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NHTC - Q3 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 Third Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. I'd 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 Third 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 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.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.

Total revenue for the third quarter was \$47 million, a 17% increase year-over-year. The increase was driven by momentum we created since the beginning of this year. Many of our Chinese groups have managed strong volume growth over last year. This momentum has carried forward despite a generally difficult trading environment. In the third quarter of 2017, market conditions were impacted by Hong Kong's handover anniversary and the Communist Party's National Congress. This year, we are facing new challenges arising from the ongoing trade disputes between the U.S. and China.

So far in 2018, both a rapidly depreciating Chinese yuan down 10% since February and the seasonality associated with the summer months contributed to an 8% decline in our revenue from the second quarter to the third quarter this year. Without the adverse effect of the yuan devaluation, our third quarter revenue would have been flat with the second quarter.

In regard to our growth initiatives, I'll first focus on our geographical expansion plans, followed by leader training and engagement and product expansion. During the quarter, we made progress in Latin America with a successful standing-room only event, building our future in Mexico City. The Mexican market is energized, and members are looking forward to their next event to be held in early December where we plan to introduce our Omega-3 and Botanical Hand Protector products. Additionally, we are taking preliminary steps to expand our reach into Bolivia and Colombia, given the strong reception and traction we experienced in the Peruvian market and the contacts that our existing members have in these countries.



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Another expansion target we are excited to announce is India. So far, we have engaged a service provider to assist with product registration and are making progress with setting up the regulatory infrastructure in identifying local partners. We look forward to discussing our progress in India in the coming quarters.

In regard to leader training and engagement, we held the Hong Kong Ambassador Academy in August, our largest event of the year with over 4,200 attendees. Product sales exceeded \$5.3 million, fueled by several successful outside promotions.

As previously discussed, we launched our new active line to complement our existing product categories. The active line products are geared towards those that lead an active and healthy lifestyle to help support pre and post workout endurance and recovery. We also released Adaptogen, a red ginseng tea, and have begun to rollout Airelle, our North American skincare line internationally. The response to our 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 before the end of the year.

In July, we hosted another successful Fly High training event in Kuala Lumpur with 300 members participating in personal development activities, leadership seminars and product training. Attendees, mostly Chinese, also tour our Malaysian office to learn more about the market and join in team building activities.

In the current quarter, we have qualification period underway for an extended trip to Switzerland in 2019, and this week, 230 of our Chinese members would travel to South Africa.

In summary, our performance in the third quarter reflected a continuation of the effectiveness of our marketing programs and solid demand for our products since the beginning of the year. Overall, the macro economic environment remains challenging due to the potential impact, global trade conflicts as well as additional exchange rate fluctuations that could effectively make our products more expensive. We had no control over these conditions, but I think we've been doing a good job navigating in an increasingly difficult and unpredictable setting. With that, I'd like to turn the call over to Scott Davidson, our CFO to discuss our third quarter financials in detail. Scott?

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

Thank you, Chris. \$47 million in total revenue for the third quarter was 88% comprised of sales from Hong Kong, which increased 18% year-over-year to \$41.4 million. Outside of Hong Kong, revenue increased 10% year-over-year to \$5.6 million.

Our Active Member base increased 4% to 97,000 at September 30, up from 93,000 at June 30, and down 3% from 99,700 at September 30 of last year.

Turning to our cost and operating expenses. Our gross profit margin for the third quarter remains solid at 78.9% compared to 79.6% in both the prior quarter and the second quarter 2018. This slight decline was primarily due to product promotions in Hong Kong and higher freight cost partially related to the shipment of free promotional items. Commissions expense as a percent of total revenue increased to 46.8% from 39.4% in the third quarter last year, and is higher than the Q2 year-to-date rate of 43.8% mainly due to higher estimated cost for ongoing cash and other incentive programs.

Selling, general and administrative expenses for the quarter were \$7.3 million versus \$7.6 million a year ago, primarily due to decreases in employee-related costs, which were partially offset by an increase in credit card fees. As a result, operating income for the quarter totaled \$7.8 million compared to \$8.5 million in the third quarter last year and \$10.1 million in the second quarter this year. Our operating income margin was 16.7% compared to 21.2% in the third quarter last year and 19.9% in the second quarter this year.

Our effective tax rate was 5.8%, incorporating a benefit of \$496,000 recognized during the third quarter as a result of the finalization of the deemed repatriation transition tax. Without the onetime benefit, our third quarter effective tax rate would have been 11.9%. Net income for the third quarter totaled \$7.6 million or \$0.67 per diluted share compared to net income of \$7.3 million or \$0.65 per diluted share in the third quarter of 2017, and \$9 million or \$0.80 per diluted share in the second quarter 2018.

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We generated \$8.8 million in cash provided by operations during the quarter compared to using \$5.3 million of cash from operations in the prior year quarter. Total cash and cash equivalents were \$132.2 million at September 30, up from \$128.3 million at June 30. As returning capital to our stockholders is a top priority, we used our available cash to pay out \$4.6 million in dividends during the quarter.

On October 21, 2018, our Board of Directors declared a quarterly cash dividend of \$0.16 per share, representing a 7% increase over the prior quarter dividend and a special cash dividend of \$0.18 per share, both of which will be payable on November 23 to stockholders of record as of November 13. That completes our prepared remarks. 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) This concludes today's question-and-answer session as well as today's teleconference. Thank you for your participation. You may disconnect your lines at this time.

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