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NHTC - Q3 2017 Natural Health Trends Corp Earnings Call

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## NOVEMBER 01, 2017 / 3:30PM, NHTC - Q3 2017 Natural Health Trends Corp Earnings Call

### CORPORATE PARTICIPANTS

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

**Kimberly Orlando** *ADDO Investor Relations - SVP*

**Timothy Scott Davidson** *Natural Health Trends Corp. - CFO, Chief Compliance Officer, SVP and Secretary*

### PRESENTATION

#### Operator

Greetings, and welcome to the Natural Health Trends Corporation Third Quarter 2017 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.

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#### **Kimberly Orlando** - *ADDO Investor Relations - SVP*

Thank you, and welcome to Natural Health Trends Third Quarter 2017 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 section of the company's corporate website at [www.naturalhealthtrendscorp.com](http://www.naturalhealthtrendscorp.com).

Additionally, in today's financial results press release, which was issued at approximately 9:00 a.m. Eastern time, instructions can be found for accessing the archived version of the conference call via the Internet.

At this time, I'd like to turn the call over to Chris Sharng, President of Natural Health Trends.

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#### **Chris T. Sharng** - *Natural Health Trends Corp. - CEO, President and 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 of \$40.1 million declined by 43% from the third quarter of 2016, and by 22% from the second quarter of 2017.

While we have made progress to revitalize sales growth, certain short-term factors exerted significant adverse effects and masked a quarter that was otherwise indicative of positive developments. The difficult market conditions we've been experiencing since the third quarter of 2016 was further compounded by the 20th anniversary of Hong Kong's handover in July as well as China's Communist Party's 19th National Congress in October, which tempered economic activities. These events impacted the operations of our logistics partners and detracted from our leaders' ability to organize meetings, which hindered our progress in comparison to the prior quarter. However, we view both occurrences as short-term issues.

Despite a challenging environment, on-site and follow-up orders for the Kuala Lumpur event in August was substantially greater than those of the Macau event in March. A number of our emerging markets still achieve impressive sales growth during the quarter, including Peru, Northern Europe, Southeast Asia and Japan. We also had a positive response to our most recent product introductions, notably, OcuFocus, NaturalGlo and CogniMax.



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Further, we were able to maintain a strong gross profit margin of nearly 80% and generate an operating income margin of over 21%. Our ability to preserve healthy margins is due to the strong allegiance of consumers to our products and our continued proactive expense management to better align our cost structure with a more limited upside opportunities we have been seeing in the field.

To help counter the slowdown and drive momentum in Asia, we recently enhanced our incentive programs and adjusted our bonus and reward programs in an effort to provide more resources to up-and-coming members.

We enhanced our matching bonus program in July, to motivate our top leaders to help their down line members earn increased commissions.

Instead of basing on performance for 2 consecutive months in a quarter, rank advancement can now be achieved with any 2 consecutive months throughout the year. The change was well received by our leaders who are expected to take advantage of this in the coming months.

We held 2 incentive trips during the quarter. In late September, we hosted a 6-day cruise for more than 1,300 members through East China sea from Shanghai to multiple ports in Japan.

In addition, our qualifying European members traveled to Prague for an incentive trip in late September. Overall, sentiment during the trips was very positive and we remain optimistic that these programs would generate incremental product orders and continue engagement in the business.

The qualification period for our new incentive trip to Australia runs through the end of the year. It is designed to focus on strengthening team development and promoting existing member advancement in our international recognition program.

In early October, we sponsored a series of events near Shanghai, where more than 1,400 members were in attendance. We also just completed our second domestic Fly High training, with 1,200 guests attending in Changbai in Eastern China as well as hosted a charity walk with 1,600 people participating in Taigen in Northern China.

Our fast-growing European business has center in Sweden, Finland and Ireland. To capitalize on Northern Europe's continued strong performance with double-digit growth, we plan 2 upcoming events in December. Our inaugural European Success Forum will take place in Stockholm. In conjunction with this, we will host an incentive program in Stockholm for our qualifying leaders in the region. Furthermore, our on-road royal summit incentive trip for our top leaders will be in Sweden in December. We expect these programs will increase productivity among our Active Members and create excitement around our products to drive further growth in Europe.

Expansion into new international markets remains an important priority. As we mentioned in July, we celebrated our official opening in Peru with more than 600 members in attendance. We have since received multiple registration approvals for our top-selling products, including Premium Noni Juice, StemRenu and (inaudible). Since opening this market, we have enrolled more than 9,000 Peruvian members and product orders continue to surpass our expectations, totaling \$200,000 in the third quarter and \$670,000 year-to-date. We believe this speaks to the high quality of our Peruvian member base and local team leadership.

We held our second half major event branded this year as the Ambassador Academy in Kuala Lumpur in August. Following the receipt of approval for direct-selling license in Malaysia. This 2-day event with over 5,300 mostly chinese attendees included product training, member recognition and new product launches.

New product introductions at this event included Biocell SC and Resp Care, and that is Resp Care. Biocell SC is a clinically proven trans stem cell infused version of our Biocell's skin care mask. Resp care is a liquid nutritional settlement, uniquely formulated to help protect lungs from airborne toxins.

