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NHTC - Q2 2019 Natural Health Trends Corp Earnings Call

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CORPORATE PARTICIPANTS

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

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

CONFERENCE CALL PARTICIPANTS

Ariel Papermaster

PRESENTATION

Operator

Greetings, and welcome to the Natural Health Trends Second Quarter 2019 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Ariel Papermaster with Addo Investor Relations. Thank you, you may begin.

Ariel Papermaster

Thank you, and welcome to Natural Health Trends' Second Quarter 2019 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.

It should also be noted that today's call will be webcast live and can be found on the Investor Relations section of the company's corporate website at naturalhealthtrends.com. Instructions can be found for accessing the archived version of the conference call and 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, Ariel, and thanks to everyone for joining us. With me today is Scott Davidson, our Senior Vice President and Chief Financial Officer.

To begin, I'd like to discuss our second quarter performance as well as our initiative to restore top line growth. I will then hand the call over to Scott to discuss our financials in greater detail.

Beginning with our second quarter results. Total revenue was down 54% to \$23.4 million compared to the second quarter of 2018. As we previously disclosed, we voluntarily suspended our member activities during the vast majority of the first quarter and extended that further to the entirety of the second quarter in response to the Chinese government January 8 announcement of its 100-day campaign. Throughout this campaign, which included a thorough review of certain food, equipment, small appliance manufacturers and service providers, that claimed to promote beneficial health functions. Our cooperation with the Chinese government's inspection, investigation and document request has been our top priority.

So the campaign expire in late April. There has been no official conclusion to formally end the program. The operating environment in China remains difficult for companies like ours, However, we were pleased with our leaders' capabilities to come together and adapt our business operations to this new environment. As a result, our second quarter revenue was up 21% compared to the first quarter of 2019. Following the 100 days, we are maintaining our member activity moratorium in Mainland China for the foreseeable future. This entails a voluntary suspension of company-sponsored business meetings and product roadshows.



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I would reiterate my comments from our last call that we strongly support the actions taken by the Chinese government to rule out bad products and defective practices in order to protect Chinese consumers. I still believe that our proactive approach to member activities in China is the best way to position our company for longer-term success despite the interim adverse impact to our financials.

Throughout the quarter, we deployed several different promotions to encourage product purchases which were very well received by our members. Despite the overall year-on-year revenue decrease, our second quarter reorders actually increased over a year ago and accounted for more than half of our total revenue. This is a very constructive development and reflects the underlying strength of our brand and the loyalty of our consumers. Aside from what has been taking place in China, we have been steadily ramping up activities in other promising markets, including Latin America, Southeast Asia and Europe.

Terrific progress has been made in Latin America, led by Peru. Our presence in Peru has more than double in size versus a year ago and has also grown sequentially quarter-over-quarter. We held our Peru Success Forum in Lima in May, drawing in over 2,000 attendees. We are moving forward with building new bases in Bolivia and Colombia.

In Asia, we staged our first Fly High training event for our Chinese members outside China with over 420 attendees in South Korea in early June, and followed that up with an event in Hong Kong with over 400 in attendance. Of note, member sentiment was all around very positive considering the challenges our industry has been facing in China

Additionally, the March introduction of [Adonis], our latest skincare system, performed well with sales reaching an accumulated \$700,000. In Malaysia, we conducted a product roadshow for Premium Noni Juice, which in addition to other product-specific promotions, encouraged strong product reorders.

In India, we celebrated the grand opening of our office in Mumbai just 6 weeks ago. At our April event in Mumbai and Delhi, we introduced both Alura Lux and our Skindulgence firming system, generating \$129,000 in total sales during the second quarter. Further product registration should drive incremental sales during the second half of 2019. We believe that India represents a significant opportunity.

In Europe, we achieved great traction with our growing base of preferred customers, who are those who enjoy our product as consumers and do not look to earn a commission on direct sales of our product. The number of preferred customers grew both year-over-year and quarter-over-quarter, primarily in Sweden, where our preferred customer base was first developed in May of 2017. [We are largely in support] in the success of the preferred customer base. Our hope is it will proliferate into other EU market.

Lastly, we have a brand-new European-specific app in development to facilitate member communication and productivity. Through this proprietary application, we are working to develop an integrated enterprise system to unify the front and the back end software platforms, eventually for all markets. More on this to come in future quarters.

In summary, while we face challenges in China that placed significant pressure on our top line, we were very pleased with the high level of commitment shown by our members through the difficult operating environment.

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 \$23.4 million, a decline of 54% compared to \$50.9 million in the second quarter of 2018, and an increase of 21% compared to \$19.3 million in the first quarter of 2019. The year-over-year decline was primarily the result of the 100-day campaign in China. Our active member base decreased 10% to 78,280 at June 30 from 87,300 at March 31, and was down 16% from 93,000 at June 30 of last year.

Turning to our cost and operating expenses. Gross profit margin of 76.9% declined from 79.6% in the second quarter of last year and improved from 73% in the first quarter of 2019. The year-over-year decline in gross profit margin reflects product promotions and higher logistics cost.

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Commissions expensed as a percent of total revenue of 48.7% increased from 43.8% in the second quarter last year, and decreased from 49.1% in the first quarter of 2019. The year-over-year increase as a percentage of net sales was largely due to higher cost of a special incentive program to help ease qualification status for our members during this extraordinary period.

Selling, general and administrative expenses for the quarter decreased 18% to \$6.6 million from \$8.1 million a year ago and decreased 9% from \$7.3 million in the prior quarter. The decrease versus the same quarter a year ago was primarily due to a decrease in both employee-related cost and credit card fees, partially offset by member-related cost, event cost and professional fees. The decrease versus the prior quarter is due to less event cost as our first major event of the year occurred in March.

As a result, operating loss for the quarter was \$4,000 compared to operating income of \$10.1 million in the second quarter of last year and an operating loss of \$2.7 million in the first quarter of 2019. Our second quarter operating loss included \$1.2 million of mainly team support, product discount and legal cost incurred during the quarter that we do not anticipate to be recurring at this elevated level going forward. We recorded an income tax benefit of \$28,000 for the quarter due to the current period loss. This compares to an income tax provision of \$1.1 million recognized in the second quarter of last year. Net income for the second quarter totaled \$397,000 or \$0.04 per diluted share compared to \$9 million or \$0.80 per diluted share in the second quarter of 2018 and a net loss of \$1.9 million or \$0.17 per diluted share in the first part of 2019.

Net cash used in operating activities was \$3.7 million during the quarter, including a \$1.7 million installment payment on tax payables arising from the 2016 Tax Reform Act, compared to net cash provided by operating activities of \$5.3 million in the second quarter of 2018. Total cash and cash equivalents were \$108.1 million at June 30, down from \$118.7 million at March 31.

During the quarter, we repurchased nearly 613,000 shares of our common stock at an average price of \$10.90 per share for a total of \$6.7 million. As of June 30, \$25.3 million of the previously approved stock repurchase program remain available for future purchases. As always, we will continue to evaluate our capital allocation strategy going forward to deliver increased value to our shareholders.

That completes our prepared remarks. I will now turn the call back over to the operator.

Operator

Thank you. Ladies and gentlemen, this does conclude today's teleconference. We thank you for your participation and you may disconnect your lines at this time.

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