has no reason to believe that any nominee will be unable to serve.

The following is a brief biography of each nominee and each director whose term will continue after the Annual Meeting and a discussion of the specific experience, qualifications, attributes or skills of each nominee that led the Nominating and Corporate Governance Committee to recommend that person as a nominee for director, as of the date of this proxy statement. The Nominating and Corporate Governance Committee seeks to assemble a board that, as a whole, possesses the appropriate balance of professional and industry knowledge, financial expertise and high-level management experience necessary to oversee and direct the Company's business. To that end, the Committee has identified and evaluated nominees in the broader context of the board's overall composition, with the goal of recruiting members who complement and strengthen the skills of other members and who also exhibit integrity, collegiality, sound business judgment and other qualities that the committee views as critical to effective functioning of the Board. The brief biographies below include information, as of the date of this proxy statement, regarding the specific and particular experience, qualifications, attributes or skills of each director or nominee that led the Committee to believe that the nominee should continue to serve on the Board or that the director continues to be a valuable member of the Board. However, each of the members of the Committee may have a variety of reasons why he or she believes a particular person would be an appropriate nominee for the Board, and these views may differ from the views of other members.

NOMINEES FOR ELECTION FOR A THREE-YEAR TERM EXPIRING AT THE 2013 ANNUAL MEETING

Jean Deleage, Ph.D., age 69, joined us as a director in January 1997. The Nominating and Corporate Governance Committee concluded that Dr. Deleage should continue to serve as a director of Rigel in part due to his extensive experience and record of success as an investor in life sciences companies, bringing a distinct focus on stockholder return to the Board. Dr. Deleage is a founder and managing director of Alta Partners, a venture capital firm investing in information technologies and life science companies. Alta Partners was founded in 1996. In 1979, Dr. Deleage founded and served as managing partner of Burr, Egan, Deleage & Co., a venture capital firm in San Francisco and Boston. In 1971, Dr. Deleage became a member of Sofinnova's initial team, a venture capital organization in Paris, France, and in 1976 he formed Sofinnova, Inc., the U.S. subsidiary of Sofinnova. Dr. Deleage currently serves on the Boards of Directors of Innate Pharma SA and LifeCycle Pharma A/S. Dr. Deleage also serves on the boards of several private companies, including 7TM A/S, Nereus Pharmaceuticals, Inc., PamGene International B.V., Plexxikon, Inc. and Adiocia SAS. He served on the Boards of Directors of TorreyPines Therapeutics, Inc. from 2000 until 2009, Genedata AG from 2001 until 2006, and IDM Pharma Inc. from 2005 until 2009. Dr. Deleage holds a Master's degree in Electrical Engineering from the Ecole Superieure d'Electricite and a Ph.D. in Economics from the Sorbonne. In 1984, he was awarded the Ordre National du Merite, and in 1993, he was awarded the Legion of Honor from the French government in recognition of his career accomplishments.

Peter S. Ringrose, Ph.D., age 64, joined us as a director in February 2005. The Nominating and Corporate Governance Committee concluded that Dr. Ringrose should continue to serve as a director of Rigel in part due to his extensive research experience at large pharmaceutical companies, enabling the Board to benefit from his insight when negotiating partnership deals with large pharmaceutical companies, a core element of our business model. Dr. Ringrose's experience in the pharmaceutical industry spans more than 30 years and includes key leadership positions as Senior Vice President for Worldwide Drug Discovery and Medicinal R & D Europe at Pfizer Inc., a pharmaceutical company, and Division Director of Chemotherapy, Infectious Diseases and Molecular Sciences at the Sandoz Research Institute in Vienna, Austria. In 2002, Dr. Ringrose retired from Bristol-Myers Squibb, a pharmaceutical company, where he served as Chief Scientific Officer from January 2000 to December 2002, as well as President of the Pharmaceutical Research Institute from January 1997 to December 2002. Dr. Ringrose has served as chair of the Biotechnology and Biological Sciences Research Council (UK) from 2003 until 2009, and was a member of the UK Government's Technology Strategy Board. He is a Council member of the Foundation for Science and Technology in the United Kingdom and also chairs the Corporate Partnership Board at Pembroke College, Cambridge where he is a lifetime Honorary Pitt Fellow. Dr. Ringrose is also a non-executive director of Astex Therapeutics and Biotica Technology Ltd. (Cambridge UK) and served on the Scientific Advisory Boards of Schering-Plough Research Institute, Cempra Pharmaceuticals, Inc. and Accenture Inc. Dr. Ringrose also served on the board of governors for the New York Academy of Sciences from 1999 to 2005. He has served on the boards of Cambridge Antibody Technology Ltd., ImClone Systems, Inc. and Pfizer, Ltd. and on the Scientific Advisory Board at Merlin Biosciences Ltd. Dr. Ringrose received a B.S., an M.A. and a Ph.D. from the University of Cambridge.

Bradford S. Goodwin, age 55, joined us as a director in January 2007. The Nominating and Corporate Governance Committee concluded that Mr. Goodwin should continue to serve as a director of Rigel in part due to his financial expertise and extensive public accounting and corporate governance experience, as well as his experience sitting on the audit committees of other public companies. Mr. Goodwin is currently President and CEO of Keren Pharmaceutical, Inc. and the non-executive

Chairman of Facet Biotech Corporation. In addition to serving on the Facet Biotech board, he currently serves on the Boards of Directors of NeurogesX, Inc. Mr. Goodwin's prior public company board service includes PDL BioPharma, Inc. from 2006 to 2008, CoTherix, Inc. from 2004 until 2007 and Novacea, Inc. from 2002 until 2006. From 2001 to 2006, he was Chief Executive Officer and Director of Novacea, Inc., a publicly-held biopharmaceutical company focused on in-licensing, developing and commercializing novel therapies for cancer. Prior to Novacea, Mr. Goodwin was President, Chief Operating Officer and Founder of Collabra Pharma, Inc., a company focused on pharmaceutical product licensing and development. Before starting Collabra, he held various senior executive positions with Genentech, Inc., including Vice President of Finance. After becoming a CPA while working as an auditor at PricewaterhouseCoopers, he served on expert advisory committees of the American Institute of Certified Public Accountants, the Financial Accounting Standards Board and the International Accounting Standards Board. Mr. Goodwin holds a B.S. in Business Administration from the University of California, Berkeley.

**THE BOARD OF DIRECTORS RECOMMENDS
A VOTE IN FAVOR OF EACH NAMED NOMINEE.**

DIRECTORS CONTINUING IN OFFICE UNTIL THE 2011 ANNUAL MEETING

Walter H. Moos, Ph.D., age 55, joined us as a director in March 1997. The Nominating and Corporate Governance Committee concluded that Dr. Moos continues to be a valuable member of the Board in part due to his extensive leadership skills and operational expertise, as well as his expertise in the chemical sciences, which is particularly relevant to our business as we are a company focused on small molecules. In March 2005, Dr. Moos joined SRI International, an independent nonprofit research institute, as head of the biosciences division. From 1997 to 2004, Dr. Moos served as the Chairman and Chief Executive Officer of MitoKor, Inc., a biotechnology company. From 1991 to 1997, he served as Corporate Vice President and Vice President, Research and Development in the Technologies Division of Chiron Corporation, a biotechnology company. From 1982 to 1991, Dr. Moos held several positions at the Parke-Davis Pharmaceutical Research Division of the Warner-Lambert Company, last holding the position of Vice President, Neuroscience and Biological Chemistry. He has been an Adjunct Professor at the University of California, San Francisco, since 1992. Dr. Moos served on the Board of Directors of MIGENIX Inc. from 2004 to 2008. He has also served on the boards of numerous private companies and several non-profit organizations. Dr. Moos has been an advisor to the National Academy of Sciences and venture capital firms. He also has served as an adjunct faculty member at the University of Michigan and at James Madison University. Dr. Moos holds an A.B. from Harvard University and a Ph.D. in Chemistry from the University of California, Berkeley.

Hollings C. Renton, age 63, joined us as a director in January 2004. The Nominating and Corporate Governance Committee concluded that Mr. Renton continues to be a valuable member of the Board in part due to his extensive experience developing product candidates from discovery, through development, regulatory approval and commercialization, which is directly relevant to our business. From June 2000 to March 2008, Mr. Renton has served as Chairman of the Board of Onyx Pharmaceuticals, Inc., where he also served as President and Chief Executive Officer from March 1993 and a director from April 1992. Prior to joining Onyx, Mr. Renton was the President and Chief Operating Officer of Chiron Corporation. He assumed that position in 1991 on Chiron's acquisition of Cetus Corporation, where he had been President since 1990 and Chief Operating Officer since 1987. He joined Cetus in 1981 and was Chief Financial Officer from 1983 to 1987. He holds an M.B.A. from the University of Michigan and a B.S. in Mathematics from Colorado State University. Mr. Renton serves as Chairman of the Boards of Directors of Affymax, Inc., Co-Chairman of the Board of Directors and lead director of Portola Pharmaceuticals, Inc. and a member of the Board of Directors of Cepheid and the Special Olympics of Northern California.

Stephen A. Sherwin, M.D., age 61, joined us as a director in March 2000. As one of only two medical doctors on the Board, the Nominating and Corporate Governance Committee concluded that Dr. Sherwin continues to be a valuable member of the Board in part due to his extensive clinical research experience, which is directly relevant to our business. Dr. Sherwin is Chairman of Ceregene, Inc., a company which he co-founded in 2001 which develops gene therapies for neurodegenerative diseases. Dr. Sherwin also serves on the Boards of Directors of BioSante Pharmaceuticals, Neurocrine Biosciences, Inc. and Biogen Idec. In addition, Dr. Sherwin has served on the board of the Biotechnology Industry Organization since 2002 and was elected Chairman in 2009. Until Cell Genesys, Inc. merged with BioSante Pharmaceuticals in 2009, Dr. Sherwin served as Chief Executive Officer of Cell Genesys from the beginning of the company's operations in 1990, and also served as Chairman of the Board since 1994. He was also co-founder and Chairman of the Board of Abgenix, Inc, an antibody company which was acquired by Amgen, Inc. in 2006. From 1983 to 1990, Dr. Sherwin held various positions at Genentech, Inc., a biopharmaceutical company, most recently as Vice President of Clinical Research. Prior to 1983, he was on the staff of the National Cancer Institute. Dr. Sherwin holds a B.A. *summa cum laude* in Biology from Yale University and an M.D. from Harvard Medical School. He is board-certified in internal medicine and medical oncology and was formerly an Associate Clinical Professor of Medicine at the University of California, San Francisco, and Attending Physician in the Oncology/AIDS Division at San Francisco General Hospital. He is a fellow of the American College of Physicians and a member of the American Society of Clinical Oncology.

