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NHTC - Q4 2017 Natural Health Trends Corp Earnings Call

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## CORPORATE PARTICIPANTS

**Chris T. Sharng** *Natural Health Trends Corp. - CEO, President and Director*

**Kimberly Orlando** *ADDO Investor Relations - SVP*

**Timothy Scott Davidson** *Natural Health Trends Corp. - CFO, Chief Compliance Officer, SVP and Secretary*

## PRESENTATION

### Operator

Greetings, and welcome to the Natural Health Trends Corporation Fourth Quarter and Full Year 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Kimberly Orlando of Addo Investor Relations. Thank you. You may begin.

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**Kimberly Orlando** - *ADDO Investor Relations - SVP*

Thank you, and welcome to Natural Health Trends fourth quarter and full year 2017 earnings conference call.

During today's call, there may be statements made relating to the future results of the company that are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Actual results, performance, or achievements could differ materially from those anticipated in such forward-looking statements due to the result of certain factors, including those set forth in the company's filings with the Securities and Exchange Commission.

In addition, on this call, we'll refer to non-GAAP diluted earnings per share, a non-GAAP measure, that will be used in combination with GAAP results, provides us with additional analytical tools to understand our operations.

It should also be noted that today's call will be webcast live, and can be found on the Investors section of the company's corporate website at [www.naturalhealthtrends.com](http://www.naturalhealthtrends.com).

Instructions can be found for accessing the archived version of the conference call in today's financial results press release, which was issued at approximately 9:00 a.m. Eastern time.

At this time, I'd like to turn the call over to Chris Sharng, President of Natural Health Trends.

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**Chris T. Sharng** - *Natural Health Trends Corp. - CEO, President and Director*

Thank you, Kim, and thanks to everyone for joining us.

With me today is Scott Davidson, our Senior Vice President and Chief Financial Officer.

2017 was a challenging year for our business.

Total revenue declined to \$197.6 million compared to \$287.7 million in 2016.

Much of this decrease could be traced to factors beyond our control, including the G20 Summit, 20th Anniversary of Hong Kong's handover and China's Communist Party's 19th National congress, which impair our members ability to conduct business.



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With that said, the fourth quarter of 2017 marked our first sequential quarterly sales growth since the second quarter of 2016. We believe this was a result of the improvements we've made to our commission plans, combined with a number of effective incentive trips and training programs.

In addition, we introduced products into new markets throughout the year, supporting increased volume.

Outside of China, our business in Europe, Southeast Asia and Japan grew net sales over 2016 levels.

Despite a year-on-year slowdown in net sales, we've worked hard to preserve our strong margin profile through ongoing proactive expense management to align our cost structure with current sales levels.

For 2017, our gross profit margin was 80% and operating income margin was 22%, roughly in line with 2016.

As I touch on briefly, we refined our incentive programs and bonus and reward structure in 2017. We saw encouraging results from these changes begin to manifest in the fourth quarter. In 2018, we will implement additional modifications to narrow the gap between lower rank and mid-level leaders, including a onetime cash bonus for its new participants in the international recognition program.

Our overarching goal is to provide the necessary resources for up-and-coming members to reignite momentum in Asia.

Incentive trips were another driver of the sequential increase in net sales, which energized productivity in our active member base and renew excitement around our products.

In early October, 1,300 of our members embarked on a 6-day cruise through the East China Sea, from Shanghai to multiple ports in Japan, and participated in several onboard training sessions.

Our member's positive experience was broadcast on a social media back to China.

We also hosted a successful event in Lima, Peru last November with over 1,000 attendees. We plan to leverage the experience of our leaders in Peru to help grow our business in Latin America.

To capitalize on Europe's double-digit top line growth, we planned 2 December events in Stockholm. Our Royal Summit and European Success Forum. These events were well attended and included team building and training exercises.

Additionally, we initiated a preferred customer program in Europe. These preferred customers intend to be no more than consumers of our products, and do not wish to engage in selling.