To further support our growing U.S. member base on the East Coast, we are building our third North American Healthy Lifestyle Center Plus or HLC Plus in Metuchen, New Jersey. As a reminder, an HLC Plus is a brick-and-mortar multifunctional space designed to provide members with the opportunity to personally experience our products as well as a place to conduct meetings and training. We anticipate the grand opening will take place in early 2018.

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In China, we are still in process with our application for a direct selling license. However, the timing of obtaining the license and whether or not we can obtain one, remains beyond our control. We are working with the Chinese government through the proper steps and will provide updates as material developments arise.

Before I conclude, I'd like to touch on our allocation of capital. We generated \$15.3 million in cash flow from operations during the first 9 months of 2017, and are comfortable with our overall liquidity position. We paid out over 90% of our cash flow from operations in dividends and remain in a position to continue to return cash to our stockholders, given our strong balance sheet and management of working capital.

Despite, the long and short-term challenges that have continued to overshadow our positive momentum, we are confident in our ability to revitalize sales in our Asian market. We have been able to retain all of our top [world] leaders since the slowdown began a year ago and are actively working to enhance our sales force.

With that, I'd like to turn the call over to Scott Davidson, our CFO, to discuss our third quarter financials in detail. Scott?

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### **Timothy Scott Davidson** - *Natural Health Trends Corp. - CFO, Chief Compliance Officer, SVP and Secretary*

Thank you, Chris. As discussed, total revenue for the third quarter was \$40.1 million, reflecting a decrease of 43% compared to \$70.7 million in the third quarter of 2016. Sales in Hong Kong which accounted for 87% of our third quarter revenue, decreased 47% year-over-year to \$35 million. Outside of Hong Kong, revenue increased 6% year-over-year to \$5.1 million.

Our Active Member base declined to approximately 99,700 at September 30, from 107,300 at June 30 and from 122,900 at September 30 of last year.

In regards to our cost and operating expenses. Our gross profit margin for the third quarter was 79.6% compared to 80.7% in the third quarter last year. The slight reduction was due to lower event revenue this year, offset by reduced shipping cost.

Commissions expense as a percent of total revenue decreased to 39.4% from 43.3% in the third quarter last year, primarily due to less cost incurred for our third quarter incentive trip than we expected. Excluding this benefit, commissions expense as a percent of net sales for the third quarter of 2017 would've been consistent with the prior quarter.

Selling, general and administrative expenses for the quarter decreased 33% to \$7.5 million versus \$11.2 million a year ago. The decrease in SG&A versus the prior year period reflects the proactive cost reduction measures we have been implementing since the fourth quarter last year.

Operating income for the quarter totaled \$8.5 million, a decrease of 44% compared to \$15.2 million in the third quarter last year. As a percentage of total revenue, our operating income margin was 21.2% compared to 21.5% in the third quarter last year.

We continued to recognize an income tax provision for the expected partial repatriation of overseas profits. The effective tax rate of 14% for the third quarter compared to 18% in the prior year period was due to a true-up of foreign tax credits generated for prior tax years.

Net income totaled \$7.3 million or \$0.65 per diluted share as compared to net income of \$12.6 million or \$1.12 per diluted share in the third quarter last year.

Cash and cash equivalents as of September 30, 2017, were \$127 million, which was down from \$136.3 million at June 30.

During the quarter, we paid out \$4.1 million in dividends as well as \$5 million related to federal income taxes.

On October 30, our Board of Directors declared a quarterly cash dividend of \$0.12 per share as well as a special cash dividend of \$0.15 per share, both of which will be payable on November 24, to stockholders of record as of November 14.



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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) Our first question comes from the line of Jeff Lund, a private investor.

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**Unidentified Participant**

Chris, this is Jeff. I had a question about your dividend plan for the quarter. The current tax plan in Congress calls for some changes to corporate taxes. Why not wait to see what happens with that plan?

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

Thank you, Jeff, for calling in. The board is committed to returning capital to our shareholders and the review of capital allocation and capital return is ongoing. And we don't profess to know any more than the market, what is going on in DC with respect to this tax bill. We still keep an eye on it and it's still that it seems incorporated in our thinking. The board is absolutely confident in the business prospect for our business in the near term and also in the long term and is very comfortable with the liquidity situation that we have now. So I would strongly emphasize that the dividend and also potential of the stock repurchase continue to be available for us to return capital.

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**Operator**

Our next question comes from the line of Gordon (inaudible), a private investor.

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**Unidentified Participant**

Chris, a couple of months ago, the Chinese government was reported to announce a new policy of cracking down on pyramid schemes. Now you talked about the effects of the Hong Kong handover and the National Congress. So I was wondering did this, in any way, affect the third quarter?

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

Thank you for calling in, Gordon. Indeed, the Chinese government about 2 months ago announced a policy or campaign to crack down on -- on an anti-pyramid scheme. And even in our field, we have observed that the pyramid scheme have become increasingly rampant and aggressive. And in certain cities, it has impacted us negatively. We think that this is a good policy. We think that -- we would like to see that this policy will be effectively and fairly implemented and maintained for the long term. It will be good for our business.

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**Operator**

Thank you. We have reached the end of the question-and-answer session. And with that, the conclusion of today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.

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