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NHTC - Q1 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

Greetings, and welcome to the Natural Health Trends Corporation First Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Kimberly Orlando of Addo Investor Relations. Thank you. You may begin.

Kimberly Orlando - *ADDO Investor Relations - SVP*

Thank you, and welcome to Natural Health Trends' First Quarter 2018 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 section of the company's corporate website at 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 would 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.

Our momentum in the back half of 2017 carry into the first quarter with total revenue of \$52.4 million, increasing 14% compared to the fourth quarter of 2017 and decreasing 13% year-over-year. Importantly, the first quarter of 2018 marked our second consecutive quarter of sales growth since the second quarter of 2016. Our improved top line performance versus the prior quarter is a direct result of the substantial advancements we made during the prior 2 quarters to revitalize sales.

Specifically, we believe that the enhancement made to our commission plan to better incentivize up-and-comers and ease rank advancement, along with our effective marketing programs, drove the sequential sales growth. As previously discussed, we began implementing additional enhancements to help direct more resources to lower and mid-level rank members, including a onetime cash bonus for new participants in the international recognition program.

In January, we held our international Ambassador Academy in Hong Kong, attended by over 5,500 people. This year, the orders generated by promotions directly related to the event exceeded those of the last 3 years. As part of the occasion, we introduced our new product, CurcuMore,



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producing nearly \$600,000 in orders during the quarter as well as announced various new and exciting programs for the year ahead, which I will discuss in a moment.

Our revenue for the quarter improved despite the Chinese New Year and the holiday-related customs shutdown in mid-February. In anticipation of the closure, we did as much as we could to prepare by working directly with our leaders to preship products and were, therefore, able to mitigate some, but not all, of this logistic challenge.

Our gross profit margin for the first quarter remained strong at 80.5% compared to a record 81.2% in the first quarter of 2017. Through our ongoing proactive expense management to better align our cost structure with current sales levels, we also reported a robust operating income margin of 19.2%, as we stated that we will try targeting our profit margin to be in the high teens, compared to 21.7% in the first quarter of 2017.

During the quarter, we hosted several excursions, with many more planned for the remainder of the year. The qualification period for our first trip of 2018 ran through the end of 2017, where a group of over 240 traveled to Melbourne and Sydney, Australia in mid-April. The 7-day affair involved phenomenal performances, motivational speakers, coaching and team building exercises. Our top qualifiers and global ambassadors enjoy an extended stay in Gold Coast as part of our annual Royal Summit.

During this high-profile experience in Australia, where all of our top leaders were present, we announced a 2-month qualification for elite members to participate in an exclusive journey to Northern California scheduled for July. Here, they will have the opportunity to take part in targeted training sessions and to share best practices with their North American counterparts. Additionally, the qualification period for Greater China and North American members to travel to South Africa in the fourth quarter concludes in June.

In the Peruvian market, those meeting the criteria are entitled to 3 separate rewards, either travel to Cartagena, which took place in early April; Hong Kong in August for our 2018 Ambassador Academy; or Cancún this coming September. Not only are these events hugely impactful when it comes to team building and engagement, but they also help to boost order volume and rank advancement in our international recognition program.

Those that are eligible will also have the opportunity to attend several upcoming Fly High trainings, key to the development and success of those that are considered up-and-comers or for those newer to NHT Global. We already have roughly 1,000 set to participate in May for our Fly High in Chengdu in Southwest China as well as more than 400 for Seattle in June and over 2,000 for Malaysia in early July.

We also conducted product roadshows in China and in Kuala Lumpur on both StemRenu and RespFactor, generating a lot of excitement in those regions. It is clear that the leaders are responding positively to the enhancement we made and that our efforts to continue strengthening their product knowledge by providing the necessary tool set to expand their business and attract new customers is paying off.

Geographical expansion remains a key focus as we continue to concentrate not only on growth in our existing markets, but on entry into new attractive market to help diversify our presence.

In China, we are still in process with our application for a direct-selling license, though the timing of obtaining such a license and whether or not we can obtain one remains beyond our control. As communicated previously, we plan to be transparent as material developments arise.

In Germany and in Mexico, while it is still early, we have identified potential leaders in both countries and are continuing to work through the associated product and business registration requirements. In Mexico, we have an event this upcoming weekend with 100 confirmed attendees. In Germany, we recently consulted with local professionals and received a green light on our global marketing plan. We are actively registering dietary and food supplements according to German regulations.

Southeast Asia, as a natural expansion to our already significant Greater China market, continues to be a priority for us as well. And we are in the process of product and business registration in Thailand, Indonesia and Vietnam.



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Returning capital to our valued stockholders remains a priority. We generated \$11.1 million in cash flow from operations during the first quarter as well as paid out \$1.5 million in quarterly dividends. Additionally, following an evaluation of the 2017 Tax Cuts and Jobs Act, our Board of Directors declared a special dividend in the amount of \$20 million or \$1.76 per share.

In closing, 2018 is off to a good start despite the adverse effect that the customs slowdown had in our Hong Kong business. Our leaders remain energized and enthusiastic, and we look forward to more productive incentive trips and targeted training programs in 2018 to drive further progress and growth.

With that, I'd like to turn the call over to Scott Davidson, our CFO, to discuss our first 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 first quarter was \$52.4 million, a 13% decrease compared to \$59.9 million in the first quarter of 2017 and a 14% increase compared to \$46.1 million in the fourth quarter of 2017.

Sales in Hong Kong, which accounted for 91% of our first quarter revenue, decreased 13% year-over-year to \$47.6 million.

Outside of Hong Kong, revenue decreased 11% year-over-year to \$4.7 million.

Our Active Member base declined slightly to 95,000 at March 31 from 95,700 at December 31 and from 114,000 at March 31 last year.

Turning to our cost and operating expenses. Our gross profit margin for the first quarter remained strong at 80.5%. The prior year margin of 81.2% was higher due to greater event ticket revenue. Commissions expense as a percent of total revenue increased to 43.9% from 43.4% in the first quarter last year and is in line with the full year 2017 rate.

Selling, general and administrative expenses for the quarter decreased 6% to \$9.1 million versus \$9.7 million a year ago.

As a result, operating income for the quarter totaled \$10 million, a decrease of 23% compared to \$13 million in the first quarter last year. Our operating income margin was 19.2% compared to 21.7% in the first quarter last year.

Our effective tax rate was 14% for the first quarter compared to 21% in the prior year period due to the enactment of the Tax Cuts and Jobs Act.

Net income for the first quarter totaled \$8.8 million or \$0.78 per diluted share compared to net income of \$10.4 million or \$0.93 per diluted share in the first quarter of 2017.

We generated \$11.1 million in cash provided by operations during the quarter compared to \$13.8 million in the prior year quarter.

Total cash and cash equivalents totaled \$145.1 million as of March 31 were up from \$135.3 million at December 31. We used our available cash to pay out \$1.5 million in dividends during the quarter.

On April 17, 2018, our Board of Directors declared a quarterly cash dividend of \$0.14 per share, representing an 8% increase over the prior quarter dividend as well as a special cash dividend of \$20 million or \$1.76 per share, both of which will be payable on May 25 to stockholders of record as of May 15.

We think our first quarter results represent a good start to the year, and we look forward to continuing to revitalize growth and deliver improved financial performance in 2018 and beyond.

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) Thank you. This does conclude the question-and-answer session as well as today's teleconference. You may disconnect your lines at this time. Thank you again for your participation.

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