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NHTC - Q2 2018 Natural Health Trends Corp Earnings Call

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CORPORATE PARTICIPANTS

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

Kimberly Orlando *ADDO Investor Relations - SVP*

Timothy Scott Davidson *Natural Health Trends Corp. - Senior VP, CFO, Chief Compliance Officer & Secretary*

PRESENTATION

Operator

Ladies and gentlemen, greetings, and welcome to the Natural Health Trends Corporation Second Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Kim Orlando of Addo Investor Relations. Thank you. You may begin.

Kimberly Orlando - *ADDO Investor Relations - SVP*

Thank you, and welcome to Natural Health Trends Second Quarter 2018 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 filing with the Securities and Exchange Commission. It should also be noted that today's call will be webcast live and can be found on the Investor Section of the company's corporate website at 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.

Chris T. Sharng - *Natural Health Trends Corp. - President, CEO & 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. We recorded total revenue of \$50.9 million, down only 1% compared to the second quarter of 2017 with a strong gross profit margin of nearly 80%. Compared to the first quarter of 2018, our revenue reflected a continuation of the momentum we established in the fourth quarter of 2017. The 3% sequential decline of quarterly revenue can be attributed to the timing of our promotional activities. Major incentive trips such as those to Australia and Seattle took members out of the markets in the second quarter, but the qualifications for them concluded in prior period. Since the end of March, the Chinese yuan depreciated by 8% against the U.S. dollar through July, increasing the amount of yuan, our Chinese members need in order to buy our products. Further, there has been a lot of talk and some actions regarding a potential trade war. Although, the recent changes in the trade environment have not impacted our financial results or operations, we are uncertain whether or how we may be affected in the future. We have been developing our contingency plans in the event of an escalation that could potentially negatively affect our operations. Partially offsetting the sequential quarter decline were the enhancements we made to our commission plan. To better incentivize up-and-comers and ease rank advancement, along with our effective marketing programs. In mid-April, we traveled to Melbourne and Sydney, Australia with over 240 members, including all of our top leaders. This important 7-day affair was centered on coaching and team building activities. Moreover, as part of our Annual Royal Summit, our top qualifiers and global ambassadors enjoy an extended stay in the Gold Coast. In May, we held our first anniversary celebration in Peru with 1,000 participants to commemorate our first Latin American market. We held recognition ceremonies, training sessions and introduced our Botanical Hand Protector and Triotein product. Despite the numerous other market activities during the quarter, we continue to educate throughout the spring to attract new members and keep our leaders and their groups engaged. We recently held Fly High trainings in China, Seattle and Malaysia. As a reminder, these sessions are crucial to the development and success of those that are considered up-and-comers or for those newer to NHT Global. In Seattle, we hosted 400 attendees in June, mostly comprising of Hong Kong members in addition to those from North America. As part of the Fly High gathering, we introduced Airelle, a new skincare line in North America as a limited time promotion. The (inaudible) sold out within hours and received nearly \$350,000 in orders for the quarter. The skincare line is formulated with natural ingredients and is Hollywood inspired, having been created by a Beverly Hills practitioner with a celebrity clientele. When used daily, the products are clinically