Since it was available, more than 1/3 of the new sign ups in Europe were preferred customers. We plan to deploy a similar program in the U.S. at the end of March.

This year, we moved our international Ambassador Academy in Hong Kong from March last year back to January. There, we introduced our latest product, CurcuMore, a supplement to reduce inflammation and facilitate healthy aging to an audience of over 6,000.

Looking ahead, members had the opportunity to qualify for incentive trips to Croatia and South Africa in the first half of the year, which will, in turn, boost order volume and member rank advancements in our international recognition program.

Aside from the incentive trips, we sponsored various charitable activities during the quarter, while giving back to the communities, to raise brand awareness and foster loyalty through member involvement. We completed 2 charity walks in 2 of our major markets in China and continue to participate in the government's Million Forest Initiative, through donating and planting trees in the country's parched north west.



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Planting trees is a part of China's efforts to improve air quality and the environment. Moreover, we funded the construction of 3 elementary schools in disadvantaged areas in China, improving the learning environment for local children.

In conjunction with our effort to spur growth in our largest market, we remain focused on geographical expansion to diversify our presence.

In Europe specifically, we are working to expand into Germany, though we are still very early in the process.

We recently met with potential leaders and are working through the associated product registration requirements.

In Latin America, following our successful entry into the Peruvian market in mid-2017, we are now working on entering Mexico. We are in the process of product registrations and have identified a group of prospective leaders.

In China, we remain in process with our application for a direct selling license. However, the timing of obtaining such a license and whether or not we can obtain one remains beyond our control. We will be transparent as material developments occur.

In North America, we officially opened our third Healthy Lifestyle Center Plus in Metuchen, New Jersey last weekend, to support our growing U.S. member base in the area. This multifunctional space provides leaders with a place to conduct meetings and training and allows members to personally experience our products.

In summary, our balance sheet and overall liquidity position remains strong. We generated \$27 million in cash flow from operations in 2017, and paid out \$17 million in dividends to our shareholders.

Following the 2017 Tax Cuts and Jobs Act in December, we are returning some of the benefits we received to our worldwide rank-and-file employees, in the form of a onetime bonus payment.

Despite a challenging year for our company, we were encouraged by our fourth quarter performance, which reflected the first sequential increase in net sales in 5 quarters, and we are pleased that 2018 is off to a promising start.

With that, I'd like to turn the call over to Scott Davidson, our CFO to discuss our fourth quarter financials in detail. Scott?

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### **Timothy Scott Davidson** - *Natural Health Trends Corp. - CFO, Chief Compliance Officer, SVP and Secretary*

Thank you, Chris. Total revenue for the fourth quarter was \$46.1 million, a 26% decrease compared to \$62.3 million in the fourth quarter of 2016 and a 15% increase compared to \$40.1 million in the third quarter of 2017.

Sales in Hong Kong, which accounted for 86% of our fourth quarter revenue, decreased 29% year-over-year to \$39.6 million.

Outside of Hong Kong, revenue increased 4% year-over-year to \$6.5 million.

Our Active Member base declined to approximately 95,700 at December 31, from 99,700 at September 30 and from 119,000 at December 31 last year.

Turning to our cost and operating expenses. Our gross profit margin for the fourth quarter was 79.6% compared to 80.8% in fourth quarter of last year. The reduction was due primarily to training fees earned during the fourth quarter of last year and product promotions run in the fourth quarter this year.

Commissions expense, as a percent of total revenue, increased to 43% from 34.5% in the fourth quarter last year.

On a full year basis, commissions expense was 42.3% of total revenue, a slight decrease from 43.5% in 2016.



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Selling, general and administrative expenses for the quarter decreased 8% to \$8.1 million versus \$8.7 million a year ago. The decrease in SG&A versus the prior year period continues to reflect the proactive cost reduction measures we implemented in the fourth quarter of 2016.

Operating income for the quarter totaled \$8.7 million, a decrease of 57% compared to \$20 million in the fourth quarter last year. Our operating income margin was 18.8% compared to 32.1% in the fourth quarter last year.