DIRECTORS CONTINUING IN OFFICE UNTIL THE 2012 ANNUAL MEETING

James M. Gower, age 61, joined us as our President, Chief Executive Officer and as a member of our Board in January 1997, and has been our Chairman of the Board and Chief Executive Officer since October 2001. The Nominating and Corporate Governance Committee concluded that Mr. Gower continues to be a valuable member of the Board in part due to his role as our President and Chief Executive Officer and his knowledge of the day-to-day operations of Rigel obtained as a result of that role. From 1992 to March 1996, Mr. Gower was President and Chief Executive Officer of Tularik Inc., a biotechnology company developing small-molecule drugs regulating gene expression. Prior to Tularik, Mr. Gower spent ten years at Genentech, Inc., a biopharmaceutical company, where he most recently served as Senior Vice President. During his ten years at Genentech, Mr. Gower was responsible for business development and sales and marketing functions. In addition, he established and managed Genentech's foreign operations in Canada and Japan and served as President of Genentech Development Corporation. Mr. Gower served on the Board of Directors of Cell Genesys, Inc. from 1996 until 2009. He holds a B.S. and an M.B.A. in Operations Research from the University of Tennessee.

Gary A. Lyons, age 58, joined us as a director in October 2005. The Nominating and Corporate Governance Committee concluded that Mr. Lyons continues to be a valuable member of the Board in part due to his extensive experience negotiating and developing collaborative relationships, his sales expertise and his track record of assessing the market for pharmaceutical candidates, all of which are key to the success our business. Mr. Lyons is also a member of the Board of Directors of Neurocrine Biosciences, Inc., a biopharmaceutical company. Mr. Lyons served as Neurocrine's Chief Executive Officer and member of the board from 1993 until 2008. Mr. Lyons also serves on the Boards of Directors of Vical, Inc., Poniard Pharmaceuticals, Inc., and Facet Biotech Corporation, and served on the board of PDL BioPharma, Inc. from July 2008 until he resigned in December 2008 to join the board of Facet following Facet's spin-off from PDL. From 1983 to 1993, he held a number of management positions at Genentech, Inc., including Vice President of Business Development and Vice President of Sales, and also served as a member of Genentech's Executive Committee. Mr. Lyons was responsible for international licensing, acquisitions and partnering for Genentech's Corporate Venture Program and had operating responsibility for two subsidiaries, Genentech Canada, Inc. and Genentech

Limited (Japan). He holds a B.S. in Marine Biology from the University of New Hampshire and an M.B.A. from Northwestern University's J.L. Kellogg Graduate School of Management.

Donald G. Payan, M.D., age 61, one of our co-founders, has been a member of our Board since July 1996 and has served as our Executive Vice President and Chief Scientific Officer since January 1997. In February 2008, Dr. Payan became our Executive Vice President, President of Discovery and Research. From January 1997 to July 1998, he also served as our Chief Operating Officer. From July 1996 to January 1997, Dr. Payan served as our President and Chief Executive Officer. The Nominating and Corporate Governance Committee concluded that Dr. Payan continues to be a valuable member of the Board in part due to the fact that he is one of our co-founders, which brings historic knowledge and continuity to the Board, as well as his extensive research experience and shown ability to grow new research programs. From December 1995 to May 1996, Dr. Payan was Vice President of AxyS Pharmaceuticals, Inc., a biopharmaceutical company. From September 1992 to December 1995, Dr. Payan was Executive Vice President and Chief Scientific Officer of Khepri Pharmaceuticals, Inc., which he founded and subsequently merged with AxyS Pharmaceuticals. Dr. Payan holds a B.S. and an M.D. from Stanford University and did his residency training in Medicine at the Massachusetts General Hospital. Dr. Payan is a former Professor at the University of California, San Francisco and member of The Howard Hughes Medical Institute.

INFORMATION REGARDING THE BOARD OF DIRECTORS AND CORPORATE GOVERNANCE

Independence of the Board of Directors

The Nasdaq Stock Market ("Nasdaq") listing standards require that a majority of the members of a listed company's Board of Directors qualify as "independent," as affirmatively determined by the Board. The Board consults with our counsel from time to time to ensure that the Board's determinations are consistent with relevant securities and other laws and regulations regarding the definition of "independent," including those set forth in pertinent listing standards of Nasdaq.

Consistent with these considerations, after review of all relevant identified transactions and relationships between each director, or any of his family members, and Rigel, our senior management and our independent registered public accounting firm, the Board has affirmatively determined that all of our current directors are independent directors within the meaning of the applicable Nasdaq listing standards, except for James M. Gower, our Chairman of the Board and Chief Executive Officer, and Donald G. Payan, our Executive Vice President, President of Discovery and Research, who are not independent directors by virtue of their employment with the Company. In making this determination, the Board found that none of the directors or nominees for director determined to be independent by the Board had a material or other disqualifying relationship with Rigel.

Meetings of the Board of Directors

The Board met five times during fiscal year 2009. All of our directors attended at least 75% of the aggregate number of meetings of the Board and the committees on which they served that were held during the period for which they were directors or committee members, respectively. As required under applicable Nasdaq listing standards, in fiscal year 2009, Rigel's independent directors meet in executive session at which only independent directors were present at every regularly scheduled meeting of the Board.

Board Leadership Structures

Our Board of Directors is currently chaired by the President and Chief Executive Officer of the Company, Mr. Gower. Dr. Sherwin leads the communications between the independent directors at the executive sessions of the Board. We believe that combining the positions of Chief Executive Officer and Board Chair helps to ensure that the Board and management act with a common purpose and provides a single, clear chain of command to execute our strategic initiatives and business plans, particularly given our small size. In addition, we believe that a combined Chief Executive Officer/Board Chair is better positioned to act as a bridge between management and the Board, facilitating the regular flow of information. We also believe that it is advantageous to have a Board Chair with an extensive history with and knowledge of the Company (as is the case with our Chief Executive Officer) as compared to an independent Board Chair with less direct involvement in the Company's business, and thus less direct access to information.

Role Of The Board In Risk Oversight

One of the board's key functions is informed oversight of the Company's risk management process. The Board does not have a standing risk management committee, but rather administers this oversight function directly through the Board as a whole, as well as through various Board standing committees that address risks inherent in their respective areas of oversight. In particular, our Board is responsible for monitoring and assessing strategic risk exposure, our Audit Committee has the responsibility to consider and discuss our major financial risk exposures and the steps our management has taken to monitor and control these exposures. Our Nominating and Corporate Governance Committee monitors the effectiveness of our corporate governance guidelines, including whether they are successful in preventing illegal or improper liability-creating conduct. Our Compensation Committee assesses and monitors whether any of our compensation policies and programs has the potential to encourage excessive risk-taking. Both the Board as a whole and the various standing committees receive periodic reports from our General Counsel, who is also our compliance officer, as well as incidental reports as matters may arise. It is the responsibility of the committee chairs to report findings regarding material risk exposures to the Board as quickly as possible. The Board has delegated to the General Counsel the responsibility of coordinating between the Board and management with regard to the determination and implementation of responses to any problematic risk management issues.

INFORMATION REGARDING COMMITTEES OF THE BOARD OF DIRECTORS

The Board has four standing committees: an Audit Committee, a Compensation Committee, a Finance Committee and a Nominating and Corporate Governance Committee. The following table provides membership and meeting information for fiscal year 2009 for each of the Board committees:

Name	Audit	Compensation	Finance	Nominating and Corporate Governance
James M. Gower			X*	
Donald G. Payan, M.D.				
Jean Deleage, Ph.D.		X	X	
Bradford S. Goodwin	X*			
Gary A. Lyons		X		
Walter H. Moos, Ph.D.		X*		X
Hollings C. Renton	X			
Peter S. Ringrose, Ph.D.				X
Stephen A. Sherwin, M.D.	X		X	X*
Total meetings in fiscal year 2009	7	5	1	1

*

Committee Chairperson.

Below is a description of each standing committee of the Board. Each of the committees has authority to engage legal counsel or other experts or consultants, as it deems appropriate, to carry out its responsibilities. The Board has determined that each member of each committee meets the applicable Nasdaq rules and regulations regarding "independence" and that each member is free of any relationship that would impair his or her individual exercise of independent judgment with regard to the Company.

Audit Committee

The Audit Committee of the Board of Directors was established by the Board in accordance with Section 3(a)(58)(A) of the Exchange Act to oversee Rigel's corporate accounting and financial reporting processes and audits of our financial statements. The Audit Committee: evaluates the performance of and assesses the qualifications of the independent registered public accounting firm; determines and approves the engagement of the independent registered public accounting firm; determines whether to retain or terminate the existing independent registered public accounting firm or to appoint and engage a new independent public registered accounting firm; reviews and approves the retention of the independent registered public accounting firm to perform any proposed audit, review and attest services and any permissible non-audit services; monitors the rotation of partners of the independent registered public accounting firm on Rigel's audit engagement team as required by law; reviews and assesses the objectivity and independence of our independent registered public accounting firm; reviews the financial statements to be included in Rigel's Annual Report on Form 10-K; discusses with management and the independent registered public accounting firm the results of the annual audit and the results of Rigel's quarterly financial statements; reviews with management the disclosure under "Management's Discussion and Analysis of Financial Condition and Results of Operation" in the Company's periodic reports filed with the SEC; confers with management and the independent registered public accounting firm regarding the effectiveness of internal controls over financial reporting; establishes procedures, as required under applicable law, for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters and the confidential and anonymous submission by employees of concerns regarding questionable accounting or auditing matters; reviews the results of management's efforts to monitor compliance with Rigel's programs and policies designed to ensure adherence to applicable laws and rules and Rigel's Code of Conduct, including reviewing and approving related-party transactions. In addition, our Audit Committee has the responsibility to consider and discuss our major financial risk exposures and the steps our management has taken to monitor and control these exposures.

