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NHTC - Q4 2018 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 Fourth Quarter and Full Year 2018 Earnings Conference Call. (Operator Instructions)

Please note that this conference is being recorded.

I will now turn the conference over to Ariel Papermaster with Addo. Ms. Papermaster, please begin.

Ariel Papermaster

Thank you, and welcome to Natural Health Trends Fourth Quarter and Full Year 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 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 Investors section of the company's corporate website at www.naturalhealthtrendscorp.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 4:05 p.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.

As a result of the increasingly unpredictable macroeconomic environment, 2018 was a challenging year for our business. Total revenue was $191.9 million compared to $197.6 million in 2017.

This decrease was primarily driven by factors beyond our control, including increased global trade tensions, China's slowing economy and the weaker Chinese currency, which resulted in a more difficult operating environment for our business.

Despite these market conditions, our members maintained solid order volume during the year. The Chinese yuan's depreciation of 10% against the Hong Kong dollar since last February contributed to a 3% decline in revenue for 2018. Without the impact of the yuan devaluation, which effectively makes our products more expensive for our Chinese consumers, revenue for the full year of 2018 would have been flat with 2017.

Importantly, despite a year-over-year decline in our top line, we were able to maintain strong margin profile. For our 2018, our gross profit margin was 80%, and operating income margin was 18%.

Our ability to preserve healthy margins is due to strong consumer demand for our products and our continued proactive expense management to better align our cost structure with current sales levels.

During the quarter, our momentum in Peru continue, as December delivered a record number of orders for this market. We believe this demonstrates the high quality of our Peruvian member base and local leadership team. In addition to Peru, a number of our other markets achieved notable sales growth during the year. Our business in Japan, Korea, the United States and Canada, all grew net sales over 2017 levels. As a result of this success and with the help of our Peruvian leadership team, we are moving forward with building a presence in both Bolivia and Colombia.

Additionally, in India, we have made terrific progress in meeting the regulatory and operational requirements. We are very excited to announce that our members in India are eagerly awaiting our business to be up and running, and we expect to begin taking orders by the end of February and start shipping product in March. India represents a significant opportunity, and we look forward to discussing our attraction in this market in the coming quarters.

As previously discussed, in December 2017, we initiated a preferred customer feature in Europe. Preferred customers are consumers of our products and do not wish to engage in selling. We have continued to refine this offering and have been pleased with the reception, generating a high level of recurring revenue.

To capitalize on this success, we launched a similar program in Japan last month and have plans for other markets as well.

During the quarter, we conducted product roadshows in Canada, Russia, Peru and Mexico, which aimed to strengthen product knowledge, providing the necessary tools to help educate prospective customers.

Also as previously mentioned, we continue to roll out a new active line to complement our existing product categories. The active line products are designed for those who lead an active lifestyle to help support workout endurance and recovery.

We have also begun to release Airelle, our North American skincare line in Peru and Europe. The response to these new products has been very encouraging.

We look forward to introducing them into new markets and further educating our members through various product roadshows set to take place in the first half of this year.

In addition to these events, we sponsor various charitable activities during the quarter to give back to local communities. They spread awareness and foster loyalty through member involvement.

In December, we participated in 2 events in China, a charity walk to raise money for rebuilding local schools and a ceremony to commemorate our donation to low-income families with school-aged children.

Now, I will like to briefly discuss the business environment for us in China. There has been a lot of discussion and speculation following the Chinese government's recent announcement of its 100-day campaign to review and focus on the regulations for certain food, equipment, small appliances and services that producers claim to promote health functions.

While the results of this program have not yet been fully determined, we strongly support this initiative as we believe that this is a positive development that will benefit the Chinese consumers and NHT Global by removing companies that operate illegally, manufacture and sell counterfeit and substandard products and use false advertising and misleading claims.

However, we recognize that this campaign has the potential to make the operating environment more difficult for our business and impact our financial results in the near term. For example, because of this campaign, we voluntarily decided in January to temporarily suspend our member activities as we have previously done in past years to proactively cooperate with all relevant government agencies to ensure we continue to conduct our business in compliance with all applicable laws in China.

While I am confident this is the best approach to position our company to successfully operate in the long-term, the suspension of member activities may have a material adverse effect on our business in the near term.

In summary, I am very pleased with the ability of our company and members to navigate the increasingly difficult and uncertain global trade environment.

While we experienced attractive growth in many markets, our full year order volume held steady from the previous year, and the positive sentiment from our leaders is encouraging.

Given the global macroeconomic climate and the increased regulatory and media scrutiny in China, we are cautious as it relates to our performance in 2019. This includes the potential impact on our operations from the global trade environment and exchange rate fluctuations as well as the Chinese government's 100-day campaign and adverse local publicity.

Despite these elements that are outside of our control, we remain focused 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 fourth 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 fourth quarter was $41.6 million, a 10% decrease compared to $46.1 million in the fourth quarter of 2017.

Sales in Hong Kong, which accounted for 86% of our fourth quarter revenue decreased 10% year-over-year to $35.8 million.

Outside of Hong Kong, revenue decreased 10% year-over-year to $5.8 million.

Our active member base increased 1% to 97,800 at December 31, up from 97,200 at September 30 and up 2% from 95,700 at December 31 last year.

Turning to our cost and operating expenses. Our gross profit margin for the fourth quarter remained solid at 78.8% compared to 79.6% in the prior year quarter, and 78.9% in the third quarter of 2018.

Commissions expense as a percent of total revenue increased to 48.6% from 42.9% in the fourth quarter last year.

On a full year basis, commissions expense was 45.6% of total revenue, up from 42.3% in 2017. The increase as a percent of net sales was primarily due to more benefits earned by our members under our ongoing cash and other incentive programs.

Selling, general and administrative expenses for the quarter were $6.8 million versus $8.2 million a year ago, primarily due to a decrease in employee-related cost.

As a result, operating income for the quarter totaled $5.7 million compared to $8.7 million in the fourth quarter of last year and $7.8 million in the third quarter of this year.

Our operating income margin was 13.8% compared to 18.8% in the fourth quarter of last year and 16.7% in the third quarter of this year.

We recorded an income tax provision of $500,000 for the fourth quarter of 2018, resulting in an effective tax rate of 8.2%.

Our full year effective tax rate was 10.1%. Net income for the fourth quarter totaled $5.6 million or $0.49 per diluted share, compared to a net loss of $4.5 million or $0.40 per diluted share in the fourth quarter of 2017 and net income of $7.6 million or $0.67 per diluted share in the third quarter of 2018.

We generated $4.4 million in cash provided by operations during the quarter and $29.7 million for the full year. Total cash and cash equivalents were $132.7 million at December 31, up from $132.2 million at September 30.

Returning capital to our stockholders remains a top priority. We paid out $3.9 million in dividends during the quarter and $31.5 million in dividends for 2018.

Our strong balance sheet and working capital management enable us to return capital to our stockholders, while simultaneously focusing on our growth initiatives.

As of December 31, $32 million of the previously approved stock repurchase program remained available for future purchases, inclusive of any related estimated income tax.

We will continuously evaluate our capital allocation priorities going forward in a concerted effort to build sustainable, long-term growth for our stockholders.

I am pleased to announce on January 27, 2019, our Board of Directors declared a quarterly cash dividend of $0.16 per share and a special cash dividend of $0.08 per share, both of which will be payable on March 15 to stockholders of record as of March 5.

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

Operator

This will conclude today's conference. You may disconnect your lines at this time. We thank you for your participation.