For the full year, our operating income margin was 22%, consistent with 2016.

As a result of the Tax Cuts and Jobs Act of 2017, we record a onetime net charge of \$12.5 million, or a impact of \$1.11, per diluted share.

Net loss for the fourth quarter totaled \$4.5 million, or a loss of \$0.40 per diluted share compared to net income of \$19 million, or \$1.70 per diluted share in the fourth quarter of 2016.

Excluding the impact of tax reform, non-GAAP earnings per diluted share were \$0.71 for the fourth quarter of 2017.

For the full year, net income totaled \$23.6 million, or \$2.09 per diluted share, compared to \$55.1 million or \$4.81 per diluted share in 2016.

Excluding the impact of tax reform, full year 2017 non-GAAP earnings per diluted share was \$3.20.

We generated \$11.3 million in cash provided by operations during the quarter and \$26.6 million for the full year.

Cash and cash equivalents as of December 31, 2017, were \$135.3 million, which is up from \$127 million at September 30.

We used our available cash to pay out \$3.1 million in dividends during the quarter.

On February 6, 2018, our Board of Directors declared a quarterly cash dividend of \$0.13, representing a 8% increase over the prior quarter dividend, which will be payable on March 9, 2018 to stockholders of record as of February 27, 2018.

We look forward to 2018 and remain optimistic in our ability to revitalize companywide growth.

That completes our prepared remarks, and I will now turn the call back over to the operator to begin the question-and-answer session. Operator?

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from the line of Goran Kronic, who is a private investor.

### Unidentified Participant

I have a few questions that are related. I wonder how much of your cash balance was offshore, and now with tax overhaul enacted, what is your plan for the cash outside the U.S.? And what is your effective tax rate going forward?



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**Chris T. Sharnq** - *Natural Health Trends Corp. - CEO, President and Director*

Thank you for calling in, Goran. And essentially, all of our cash balance is offshore, which is as a result of years of our historic profits that has not yet to be repatriated. In our plan, we'll continue to focus on investing in our business, as well as returning capital to our shareholders. And we are very pleased with the tax overhaul that has substantially lowered the cost for us to repatriate our overseas profits.

And we see more flexibility in moving cash around. So I think that's a very good move for us.

We -- at this point, we're not ready to comment specifically on our effective tax rate going forward, and we need more time to evaluate and more details on the rules continue to be available as we speak. So we'll have a better idea about what the tax rate will be going forward in the coming weeks.

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**Operator**

Thank you. Our next question comes from the line of Jeff Wund, who is a private investor.

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**Unidentified Analyst**

Other network marketing companies have introduced their own preferred customer programs. How do you think overall productivity will be impacted, if members are focused on smaller, but more regular product orders? Will that have a negative impact?

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**Chris T. Sharnq** - *Natural Health Trends Corp. - CEO, President and Director*

Thank you for calling in, Jeff. We would like to think that offering a preferred customer account to our members is not as drastic of a move, because, I would like to highlight the fact that our company has never imposed an onerous maintenance requirement on our members. And by that, I meant that we do not require our members to purchase a minimum amount of inventory just to maintain the eligibility of commission payments, as many other peer companies in the business would do.

But with that said, we are only making this preferred customer account so far available in the U.S. and Europe. We have a growing business in Europe. We have a very promising business in the U.S. and they are still relatively small in our overall revenue. And we do have the leader's support, a very strong support to experiment with this preferred customer's account. We are in the phase of evaluating how we do it and we will continue to fine-tune it, as we roll this out in U.S. in the first quarter. And we're a very long way from making a decision about expanding the preferred customers. We certainly will keep you posted as to our progress, and thank you for your question.

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**Operator**

Thank you. Ladies and gentlemen. We have reached the end of our question-and-answer session. This concludes today's teleconference. Thank you for your time and participation. You may disconnect your lines at this time, and have a wonderful day.

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