The following three directors are the members of the Audit Committee: Messrs. Goodwin and Renton and Dr. Sherwin, all of whom were on the Audit Committee for all of fiscal year 2009. The Audit Committee met seven times during fiscal year 2009. The Audit Committee has adopted a written charter that is available to stockholders on our website at *http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9Mjg1NjJ8Q2hpbGRJRD0tMXxUeXBlPTM=&t=1.*

The Board reviews the Nasdaq listing standards definition of "independence" for Audit Committee members on an annual basis and has determined that all members of Rigel's Audit Committee are independent (as independence is currently defined in Rules 5605(c)(2)(A)(i) and (ii) of the Nasdaq listing standards). The Board has also determined that Messrs. Renton and Goodwin each qualify as an "audit committee financial expert," as defined in applicable rules and regulations promulgated by the Securities and Exchange Commission, or the SEC, and satisfies the financial sophistication requirements of the Nasdaq listing standards. For each of Messrs. Renton and Goodwin, the Board made a qualitative assessment of each of their level of knowledge and experience, based on a number of factors, including their respective formal education and experience as a person actively supervising a principal financial officer of a public company, as well as Mr. Renton's experience as a principal financial officer for a public company and Mr. Goodwin's experience as a principal accounting officer for a public company.

REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS(1)

(1) The material in this Report of the Audit Committee of the Board of Directors is not "soliciting material," is not deemed "filed" with the SEC, and is not to be incorporated by reference into any filing of the Company under the Securities Act or the Exchange Act.

The Company's management has primary responsibility for preparing the Company's financial statements and establishing the financial reporting process. Rigel's independent registered public accounting firm is responsible for performing an audit of the Company's financial statements and expressing an opinion as to the conformity of such financial statements with United States generally accepted accounting principles.

The Audit Committee has reviewed and discussed with Rigel's management the audited financial statements for the fiscal year ended December 31, 2009. The Audit Committee has discussed with the independent registered public accounting firm the matters required to be discussed by the Statement on Auditing Standards, or SAS, No. 61, as amended (AICPA, *Professional Standards*, Vol. 1. AU section 380) and SAS No. 114, *The Auditor's Communications with Those Charged with Governance* , as adopted by the Public Company Accounting Oversight Board, or PCAOB, in Rule 3200T. The Audit Committee has also received the written disclosures and the letter from the independent registered public accountants, as required by the applicable requirements of the PCAOB regarding independent accountants' communications with the Audit Committee concerning independence, and has discussed with the independent registered public accountants their independence. Based on the foregoing, the Audit Committee has recommended to the Board that the audited financial statements be included in Rigel's Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

Audit Committee
Bradford S. Goodwin
Hollings C. Renton
Stephen A. Sherwin, M.D.

Compensation Committee

The Compensation Committee of the Board of Directors acts on behalf of the Board to review, adopt and oversee Rigel's compensation strategy, policies, plans and programs. The Compensation Committee: reviews and approves corporate performance goals and objectives relevant to the compensation of Rigel's executive officers and other senior management; reviews and approves the compensation and other terms of employment of Rigel's Chief Executive Officer; reviews and approves the compensation and other terms of employment of the other members of senior management; reviews and approves the compensation for Board members; administers Rigel's stock option and purchase plans, pension and profit sharing plans, stock bonus plans, deferred compensation plans and other similar programs; and reviews with management Rigel's Compensation Discussion and Analysis, or CD&A, and considers whether to recommend that it be included in Rigel's proxy statements and other filings. In addition, our Compensation Committee assesses and monitors whether any of our compensation policies and programs has the potential to encourage excessive risk-taking.

The following three directors are the members of the Compensation Committee: Drs. Moos and Deleage and Mr. Lyons, all of whom were on the Compensation Committee for all of fiscal year 2009. All members of Rigel's Compensation Committee are independent (as "independence" is currently defined in Rule 5605(a)(2) of the Nasdaq listing standards). The Compensation Committee met five times during fiscal year 2009. The Compensation Committee has adopted a written charter that is available to stockholders on our website at *http://media.corporate-ir.net/media_files/IROL/12/120936/Compensation_Committee_Charter.pdf*.

Typically, the Compensation Committee meets at least quarterly and with greater frequency if necessary. The agenda for each meeting is usually developed by the Chair of the Compensation Committee, in consultation with a representative from management. Our General Counsel serves as the representative of management. In addition, from time to time, various members of management and other employees, as well as outside advisors or consultants, may be invited by the Compensation Committee to make presentations, provide financial or other background information or advice, or otherwise participate in Compensation Committee meetings. The Chief Executive Officer may not participate in, or be present during, any deliberations or determinations regarding his compensation or individual performance objectives. However, the Chief Executive Officer is consulted regarding any promotion or compensation decision affecting a member of management. The charter of the Compensation Committee grants the Compensation Committee full access to all books, records, facilities and personnel of Rigel, as well as authority to obtain, at the expense of the Company, advice and assistance from internal and external legal, accounting or other advisors and consultants and other external resources that the Compensation Committee considers necessary or appropriate in the performance of its duties. In particular, the Compensation Committee has the authority to retain compensation consultants to assist in its evaluation of executive and director compensation, including the authority to approve the consultants' reasonable fees and other retention terms.

During 2008, in order to determine executive compensation for 2009, the Compensation Committee engaged Towers Perrin (which changed its name to Towers Watson & Co. following the completion of its merger with Watson Wyatt in 2010) and, in late 2008, Towers Watson prepared a draft report analyzing our executive officers' compensation packages against the 2007 compensation packages of executive officers at comparable companies. The list of comparable companies included in our peer group was developed by Towers Watson in consultation with the Compensation Committee. After the Compensation Committee received the draft report, but before Towers Watson finalized it, economic conditions changed significantly and our industry, including our identified peers, experienced higher than usual market volatility. In connection with a company-wide effort to reduce costs, the Compensation Committee had the draft report updated by management rather than Towers Watson to reflect the 2008 executive compensation practices of the 2008 peer group based on publicly available information. Given the distressed economic environment, the updated analysis was never finalized or used in connection with determining executive compensation for 2009. However, the Compensation Committee referenced the updated report with respect to setting executive compensation for 2010 and revising director compensation. The draft 2008 report is discussed further under "Competitive Market Review and Benchmarking" below. The 2008 Towers Watson engagement was the most recent engagement of a compensation consulting firm by the Compensation Committee. As compensation for their services in 2008, we paid Towers Watson $9,251.

Historically, the Compensation Committee has reviewed and recommended to the Board most of the significant adjustments to annual compensation, bonus and equity awards recommendations, and established or recommended new performance objectives at one or more meetings generally held during the first quarter of the year. The Compensation Committee also considers, at various meetings throughout the year, matters related to individual compensation, such as compensation for new executive hires, as well as high-level strategic issues, such as the efficacy of Rigel's compensation strategy, potential modifications to that strategy and new trends, plans or approaches to compensation. Unanticipated circumstances can result in a promotion or a change to an individual's compensation package. Generally, the Compensation Committee's process comprises two related elements: the determination of compensation level and the establishment or recommendation of performance objectives for the current year. In the case of the Chief Executive Officer, the evaluation of his performance is conducted by the Compensation Committee and, based upon that evaluation, the Compensation Committee either approves any adjustments to his compensation or makes a recommendation to our Board regarding any such adjustments to his compensation, as well as awards to be granted. For all executive officers and directors, as part of its deliberations, the Compensation

Committee may review and consider, as appropriate, materials such as financial reports and projections, operational data, tally sheets that set forth the total compensation that may become payable to executive officers in various hypothetical scenarios, executive and director stock ownership information, company stock performance data, analyses of historical executive compensation levels and current Company-wide compensation levels, and recommendations of the Compensation Committee's compensation consultant, including analyses of executive and director compensation paid at other companies identified by the consultant or public information. However, to date, Towers Watson has not participated in the determination of director compensation, although, as discussed above, the Compensation Committee referenced the updated draft report of Towers Watson in revising director compensation for 2010.

The specific recommendations of the Compensation Committee with respect to executive compensation for fiscal years 2009 and 2010 are described in greater detail in the Compensation Discussion and Analysis section of this proxy statement.

Risk Assessment of Compensation Policies and Practices

Management has assessed the compensation policies and practices for our employees and concluded that they do not create risks that are reasonably likely to have a material adverse effect on the company. Management's analysis was presented to both the Board and the Compensation Committee.

Compensation Committee Interlocks and Insider Participation

No member of the Compensation Committee is currently, or ever has been, an officer or employee of Rigel. No executive officer of Rigel has served as a member of the Board of Directors or Compensation Committee of any entity that has one or more executive officers serving as a member of our Compensation Committee.

Rigel has entered into indemnity agreements with all of our board members, including the members of our Compensation Committee, which provide, among other things, that the Company will indemnify each of them, under the circumstances and to the extent provided for therein, for expenses, damages, judgments, fines and settlements he or she may be required to pay in actions or proceedings which he is or may be made a party by reason of his position as a director of Rigel, and otherwise to the fullest extent permitted under Delaware law and Rigel's Bylaws.

REPORT OF THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS(2)

(2) The material in this Report of the Compensation Committee of the Board is not "soliciting material," is not deemed "filed" with the SEC, and is not to be incorporated by reference into any filing of the Company under the Securities Act or the Exchange Act.

The Compensation Committee has reviewed and discussed with management the Compensation Discussion and Analysis section of this proxy statement. Based on this review and discussion, the Compensation Committee has recommended to the Board that the Compensation Discussion and Analysis be included in this proxy statement and incorporated into our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

Compensation Committee
Jean Deleage, Ph.D.
Gary A. Lyons
Walter H. Moos, Ph.D.

Finance Committee

The Finance Committee of the Board was formed in September 2004. The Finance Committee reviews and approves the overall strategy, plans, policies and actions related to adjustments to Rigel's capital structure, certain financing arrangements and strategic collaborations for the Company. The following three directors are the members of the Finance Committee: Mr. Gower and Drs. Deleage and Sherwin, each of whom were on the Finance Committee for all of fiscal year 2009. Drs. Deleage and Sherwin are each considered independent, as "independence" is currently defined in Rule 5605(a)(2) of the Nasdaq listing standards. The Finance Committee met one time during fiscal year 2009.

Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee of the Board is responsible for identifying, reviewing and evaluating candidates to serve as directors of the Company (consistent with criteria approved by the Board), reviewing and evaluating incumbent directors, recommending candidates for election to the Board, making recommendations to the Board regarding the membership of the committees of the Board, assessing the performance of management and the Board, and developing a set of corporate governance guidelines for Rigel. In addition, our Nominating and Corporate Governance Committee monitors the effectiveness of our corporate governance guidelines, including whether they are successful in preventing illegal or improper liability-creating conduct.

The following three directors are the members of the Nominating and Corporate Governance Committee: Drs. Moos, Sherwin and Ringrose, all of whom were on the Nominating and Corporate Governance Committee for all of fiscal year 2009. All members of the Nominating and Corporate Governance Committee are independent, as "independence" is currently defined in Rule 5605(a)(2) of the Nasdaq listing standards. The Nominating and Corporate Governance Committee met one time during fiscal year 2009. The Nominating and Corporate Governance Committee has adopted a written charter that is available to stockholders on our website at *http://media.corporate-ir.net/media_files/IROL/12/120936/corpgov/NominatingCommitteeCharter.pdf*.