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proven to help slow the signs of aging. In Europe, Russia and Peru, we conducted product roadshows, which aim to strengthen product knowledge, providing the necessary tools to help educate prospective customers. Additionally, we introduced a new shampoo conditioner and body wash in China as part of our beauty line, which has contributed positively to sell so far. In the third quarter, we will unveil our active line, an entirely new product category to complement our existing wellness, lifestyle, herbal, beauty, home and baby lines. Active products will target those that lead an active healthy lifestyle to help support pre-and post-workout endurance and recovery. We will be providing more details around the launch of our active line at our 2018 International Ambassador Academy in Hong Kong later this month. Geographical expansion remains an important focus for us from a diversification standpoint. In China, we are still in process with our application for direct selling license, though the timing of obtaining such a license or whether or not we can obtain one remains beyond our control. In Germany, we are continuing with our effort to ensure compliance with regulatory requirements and are preparing to officially enter this market. In Latin America, we are following up on a growing interest for our products after a very successful first year in Peru and are considering further expansion in the region. For instance, in Mexico, we are preparing our second launch event in Mexico City this month. Southeast Asia also represents a significant opportunity as this market is a natural extension of Greater China. We are in process with product and business registration in Thailand, Indonesia and Vietnam. Meanwhile, I'd like to highlight that we generated \$5.3 million in cash flow from operations during the quarter and paid \$21.6 million in dividends. As returning capital to our valued stockholders remains a top priority. On that note, our Board of Directors recently declared another special dividend in the amount of \$0.25 per share, on top of a regular quarterly dividend of \$0.15 per share, which is up 7% over the preceding quarter. In summary, while our second quarter order volume held and the overall positive sentiments from our leaders is encouraging, we are cautious as it relates to our performance in the second half of the year, given the broader macro factors at play. This includes the potential impact on our operations from the uncertain global trade environment and exchange rate fluctuations. Despite these elements that are beyond our control, we look forward to our International Ambassador Academy this month in Hong Kong and we will focus -- we will continue to focus on geographical expansion opportunities and leader education to further our progress. With that, I'd like to turn the call over to Scott Davidson, our CFO, to discuss our second quarter financials in detail. Scott?

Timothy Scott Davidson - *Natural Health Trends Corp. - Senior VP, CFO, Chief Compliance Officer & Secretary*

Thank you, Chris. Total revenue for the second quarter was \$50.9 million, reflecting a slight decrease of 1% compared to \$51.5 million in the second quarter of 2017 and a 3% decrease compared to \$52.4 million in the first quarter of 2018. Sales in Hong Kong, which account for 88% of our total second quarter revenue, decreased 2% year-over-year to \$44.6 million. Outside of Hong Kong, revenue increased 9% year-over-year to \$6.3 million. Our Active Member base declined by 2% to 93,000 at June 30 from 95,000 at March 31 and by 13% from 107,000 at June 30 of last year. Turning to our cost and operating expenses. Our gross profit margin for the second quarter remains solid at 79.6% compared to 81% in the prior year quarter and 80.5% in the first quarter of 2018. The margin decrease was due primarily to onetime promotions in our China e-commerce business. Commission's expense as a percent of total revenue increased to 43.8% from 42.9% in the second quarter last year and is consistent with the first quarter 2018 rate of 43.9%. Selling, general and administrative expenses for the quarter were \$8.1 million versus \$6.7 million a year ago, primarily due to increases in employee-related cost, partially offset by decreases in professional fee. As a result, operating income for the quarter totaled \$10.1 million compared to \$12.9 million in the second quarter last year and \$2 million in the first quarter of 2018. Our operating income margin was 19.9% compared to 25% in the second quarter of last year and 19.2% in the first quarter of 2018. Our effective tax rate was 11.2% for the second quarter compared to 20.4% in the prior year period and 13.5% in the first quarter of 2018, primarily due to the enactment of the Tax Cuts and Jobs Act. Net income for the second quarter totaled \$9 million or \$0.80 per diluted share compared to net income of \$10.3 million or \$0.91 per diluted share in the second quarter of 2017 and \$8.8 million or \$0.78 per diluted share in the first quarter of 2018. We generated \$5.3 million in cash provided by operations during the quarter compared to \$6.8 million in the prior year quarter. Total cash and cash equivalents were \$128.3 million as of June 30, down from \$145.1 million at March 31. We used our available cash to pay out \$21.6 million in dividends during the quarter. On July 18, our Board of Directors declared a quarterly cash dividend of \$0.15 per share, representing a 7% increase over the prior quarter dividend and a special cash dividend of \$0.25 per share, both of which will be payable on August 24 to stockholders of record as of August 14. That completes our prepared remarks. I will now turn the call back over to the operator to begin the question-and-answer session. Operator?



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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Ladies and gentlemen, we have no questions in queue at this time. At this time, we'd now like to conclude today's teleconference. You may now disconnect your lines at this time. Thank you for your participation, and have a wonderful day.

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