The Nominating and Corporate Governance Committee believes that candidates for director should have certain minimum qualifications. The Nominating and Corporate Governance Committee will generally consider such factors as possessing relevant expertise upon which to be able to offer advice and guidance to management, the ability to read and understand basic financial statements, having sufficient time to devote to the affairs of Rigel, reputation for personal integrity and ethics, demonstrated excellence in his or her field, having the ability to exercise sound business judgment and having the commitment to rigorously represent the long-term interests of Rigel's stockholders. However, the Nominating and Corporate Governance Committee retains the right to modify these qualifications from time to time. The Nominating and Corporate Governance Committee also values diversity as a factor in selecting nominees to serve on the Board. Although there is no specific policy on diversity, the Nominating and Corporate Governance Committee considers the criteria noted above in selecting nominees for directors, including members from diverse backgrounds who combine a broad spectrum of experience and expertise. Candidates for director nominees are reviewed in the context of the current composition of the Board, the operating requirements of Rigel and the long-term interests of stockholders. In conducting this assessment, the Nominating and Corporate Governance Committee considers all factors as it deems appropriate, given the current needs of the Board and Rigel, to maintain a balance of knowlefont style="font-family:inherit;font-size:10pt;">(2,887

)

(1,930
)

(11,633
)
Income tax (benefit) expense
(1,170
)

(489
)

(1,136
)

130

Income (loss) from continuing operations
281

(2,398
)

(794
)

(11,763
)
Discontinued operation:

Loss from discontinued operation before income taxes
(19
)

(1,728
)

(509
)

(10,778
)
Income tax expense of discontinued operation
354

180

451

261

Loss from discontinued operation
(373
)

(1,908
)

(960
)

(11,039
)
Net loss
$
(92
)

$
(4,306
)

$
(1,754
)

$
(22,802
)
Income (loss) per share from continuing operations:
Basic and diluted
$
0.01

$
(0.08
)

$
(0.03
)

$
(0.38
)
Loss per share from discontinued operation:
Basic and diluted
$
(0.01
)

$
(0.06
)

$
(0.03
)

$
(0.36
)
Net loss per share:
Basic and diluted
$
(0.00
)

$
(0.14
)

$
(0.06
)

$
(0.74
)
Weighted average shares outstanding:
Basic and diluted
30,747

30,744

30,746

30,744

See accompanying notes to condensed consolidated financial statements.

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NAUTILUS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited and in thousands)

	Nine months ended September 30,	
	2011	2010
Cash flows from operating activities:		
Loss from continuing operations	$(794)	$(11,763)
Loss from discontinued operation	(960)	(11,039)
Net loss	(1,754)	(22,802)
Adjustments to reconcile net loss to cash flows from operating activities:		
Depreciation and amortization	3,036	5,171
Allowance for doubtful accounts	(84)	1,278
Inventory lower-of-cost-or-market adjustments	85	2,177
Stock-based compensation expense	151	490
Loss on asset disposals	57	144
Reduction of previously estimated asset disposal loss	(933)	(3,156)
Deferred income taxes, net of valuation allowances	452	372
Changes in operating assets and liabilities:		
Trade receivables	7,969	13,528
Inventories	(3,057)	3,694
Prepaids and other current assets	1,325	1,059
Income taxes	(1,034)	12,490
Trade payables	(6,731)	(18,499)
Accrued liabilities, including warranty obligations	(1,033)	(5,301)
Net cash used in operating activities	(1,551)	(9,355)
Cash flows from investing activities:		
Proceeds from sale of discontinued operation	1,042	6,930
Proceeds from other asset sales	—	16
Purchases of software and equipment	(2,098)	(189)
Net decrease in restricted cash	351	4,439
Net cash (used in) provided by investing activities	(705)	11,196
Cash flows from financing activities:		
Proceeds from long-term borrowings	—	5,000
Financing costs	(36)	(353)
Proceeds from exercise of stock options	4	—
Net cash (used in) provided by financing activities	(32)	4,647
Net effect of currency exchange rate changes	(490)	708
Net (decrease) increase in cash and cash equivalents	(2,778)	7,196
Cash and cash equivalents, beginning of year	14,296	7,289
Cash and cash equivalents, end of period	$11,518	$14,485
Supplemental disclosure of cash flow information:		
Cash refunded for income taxes, net of payments	$164	$12,607

See accompanying notes to condensed consolidated financial statements.

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NAUTILUS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(1) GENERAL INFORMATION

Basis of Consolidation and Presentation

The accompanying condensed consolidated financial statements present the financial position, results of operations and cash flows of Nautilus, Inc. and its subsidiaries (collectively, “Nautilus” or the “Company”), all of which are wholly owned. Intercompany transactions and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements have not been audited. Nautilus has condensed or omitted certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). Management believes the disclosures contained herein are adequate to make the information presented not misleading. However, these condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto included in its Annual Report on Form 10-K for the year ended December 31, 2010 (the “ 2010 Form 10-K”).

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Further information regarding significant estimates can be found in the Company's 2010 Form 10-K.

In the opinion of management, the accompanying condensed consolidated financial statements reflect all adjustments necessary to present fairly the Company's financial position as of September 30, 2011 and December 31, 2010, and results of operations and cash flows for the three and nine months ended September 30, 2011 and 2010. Interim results are not necessarily indicative of results for a full year. The Company's revenues typically vary seasonally and this seasonality can have a significant effect on operating results, inventory levels and working capital needs.

Unless indicated otherwise, all information regarding the Company's operating results pertains to its continuing operations.

New Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2011-05, Presentation of Comprehensive Income ("ASU 2011-05"), which revises the manner in which entities present comprehensive income in their financial statements. For public entities, ASU 2011-05 amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Since the requirements of ASU 2011-05 relate only to presentation, its adoption will not have any effect on the Company's financial position, results of operations or cash flows.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, Testing Goodwill for Impairment ("ASU 2011-08"), which gives companies the option of performing a qualitative assessment that may allow them to avoid performing the first step of the two-step goodwill impairment test required under Accounting Standards Topic 350, Intangibles—Goodwill and Other. The guidance is effective for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company is currently assessing the impact of ASU 2011-08 on its financial statements.

(2) DISCONTINUED OPERATION

On September 25, 2009, in light of continuing operating losses in its Commercial business and in order to focus exclusively on managing its Direct and Retail consumer businesses, the Company committed to a plan for the complete divestiture of its Commercial business, which qualified for held-for-sale accounting treatment. The Commercial business is presented as a discontinued operation in the Company's condensed consolidated statements of operations for all periods. Following is a summary of the operating results of the Company's former Commercial business for the three and nine months ended September 30, 2011 and 2010 (in thousands):

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	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Revenue	$—	$427	$84	$11,654
Loss before income taxes	$(313)	$(2,546)	$(1,430)	$(13,934)
Reduction of previously-estimated disposal loss	294	818	921	3,156
Income tax expense	(354)	(180)	(451)	(261)
Loss from discontinued operation	$(373)	$(1,908)	$(960)	$(11,039)

Disposal of Commercial business assets was completed in April 2011. Revenue for the nine months ended September 30, 2011 consisted of sales of small quantities of discontinued product and spare parts inventories that were not acquired by buyers of components of the Commercial business. The Company may incur additional expenses in future periods in connection with the settlement of contingencies arising from and directly related to the Commercial business prior to its disposal. For further information regarding contingencies related to the Company's former Commercial business, see Note 11, Commitments and Contingencies.

The following table presents adjustments of previously completed disposal transactions for the three months ended September 30, 2011 (in thousands):

	Previously Estimated Disposal Loss as of 6/30/11	Gain (Loss) on Completed Disposals	Reduction of Previously Estimated Disposal Loss	Disposal Loss Impairment as of 9/30/11
Adjustments of previously completed disposal transactions	$—	$—	$294	$—
	$—	$—	$294	$—

The following table presents gain or loss recognized on completed disposal transactions for the nine months ended September 30, 2011 (in thousands):

	Previously Estimated Disposal Loss as of 12/31/10	Gain (Loss) on Completed Disposals	Reduction of Previously Estimated Disposal Loss	Disposal Loss Impairment as of 9/30/11
Sales of real property	$(666)	$(658)	$8	$—
Adjustments of previously completed disposal transactions	—	913	913	—
	$(666)	$255	$921	$—

The following table presents gain or loss recognized on completed disposal transactions for the three months ended September 30, 2010 (in thousands):

	Previously Estimated Disposal Loss as of 6/30/10	Gain (Loss) on Completed Disposals	Reduction of Previously Estimated Disposal Loss	Disposal Loss Impairment as of 9/30/10
Sale of real property	$(1,284)	$(706)	$578	
Other completed disposals	(184)	(472)	(288)	—
Adjustments of previously completed disposal transactions	—	499	499	—
Remaining assets held-for-sale as of September 30, 2010	(1,485)	—	29	(1,456)

	$(2,953)	$(679)	$818	$(1,456)

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The following table presents gain or loss recognized on completed disposal transactions for the nine months ended September 30, 2010 (in thousands):

	Previously Estimated Disposal Loss as of 12/31/09	Gain (Loss) on Completed Disposals	Reduction of Previously Estimated Disposal Loss	Disposal Loss Impairment as of 9/30/10
Sale of Commercial equipment manufacturing operation	$(6,212)	$(4,816)	$1,396	$—
Sale of real property	(1,268)	(706)	562	
Other completed disposals	(564)	(496)	68	—
Adjustments of previously completed disposal transactions	—	364	364	—
Remaining assets held-for-sale as of September 30, 2010	(2,222)	—	766	(1,456)
	$(10,266)	$(5,654)	$3,156	$(1,456)

The following table summarizes liabilities for exit costs related to the Commercial business discontinued operation, included in "Accrued liabilities" and "Other long-term liabilities" in the Company's condensed consolidated balance sheets (in thousands):

	Severance and Benefits	Facilities Leases	Total Liabilities
Balance as of December 31, 2010	$476	$2,160	$2,636
Accruals	112	265	377
Payments	(476)	(387)	(863)
Balance as of September 30, 2011	$112	$2,038	$2,150

(3) INVENTORIES

Inventories, net of valuation allowances, as of September 30, 2011 and December 31, 2010 consisted of the following (in thousands):

	As of September 30, 2011	December 31, 2010
Finished goods	$12,052	$8,533
Parts and components	1,440	1,814
	$13,492	$10,347

Valuation allowances were $1.0 million and $1.1 million as of September 30, 2011 and December 31, 2010, respectively, and related primarily to excess parts inventories.

(4) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment as of September 30, 2011 and December 31, 2010 consisted of the following (in thousands):

	Estimated Useful Life (in years)	As of September 30, 2011	December 31, 2010
Leasehold improvements	5 to 20	$2,568	$2,588
Computer equipment and software	2 to 5	38,046	38,033
Machinery and equipment	3 to 5	6,687	6,703

Furniture and fixtures	5	695	955
Work in progress [1]	n/a	2,043	101
		50,039	48,380
Accumulated depreciation		(45,749)	(44,585)
		$4,290	$3,795

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[1] Work in progress includes internal use software development and production tooling construction in progress.

(5) GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and other intangible assets as of September 30, 2011 and December 31, 2010 consisted of the following (in thousands):

	Estimated Useful Life (in years)	As of September 30, 2011	December 31, 2010
Goodwill	n/a	$2,837	$2,931
Other intangible assets:			
Indefinite-lived trademarks	n/a	$9,052	$9,052
Patents	1 to 16	18,154	18,154
		27,206	27,206
Accumulated amortization - patents		(9,977)	(8,432)
		$17,229	$18,774

Nautilus reviews goodwill and indefinite-lived intangible assets for impairment in the fourth quarter of each year, or more frequently when events or changes in circumstances indicate the assets may be impaired. The change in goodwill since December 31, 2010 is due to currency exchange rate fluctuations between the U.S. and Canadian dollars.

(6) PRODUCT WARRANTIES

The Company's products carry limited, defined warranties for defects in materials or workmanship which, according to their terms, generally obligate Nautilus to pay the costs of supplying and shipping replacement parts to customers and, in certain instances, for labor and other costs to service products. Outstanding product warranty periods range from sixty days to the lifetime of certain product components in certain limited situations. Changes in the Company's product warranty liability in the three and nine months ended September 30, 2011 and 2010 were as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Balance at beginning of period	$3,358	$6,258	$3,935	$8,379
Accruals	606	361	1,625	1,062
Adjustments	(370)	(525)	(730)	(1,245)
Payments	(1,422)	(1,199)	(2,658)	(3,301)
Balance at end of period	$2,172	$4,895	$2,172	$4,895

Warranty liability accruals in each period related only to the Company's continuing operations. The majority of payments in each period related to the Company's former Commercial business, a discontinued operation. Adjustments in each period primarily related to the assignment of certain Commercial warranty obligations to the buyer of certain components of the Company's former Commercial business and settlements of outstanding Commercial warranty liabilities with certain customers.

(7) BORROWINGS

The Company has a Loan and Security Agreement (the “Loan Agreement”) with Bank of the West, which provides a revolving secured credit line of up to $15.0 million. The amount available for borrowings varies based upon the total amount of eligible accounts receivable and inventory as of the end of the preceding month. The Loan Agreement is available for working capital, standby letters of credit and general corporate purposes through August 31, 2012, assuming the Company satisfies certain terms and conditions at the time borrowings are requested. The interest rate on future borrowings, if any, under the Loan Agreement will be based on the bank's Base Rate plus 150 to 225 basis points or LIBOR plus 225 to 325 basis points and the Company's financial condition at the time it elects to borrow. The Loan Agreement includes a fee for the unused portion of the credit facility, which will vary depending on the Company's borrowing base availability.

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The Loan Agreement is collateralized by substantially all of the Company's assets and contains customary covenants, including minimum current ratio, minimum liquidity, minimum EBITDA (defined as "earnings before interest, taxes, depreciation and amortization") and limitations on capital expenditures, mergers and acquisitions, indebtedness, liens, dispositions, dividends and investments. The Loan Agreement also contains customary events of default. Upon an event of default, the lender would have the option of accelerating all obligations under the Loan Agreement. Standby letters of credit under the Loan Agreement are treated as a reduction of the Company's available borrowing base.

On July 20, 2011, the Company and Bank of the West entered into a Third Amendment (the “Amendment”) of the Loan Agreement. The effect of the Amendment is generally to ease the restrictiveness of certain provisions by increasing the borrowing availability, raising the limitation on capital expenditures and reducing interest rates applicable to any outstanding amounts. The Amendment, dated effective as of June 30, 2011, increases the amount of eligible accounts receivable for calculating the borrowing base. Specifically, the Amendment (i) permits up to 40% of total accounts receivable included in the borrowing base to consist of receivables of a specific customer, an increase from the prior limitation of 25%; and (ii) permits accounts receivable of certain customers granted extended payment terms to be included in the borrowing base, subject to certain conditions and limitations. In addition, the Company and Bank of the West agreed to increase the limitation on the Company's capital expenditures permitted in any one calendar year from $1,500,000 to $3,000,000, and to reduce the interest rate margins applied to amounts outstanding under the Loan Agreement.

As of September 30, 2011, the Company had no outstanding borrowings and $3.2 million in standby letters of credit issued under the Loan Agreement. As of September 30, 2011, the Company was in compliance with the financial covenants of the Loan Agreement.

On September 3, 2010, the Company entered into a Note Purchase Agreement (the “Purchase Agreement”) with certain entities (collectively, the “Sherborne Purchasers”) under common control of Sherborne Investors GP, LLC and its affiliates (collectively “Sherborne”). Sherborne was formerly the Company's largest shareholder and is controlled by Edward J. Bramson, the Company's former Chairman and Chief Executive Officer, and Craig L. McKibben, a former member of the Company's Board of Directors.

Pursuant to the Purchase Agreement, the Company issued to the Sherborne Purchasers $6,096,996 in aggregate principal amount at maturity of its Increasing Rate Senior Discount Notes due December 31, 2012 (the “Notes”). The Notes have an original principal amount totaling $5,000,000. The outstanding principal amount of the Notes accretes value at rates equal to 2.5% per annum from September 3, 2010 through February 28, 2011; 6.0% per annum from March 1, 2011 through August 31, 2011; 9.5% per annum from September 1, 2011 through February 29, 2012; 13.0% per annum from March 1, 2012 through August 31, 2012; and 14.5% per annum thereafter. If all the Notes are paid at maturity, the effective rate of interest over the term of the Purchase Agreement would be approximately 8.7% per annum, which is the rate at which interest expense is accrued by the Company. Prepayment of amounts due under the Notes is permitted under the Purchase Agreement, subject to certain restrictions in both the Purchase Agreement and the Loan Agreement.

On July 19, 2011, beneficial interest in the Notes was assigned by the Sherborne Purchasers pro-rata to their respective investors in the manner permitted by the Purchase Agreement. Such assignment was made in connection with the resignation, of Messrs. Bramson and McKibben from their respective positions with Nautilus on May 26, 2011, and the subsequent pro-rata distribution by certain Sherborne-affiliated entities to their respective investors of the common stock of the Company owned by such entities.

The Notes are subordinated to the Loan Agreement. The Purchase Agreement includes certain negative covenants, including restrictions on the incurrence of additional indebtedness, liens, liquidation of assets, capital expenditures, payment of dividends, changes in the Company's business operations and change of control transactions. The Purchase Agreement includes customary events of default, including nonpayment, insolvency, breach of warranty or covenant, cross-default of the Loan Agreement, material adverse changes and other events. Upon the occurrence of an event of default all outstanding obligations under the Notes may be declared due and payable. The accretion rate of the Notes may be increased by 2% per annum during the continuance of an event of default.

(8) INCOME (LOSS) PER SHARE

Basic income (loss) per share was computed using the weighted average number of common shares outstanding. For the computation of diluted income (loss) per share, the number of basic weighted average shares outstanding was increased by dilutive potential common shares related to stock-based compensation, as determined by the treasury stock method. The weighted average numbers of shares outstanding used to compute net loss per share were as follows:

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	Three months ended September 30,		Nine months ended September 30,	
(Number of shares in thousands)	2011	2010	2011	2010
Basic weighted average shares outstanding	30,747	30,744	30,746	30,744
Dilutive potential common shares [1]	—	—	—	—
Diluted weighted average shares outstanding	30,747	30,744	30,746	30,744
[1] Dilutive potential shares omitted due to net loss	5	2	25	21

Dilutive potential common shares were included in the computation of diluted income per share from continuing operations for the three months ended September 30, 2011.

The weighted average numbers of shares outstanding listed in the table below were anti-dilutive and excluded from the computation of diluted loss per share, primarily because the average market price did not exceed the exercise price. These shares may be dilutive potential common shares in the future.

	Three months ended September 30,		Nine months ended September 30,	
(Number of shares in thousands)	2011	2010	2011	2010
Stock options	1,179	1,240	1,124	1,238
Performance stock units	128	146	93	—
Restricted stock units	355	—	170	—

(9) COMPREHENSIVE LOSS

Following is a summary of the components of comprehensive loss, net of income taxes, for the three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Net loss	$(92)	$(4,306)	$(1,754)	$(22,802)
Foreign currency translation gain (loss) adjustments	(397)	(620)	(628)	19
Comprehensive loss	$(489)	$(4,926)	$(2,382)	$(22,783)

(10) SEGMENT INFORMATION

The Company has two reportable segments - Direct and Retail. Contribution is the measure of profit or loss used by the Company's chief operating decision maker and is defined as net sales less product costs and directly attributable expenses. Directly attributable expenses include selling and marketing expenses, general and administrative expenses, and research and development expenses that are directly related to segment operations. Following is summary information by reportable segment for the three and nine months ended September 30, 2011 and 2010 (in thousands):

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	Three months ended September 30, 2011	2010	Nine months ended September 30, 2011	2010
Net sales:				
Direct	$22,645	$21,504	$75,354	$68,450
Retail	13,710	16,118	42,090	43,869
Unallocated royalty income	1,047	852	2,983	2,441
Consolidated net sales	$37,402	$38,474	$120,427	$114,760
Contribution:				
Direct	$161	$(2,686)	$1,339	$(9,200)
Retail	1,319	2,001	4,420	5,594
Unallocated royalty income	1,047	854	2,983	2,443
Consolidated contribution	$2,527	$169	$8,742	$(1,163)
Reconciliation of consolidated contribution to income (loss) from continuing operations:				
Consolidated contribution	$2,527	$169	$8,742	$(1,163)
Less expenses not directly related to segments:				
General and administrative	(3,206)	(3,394)	(10,321)	(10,696)
Research and development	(34)	—	(34)	(64)
Other (expense) income	(176)	338	(317)	290
Income tax benefit (expense)	1,170	489	1,136	(130)
Income (loss) from continuing operations	$281	$(2,398)	$(794)	$(11,763)

(11) COMMITMENTS AND CONTINGENCIES

Guarantees, Commitments and Off-Balance Sheet Arrangements

As of September 30, 2011, the Company had approximately $3.2 million in standby letters of credit with certain vendors with expiration dates through September 2012.

The Company has long lead times for inventory purchases and, therefore, must secure factory capacity from its vendors in advance. As of September 30, 2011, the Company had approximately $15.1 million in non-cancelable market-based purchase obligations, all of which were for inventory purchases expected to be received in 2011 and early 2012.

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

The nature and terms of these indemnification obligations vary from contract to contract, and generally a maximum obligation is not stated within the agreements. The Company holds insurance policies that mitigate potential losses arising from certain types of indemnification obligations. Management does not deem these obligations to be significant to the Company's financial position, results of operations or cash flows and, therefore, no related liabilities were recorded as of September 30, 2011.

Guarantees, Commitments and Contingencies of Discontinued Operation

Prior to its divestiture, the Company's discontinued Commercial business would, from time-to-time, involve a third-party with lease and financing arrangements to assist customers in purchasing products. While these arrangements generally were without recourse to Nautilus, in certain cases the Company offered a guarantee or other recourse provisions. The maximum contingent liability under all such recourse provisions was approximately $1.0 million as of September 30, 2011.

The Company retained certain warranty obligations in connection with its former Commercial business and remains

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contingently liable for certain product warranty obligations which were assumed by buyers of its Commercial business product lines to the extent a buyer fails to fulfill its assumed obligations. Uncertainties exist with respect to these warranty obligations, as units previously sold to customers approach end-of-life and settlements are reached with certain customers in connection with the Company's exit from its Commercial business. As of September 30, 2011, the Company's warranty liability included $0.8 million for estimated future warranty costs of its former Commercial business.

Legal Matters

The Company is party to various legal proceedings arising from normal course business activities. In addition, the Company's tax filings are subject to audit by authorities in the jurisdictions where it conducts business, which may result in assessments of additional taxes. Management believes it has adequately provided for obligations that would result from these legal and tax proceedings. 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 2. 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 I, Item 1 of this Form 10-Q and our consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010 (the “2010 Form 10-K”). All references to the third quarters of 2011 and 2010 mean the three-month periods ended September 30, 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 our 2010 Form 10-K.

Forward-Looking Statements

This Quarterly Report on Form 10-Q 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 Form 10-Q include, without limitation, anticipated declines in sales of strength products, anticipated sales increases of cardio-oriented products and the expectation that increased sales of the TreadClimber® product line will offset anticipated declines in sales of legacy strength products; potential improvement in consumer credit financing approval rates; the continuance of promotional programs and the impact of such programs on profit margins; our new product development strategies; and our plans for achieving future profitability. 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

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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, "Risk Factors," in our 2010 Form 10-K as supplemented or modified in our quarterly reports on Form 10-Q. We do not undertake any duty to update forward-looking statements after the date they are made or to conform them to actual results or to changes in circumstances or expectations.

Available Information

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 website, www.nautilusinc.com. 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 website is not part of this report.

OVERVIEW

Nautilus is 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, including 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 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.

Net sales for the third quarter ended September 30, 2011 were $37.4 million, a decrease of $1.1 million, or 2.8%, as compared to net sales of $38.5 million for the third quarter of 2010. The decrease in net sales primarily reflected a decline of $2.4 million, or 14.9%, in our Retail segment compared to the third quarter of 2010. Lower Retail sales were primarily attributable to a 2010 third quarter sales promotion that was not repeated in the third quarter this year, a shift in the timing of certain customer orders and generally soft demand from national retailers. Net sales in our Direct segment for the third quarter of 2011 rose $1.1 million, or 5.3% compared to the 2010 third quarter, largely due to continued strong demand for our TreadClimbers. This increase was offset in part 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. Based on sales trends observed during the last three quarters, we expect that increased sales of cardio products should more than offset anticipated declines in strength product sales for the full year 2011.

Income from continuing operations was $0.3 million for the third quarter ended September 30, 2011, compared to a loss from continuing operations of $2.4 million for the third quarter of 2010. Diluted income per share from continuing operations for the third quarter of 2011 was $0.01, compared to a diluted loss per share of $(0.08) for the same quarter of 2010. The significant improvement in results of continuing operations for the third quarter of 2011 was primarily attributable to a 16.8% reduction in operating expenses achieved through more cost efficient media advertising expenditures. Selling and marketing expenses for the third quarter of 2011, as a percent of net sales, declined to 30.8% from 37.3% for the comparable 2010 period.
Net loss for the third quarter ended September 30, 2011 was $0.1 million, an improvement of $4.2 million, or 97.9%, over net loss of $4.3 million for the third quarter of 2010. Basic and diluted net loss per share for the third quarter of 2011 was breakeven $(0.00), as compared to basic and diluted net loss per share of $(0.14) for the same quarter of 2010.

During the third quarter of 2011, we continued to allocate a larger portion of our media expenditures toward our TreadClimber product line, compared to 2010, and we expect to direct the majority of such expenditures to this product category and a new product introduction during the remainder of this year. 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.

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COMPARISON OF OPERATING RESULTS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

The following table compares selected financial information in our condensed consolidated statements of operations for the three months ended September 30, 2011 and 2010 (unaudited and in thousands):

	Three months ended September 30,		Change	
	2011	2010	$	%
Net sales	$37,402	$38,474	$(1,072)	(2.8)%
Cost of sales	21,605	21,856	(251)	(1.1)%
Gross margin	15,797	16,618	(821)	(4.9)%
Operating expenses:				
Selling and marketing	11,517	14,347	(2,830)	(19.7)%
General and administrative	4,134	4,797	(663)	(13.8)%
Research and development	859	699	160	22.9 %
Total operating expenses	16,510	19,843	(3,333)	(16.8)%
Operating loss	(713)	(3,225)	2,512	77.9 %
Other income (expense):				
Interest income	5	4	1	25.0 %
Interest expense	(116)	(9)	(107)	n.m.
Other	(65)	343	(408)	n.m.
Total other income (expense)	(176)	338	(514)	n.m.
Loss before income taxes	(889)	(2,887)	1,998	69.2 %
Income tax benefit	(1,170)	(489)	(681)	(139.3)%
Income (loss) from continuing operations	281	(2,398)	2,679	n.m.
Loss from discontinued operation, net of tax	(373)	(1,908)	1,535	80.5 %
Net loss	$(92)	$(4,306)	$4,214	97.9 %

The following table compares the net sales and gross margins of our business segments for the three months ended September 30, 2011 and 2010 (unaudited and in thousands):

	Three months ended September 30,		Change	
	2011	2010	$	%
Net sales:				
Direct	$22,645	$21,504	$1,141	5.3 %
Retail	13,710	16,118	(2,408)	(14.9)%
Royalty income	1,047	852	195	22.9 %
	$37,402	$38,474	$(1,072)	(2.8)%
Gross margin:				
Direct	$11,784	$11,839	$(55)	(0.5)%
Retail	2,966	3,926	(960)	(24.4)%
Royalty income	1,047	853	194	22.7 %
	$15,797	$16,618	$(821)	(4.9)%
Gross margin percent:				
Direct	52.0 %	55.1 %	(310) basis points	
Retail	21.6 %	24.4 %	(280) basis points	

The following table compares the net sales of our major product lines within each business segment for the three months ended September 30, 2011 and 2010 (in thousands):

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	Three months ended September 30,		Change	
	2011	2010	$	%
Direct net sales:				
Cardio products[1]	$ 16,754	$ 11,434	$ 5,320	46.5 %
Strength products[2]	5,891	10,070	(4,179)	(41.5)%
	22,645	21,504	1,141	5.3 %
Retail net sales:				
Cardio products[1]	9,041	11,236	(2,195)	(19.5)%
Strength products[2]	4,669	4,882	(213)	(4.4)%
	13,710	16,118	(2,408)	(14.9)%
Royalty income	1,047	852	195	22.9 %
	$ 37,402	$ 38,474	$ (1,072)	(2.8)%

(1) Cardio products include: TreadClimbers, treadmills, exercise bikes and ellipticals.
(2) Strength products include: home gyms, selectorized dumbbells, kettlebell weights, weight benches and accessories.

Direct

Net sales for our Direct business totaled $22.6 million for the third quarter of 2011, an increase of $1.1 million, or 5.3%, compared to Direct net sales of $21.5 million for the third quarter of 2010. The comparative increase in net sales of our Direct business for the third quarter of 2011 reflected a $5.3 million, or 46.5%, increase in sales of cardio products, driven by continued strong demand for our TreadClimber products. We believe higher comparable Direct net sales underscores broadening product appeal, the effectiveness of our media advertising strategy, as well as improved consumer credit approval rates, discussed below. The increase in sales of cardio products was partially offset by a $4.2 million, or 41.5%, decline in sales of strength products, primarily due to comparatively lower sales of rod-based home gyms and a product pricing strategy used during the third quarter of 2010 that was not repeated in 2011. The decline in sales of rod-based home gyms was 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. Based on recent sales trends, we expect that increased sales of TreadClimber products will continue to more than offset anticipated declines in home gym sales through our Direct channel for the full year 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"). Prior to this transition, we had experienced continued declines in consumer credit approval rates by our previous third-party provider of consumer financing. In addition, we added one secondary third-party consumer credit financing provider during 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 third-party U.S. financing providers increased from 21% in the third quarter of 2010 to 27% in the third quarter of 2011. Management expects combined consumer credit approval rates during the remainder of 2011 to remain at approximately the same level as the third quarter of 2011.

Gross margin for our Direct business was 52.0% of net sales for the third quarter of 2011, a decrease of 310 basis points compared to the third quarter of 2010. The comparative decrease in Direct gross margin percent was attributable primarily to higher freight and warranty expenses, offset in part by improved product margins.

Retail

Net sales for our Retail business totaled $13.7 million for the third quarter of 2011, a decrease of $2.4 million, or 14.9%, compared to Retail net sales of $16.1 million for the third quarter of 2010. The decrease in Retail net sales was attributable primarily to a third quarter 2010 sales promotion that was not repeated in the third quarter this year, as well as a shift in the timing of certain customer orders from the third quarter to the fourth quarter of 2011 and overall soft demand among retailers.

Gross margin for our Retail business was 21.6% of net sales for the third quarter of 2011, a decrease of 280 basis points compared to the third quarter of 2010, primarily due to higher supply chain costs combined with the effect of lower sales volume, partially offset by improved product margins.

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Operating Expenses

Operating expenses totaled $16.5 million for the third quarter of 2011, an improvement of $3.3 million, or 16.8%, compared to operating expenses of $19.8 million for the third quarter of 2010. The improvement is principally due to more cost effective media advertising expenditures, combined with a lower general and administrative cost structure, offset in part by higher research and development expenses as we invest in new product development resources and capabilities.

Selling and Marketing

Selling and marketing expenses were $11.5 million for the third quarter of 2011, a decrease of $2.8 million, or 19.7%, compared to the third quarter of 2010. Advertising expense for our Direct business was $5.9 million for the third quarter of 2011, a decline of $2.5 million, or 29.9%, compared to the third quarter of 2010. The comparative decrease in Direct advertising expense from the prior year period was attributable primarily to the effectiveness of our media advertising, which enabled more efficient spending. Lower comparable Direct advertising expenses were offset in part by higher consumer credit financing costs, as a result of higher credit approval rates and the availability of additional secondary financing providers during the 2011 period as compared to the comparable period in 2010.

General and Administrative

General and administrative expenses were $4.1 million for the third quarter of 2011, a decrease of $0.7 million, or 13.8%, compared to the third quarter of 2010, primarily due to lower depreciation, personnel and legal expenses.

Research and Development

Research and development expenses were $0.9 million for the third quarter of 2011, an increase of $0.2 million, or 22.9%, compared to the third quarter of 2010. We expect research and development expenses to increase for the full year 2011, as compared to 2010, as we invest in new product development resources and capabilities.

Other Income and Expense

Interest Expense

Interest expense of $0.1 million for the third quarter of 2011 was incurred in connection with our long-term subordinated notes. We incurred only a nominal amount of interest expense in the third quarter of 2010.

Other Income (Expense)

Other expense was $0.1 million for the third quarter of 2011, compared to other income of $0.3 million the third quarter of 2010, primarily due to foreign currency exchange rate fluctuations.

Income Tax Benefit

Income tax benefit was $1.2 million for the third quarter of 2011, compared to income tax benefit of $0.5 million for the third quarter of 2010. Our income tax benefit for the third quarter of 2011 was primarily related to the Company's pre-tax loss in the third quarter of 2011. The income tax benefit for the third quarter of 2010 was attributable to an income tax refund claim filed in the period.

Discontinued Operation

Our Commercial business discontinued operation resulted in a loss of $0.4 million for the third quarter of 2011, compared to a loss of $1.9 million for the third quarter of 2010, as we completed the disposal of our former Commercial business in April 2011. We may incur additional expenses in future periods in connection with the settlement of contingencies arising from and directly related to the Commercial business prior to its disposal. Loss from discontinued operation for the third quarter of 2011 and 2010 was net of a reduction in the amount of pre-tax disposal loss previously estimated in connection with the divestiture of $0.3 million and $0.8 million, respectively.

COMPARISON OF OPERATING RESULTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

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The following table compares selected financial information in our condensed consolidated statements of operations for the nine months ended September 30, 2011 and 2010 (unaudited and in thousands):

	Nine months ended September 30,		Change	
	2011	2010	$	%
Net sales	$120,427	$114,760	$5,667	4.9 %
Cost of sales	68,000	61,708	6,292	10.2 %
Gross margin	52,427	53,052	(625)	(1.2)%
Operating expenses:				
Selling and marketing	38,601	47,935	(9,334)	(19.5)%
General and administrative	13,103	14,750	(1,647)	(11.2)%
Research and development	2,336	2,290	46	2.0 %
Total operating expenses	54,040	64,975	(10,935)	(16.8)%
Operating loss	(1,613)	(11,923)	10,310	86.5 %
Other income (expense):				
Interest income	14	15	(1)	(6.7)%
Interest expense	(348)	(9)	(339)	n.m.
Other	17	284	(267)	(94.0)%
Total other income (expense)	(317)	290	(607)	n.m.
Loss before income taxes	(1,930)	(11,633)	9,703	83.4 %
Income tax (benefit) expense	(1,136)	130	(1,266)	n.m.
Loss from continuing operations	(794)	(11,763)	10,969	93.3 %
Loss from discontinued operation, net of tax	(960)	(11,039)	10,079	91.3 %
Net loss	$(1,754)	$(22,802)	$21,048	92.3 %

The following table compares the net sales and gross margins of our business segments for the nine months ended September 30, 2011 and 2010 (unaudited and in thousands):

	Nine months ended September 30,		Change	
	2011	2010	$	%
Net sales:				
Direct	$75,354	$68,450	$6,904	10.1 %
Retail	42,090	43,869	(1,779)	(4.1)%
Royalty income	2,983	2,441	542	22.2 %
	$120,427	$114,760	$5,667	4.9 %
Gross margin:				
Direct	$40,037	$39,352	$685	1.7 %
Retail	9,407	11,256	(1,849)	(16.4)%
Royalty income	2,983	2,444	539	22.1 %
	$52,427	$53,052	$(625)	(1.2)%
Gross margin percent:				
Direct	53.1 %	57.5 %	(440) basis points	
Retail	22.4 %	25.7 %	(330) basis points	

The following table compares the net sales of our major product lines within each business segment for the nine months ended September 30, 2011 and 2010 (in thousands):

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	Nine months ended September 30,		Change	
	2011	2010	$	%
Direct net sales:				
Cardio products[1]	$ 52,017	$ 36,879	$ 15,138	41.0 %
Strength products[2]	23,337	31,571	(8,234)	(26.1)%
	75,354	68,450	6,904	10.1 %
Retail net sales:				
Cardio products[1]	25,790	29,310	(3,520)	(12)%
Strength products[2]	16,300	14,558	1,742	12.0 %
	42,090	43,868	(1,778)	(4.1)%
Royalty income	2,983	2,441	542	22.2 %
	$ 120,427	$ 114,759	$ 5,668	4.9 %

(1) Cardio products include: TreadClimbers, treadmills, exercise bikes and ellipticals.
(2) Strength products include: home gyms, selectorized dumbbells, kettlebell weights, weight benches and accessories.

Direct

Net sales for our Direct business totaled $75.4 million for the nine months ended September 30, 2011, an increase of $6.9 million, or 10.1%, compared to $68.5 million for the nine months ended September 30, 2010. The comparative increase in net sales in our Direct business for the first nine months of 2011 over 2010 reflected a $15.1 million, or 41.0%, increase in sales of cardio products, particularly the TreadClimber product category. We believe higher Direct net sales demonstrates broadening product appeal and the effectiveness of our media advertising strategy, as well as improved consumer credit approval rates. The increase in sales of cardio products was partially offset by an $8.2 million, or 26.1%, comparative decline in sales of strength products, primarily due to lower sales of rod-based home gyms in the 2011 period. 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. Based on recent sales trends, we expect that increased sales of TreadClimber products will continue to more than offset anticipated declines in home gym sales through our Direct channel for the full year 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"). Prior to this transition, we had experienced continued declines in consumer credit approval rates by our previous third-party provider of consumer financing. 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 14% in the first nine months of 2010 to 24% in the first nine months of 2011.

Gross margin for our Direct business was 53.1% of net sales for the nine months ended September 30, 2011, a decrease of 440 basis points compared to the nine months ended September 30, 2010. The comparative decrease in Direct gross margin percent was attributable primarily to higher freight and warranty expense, as well as to lower product margins.

Retail Business

Net sales for our Retail business totaled $42.1 million for the nine months ended September 30, 2011, a decrease of $1.8 million, or 4.1%, compared to Retail net sales of $43.9 million for the nine months ended September 30, 2010. The decrease in Retail net sales was attributable primarily to a $3.5 million, or 12.0%, a shift in the timing of certain customer orders from the third quarter to the fourth quarter of 2011, a third quarter 2010 sales promotion that was not repeated in 2011 and overall soft demand among retailers. The decline in the cardio category was offset in part by a comparative increase in Retail net sales of strength products, driven largely by growth among our e-commerce Retail customers.

Gross margin for our Retail business was 22.4% of net sales for the nine months ended September 30, 2011, a decrease of 330 basis points compared to the nine months ended September 30, 2010, primarily due to higher supply chain management costs

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and its relative effect when combined with lower sales volume.

Operating Expenses

Operating expenses totaled $54.0 million for the nine months ended September 30, 2011, an improvement of $10.9 million, or 16.8%, compared to operating expenses of $65.0 million for the nine months ended September 30, 2010, principally due to a $9.3 million, or 19.5%, reduction in selling and marketing expenses. The reduction was achieved primarily through more effective media advertising, which enabled more efficient spending. A $1.6 million, or 11.2%, reduction in general and administrative expenses compared to the prior year period also contributed to lower comparative total operating expenses for the nine-month period ended September 30, 2011.

Selling and Marketing

Selling and marketing expenses were $38.6 million for the nine months ended September 30, 2011, a decrease of $9.3 million, or 19.5%, compared to the nine months ended September 30, 2010. Advertising expenses for our Direct business were $20.0 million for the first nine months of 2011, a decrease of $11.1 million, or 35.6%, compared to the first nine months of 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 $13.1 million for the nine months ended September 30, 2011, a decrease of $1.6 million, or 11.2%, compared to the nine months ended September 30, 2010, primarily due to reduced depreciation, personnel and legal expenses.

Research and Development

Research and development expenses were $2.3 million for the nine months ended September 30, 2011, an increase of 2.0% compared to the nine months ended September 30, 2010. We expect research and development expenses to increase for the full year 2011, compared to 2010, as we invest in new product development resources and capabilities.

Other Income and Expense

Interest Expense

Interest expense was $0.3 million for the nine months ended September 30, 2011 in connection with our long-term subordinated notes, which were issued in September 2010. We incurred only a nominal amount of interest expense in the nine months ended September 30, 2010.

Other Income (Expense)

Other expense was insignificant for the nine months ended September 30, 2011, compared to other income of $0.3 million the nine months ended September 30, 2010, which was primarily due to foreign currency exchange rate fluctuations.

Income Tax Expense

Income tax benefit was $1.1 million for the nine months ended September 30, 2011, compared to income tax expense of $0.1 million for the nine months ended September 30, 2010. Our income tax benefit for the first nine months of 2011 was primarily related to the Company's pre-tax loss generated in the United States. Income tax expense for the first nine months of 2010 was attributable to taxable income generated outside of the United States.

Discontinued Operation

Our Commercial business discontinued operation resulted in a loss of $1.0 million for the nine months ended September 30, 2011, compared to a loss of $11.0 million for the nine months ended September 30, 2010, as we completed the disposal of our

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former Commercial business in early 2011. We may incur additional expenses in future periods in connection with the settlement of contingencies arising from and directly related to the Commercial business prior to its disposal. Loss from discontinued operation in the first nine months of 2011 and 2010 was net of a reduction in the amount of pre-tax disposal loss previously estimated in connection with the divestiture of $0.9 million and $3.2 million, respectively.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2011, we had $11.5 million of cash and cash equivalents, compared to $14.3 million as of December 31, 2010. Cash used in operating activities was $1.6 million for the nine months ended September 30, 2011, compared to $9.4 million for the nine months ended September 30, 2010. The improvement in net cash used in operating activities for the first nine months of 2011, compared to the first nine months of 2010, was primarily due to the reduction of losses from both our continuing operations and our discontinued Commercial business. The cash flow effect of such losses in the first nine months of 2010 was partially offset by income tax refunds of $12.6 million received during that period. Management believes that sufficient funds will be available to meet our expected cash needs for at least the next twelve months based upon cash on hand and anticipated cash flows from operations.

Cash provided by the reduction of trade receivables was $8.0 million for the nine months ended September 30, 2011, compared to $13.5 million for the nine months ended September 30, 2010. The comparatively higher reduction in receivables during the 2010 nine-month period reflects the collection of outstanding accounts receivables of our discontinued Commercial business. Similarly, cash used in reducing trade payables was $6.7 million for the nine months ended September 30, 2011, compared to $18.5 million for the nine months ended September 30, 2010, primarily due to the settlement of outstanding trade payables of our discontinued Commercial business during the prior year period. We used $3.1 million in cash during the nine months ended September 30, 2011 to improve our inventory in-stock condition in order to meet our future sales expectations.

Trade receivables were $11.5 million as of September 30, 2011, compared to $19.6 million at the end of 2010, reflecting seasonally lower activity with our Retail business customers, combined with a modest improvement in days sales outstanding ("DSO") in receivables. Trade payables decreased to $17.8 million as of September 30, 2011, compared to $24.5 million at December 31, 2010, due to a seasonally lower overall level of business activity between the fourth quarter of 2010 and the 2011 third quarter.

Cash used in investing activities of $0.7 million for the nine months ended September 30, 2011 consisted of $2.1 million used for the development of new computer software and purchases of tooling for new cardio products, partially offset by $1.0 million in proceeds from the sale of portions of our discontinued Commercial business. Cash provided by investing activities of $11.2 million for the nine months ended September 30, 2010 included $6.9 million in proceeds from the sale of portions of our discontinued Commercial business and a $4.4 million net decrease in the amount of restricted cash collateralizing our then-outstanding letters of credit. We do not expect cash provided by the sale of our discontinued Commercial business to be material in future periods.

Cash provided by financing activities during the nine months ended September 30, 2010 was primarily attributable to a note purchase agreement with the Company's former largest shareholder. For more information, see "Financing Arrangements."

Financing Arrangements

We have a Loan and Security Agreement (the “Loan Agreement”) with Bank of the West, which provides a revolving secured credit line of up to $15.0 million. The amount available for borrowings varies based upon the total amount of eligible accounts receivable and inventory as of the end of the preceding month. The Loan Agreement is available for working capital, standby letters of credit and general corporate purposes through August 31, 2012, assuming we satisfy certain terms and conditions at the time borrowings are requested. The interest rate on future borrowings, if any, under the Loan Agreement will be based on the bank's Base Rate plus 150 to 225 basis points or LIBOR plus 225 to 325 basis points and our financial condition at the time we elect to borrow. The Loan Agreement includes a fee for the unused portion of the credit facility, which will vary depending on our borrowing base availability.

The Loan Agreement is collateralized by substantially all of our assets and contains customary covenants, including minimum current ratio, minimum liquidity, minimum EBITDA (defined as "earnings before interest, taxes, depreciation and amortization") and limitations on capital expenditures, mergers and acquisitions, indebtedness, liens, dispositions, dividends and investments. The Loan Agreement also contains customary events of default. Upon an event of default, the lender would have the option of accelerating all obligations under the Loan Agreement. Standby letters of credit under the Loan Agreement are treated as a reduction of our available borrowing base.

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On July 20, 2011, we entered into a Third Amendment (the “Amendment”) of the Loan Agreement. The effect of the Amendment was generally to ease the restrictiveness of certain provisions by increasing our borrowing availability, raising the limitation on our capital expenditures and reducing interest rates applicable to any outstanding amounts. The Amendment, dated effective June 30, 2011, increases the amount of eligible accounts receivable for calculating the borrowing base. Specifically, the Amendment (i) permits up to 40% of total accounts receivable included in the borrowing base to consist of receivables of a specific customer, an increase from the prior limitation of 25%; and (ii) permits accounts receivable of certain customers granted extended payment terms to be included in the borrowing base, subject to certain conditions and limitations. In addition, Bank of the West agreed to increase the limitation on our capital expenditures permitted in any one calendar year from $1,500,000 to $3,000,000, and to reduce the interest rate margins applied to amounts outstanding under the Loan Agreement.

As of September 30, 2011, we had no outstanding borrowings and $3.2 million in standby letters of credit issued under the Loan Agreement. As of September 30, 2011, we were in compliance with the financial covenants of the Loan Agreement.

On September 3, 2010, we entered into a Note Purchase Agreement (the “Purchase Agreement”) with certain entities (collectively, the “Sherborne Purchasers”) under common control of Sherborne Investors GP, LLC and its affiliates (collectively “Sherborne”). Sherborne was formerly our largest shareholder and is controlled by Edward J. Bramson, our former Chairman and Chief Executive Officer, and Craig L. McKibben, a former member of our Board of Directors. Pursuant to the Purchase Agreement, we issued to the Sherborne Purchasers $6,096,996 in aggregate principal amount at maturity of our Increasing Rate Senior Discount Notes due December 31, 2012 (the “Notes”). The Notes have an original principal amount totaling $5,000,000 and mature on December 31, 2012. The then-outstanding principal amount of the Notes accretes value at rates equal to 2.5% per annum from September 3, 2010 through February 28, 2011; 6.0% per annum from March 1, 2011 through August 31, 2011; 9.5% per annum from September 1, 2011 through February 29, 2012; 13.0% per annum from March 1, 2012 through August 31, 2012; and 14.5% per annum thereafter. If all the Notes are paid at maturity, the effective rate of interest over the term of the Purchase Agreement would be approximately 8.7% per annum. Prepayment of amounts due under the Notes is permitted under the Purchase Agreement, subject to certain restrictions in both the Purchase Agreement and the Loan Agreement.

On July 19, 2011, beneficial interest in the Notes was assigned by the Sherborne Purchasers pro-rata to their respective investors in the manner permitted by the Purchase Agreement. Such assignment was made in connection with the resignation, of Messrs. Bramson and McKibben from their respective positions with Nautilus on May 26, 2011, and the subsequent pro-rata distribution by certain Sherborne-affiliated entities to their respective investors of the common stock of the Company owned by such entities.
The Notes are subordinated to the Loan Agreement. The Purchase Agreement includes certain negative covenants, including restrictions on the incurrence of additional indebtedness, liens, liquidation of assets, capital expenditures, payment of dividends, changes in our business operations and change of control transactions. The Purchase Agreement includes customary events of default, including nonpayment, insolvency, breach of warranty or covenant, cross-default of the Loan Agreement, material adverse changes and other events. Upon the occurrence of an event of default all outstanding obligations under the Notes may be declared due and payable. The accretion rate of the Notes may be increased by 2% per annum during the continuance of an event of default.

Commitments and Contingencies

For a description of our commitments and contingencies, refer to Note 11 to our condensed consolidated financial statements in Item 1 of this Form 10-Q.

Seasonality

We expect sales of fitness equipment products to vary seasonally. Sales are typically strongest in the first and fourth quarters of a calendar year and are generally weakest in the second quarter. During the spring and summer months, consumers tend to be more involved in outdoor activities, including exercise, which may affect sales of fitness equipment used indoors. This seasonality can have a significant effect on our operating results, inventory levels and working capital requirements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our critical accounting policies have not changed from those discussed in our 2010 Form 10-K.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

In accordance with Rule 13a-15 of the Securities Exchange Act of 1934 (the “Exchange Act”), as of the end of the period covered by this Quarterly Report on Form 10-Q, our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rule 13a- 15(e) and Rule 15d-15(e) under the Exchange Act). Based upon their evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Controls over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the three months ended September 30, 2011, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. 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 1A. Risk Factors

Nautilus operates in an environment that involves a number of risks and uncertainties. The risks and uncertainties described in our 2010 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 our 2010 Form 10-K actually occur, our business, operating results and financial position could be adversely affected. There has not been a material change to the risk factors as set forth in our 2010 Form 10-K.

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Item 6. Exhibits

The following exhibits are filed herewith.

Exhibit No.	Description
10.1	Third Amendment, executed July 20, 2011 and dated effective June 30, 2011, to the Credit Agreement by and between the Company and Bank of the West, dated as of March 8, 2010 (incorporated by reference from Exhibit 10.1 to the Company's Current Report on Form 8-K filed July 26, 2011).
10.2	Fifth Lease Modification Agreement, dated July 25, 2011, to the Office Lease by and between Nautilus, Inc. and Columbia Tech Center, L.L.C. dated June 30, 2009 (incorporated by reference from Exhibit 10.1 to the Company's Current Report on Form 8-K filed July 29, 2011).
10.3	Office Lease Agreement dated as of July 25, 2011, by and between Nautilus, Inc. and Columbia Tech Center, L.L.C. (incorporated by reference from Exhibit 10.2 to the Company's Current Report on Form 8-K filed July 29, 2011).
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14 (a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14 (a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Rule 13a-14(b) of the Securities and Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial statements from Nautilus, Inc.'s quarterly report on Form 10-Q for the quarter ended September 30, 2011, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets(unaudited), (ii) Condensed Consolidated Statements of Operations(unaudited), (iii) Condensed Consolidated Statements of Cash Flows (unaudited), and (iv) Notes to Condensed Consolidated Financial Statements (unaudited), tagged as blocks of text. Information is furnished and not filed, and is not incorporated by reference in any registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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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.

NAUTILUS, INC.

Date: November 9, 2011	By: /S/ Michael D. Mulholland Michael D. Mulholland Chief Financial Officer (Principal Financial Officer and for the Registrant)