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NHTC - Q1 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

Ladies and gentlemen, greetings, and welcome to Natural Health Trends Corporation First Quarter 2019 Earnings Conference Call. (Operator Instructions) As a reminder, this program is being recorded.

It is now my pleasure to introduce your host, Ariel Papermaster. Thank you. You may begin.

Ariel Papermaster

Thank you, and welcome to Natural Health Trends First 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 result of certain factors, including those set forth in the company's filings and 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 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.

I'll first walk through our high-level financial results, and then comment on our initiatives to renew growth before I turn the floor over to Scott to discuss our financials in greater detail.

Beginning with our first quarter results. As we previously disclosed, we voluntarily suspended our member activities during the first quarter of 2019, in response to the Chinese government's announcement of its 100-day campaign in early January. Our deliberate suspension covered more than 90% of the number of days in the quarter, which also included the Chinese New Year holidays. As a direct result, our first quarter total revenue was down 63% to \$19.3 million compared to the first quarter of 2018.

The 100-day campaign technically expire in late April, though, there has been no official conclusion to formally end the program. While our first quarter was severely impacted by this initiative, 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 deceptive practices in order to protect Chinese consumers. I believe our proactive suspension of member activities was the best approach to position our company for long-term success, despite the average impact to our financials.



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The decline in net sales was also maximized by additional factors beyond our control, including increased global trade tensions and a weaker Chinese currency. Without the year-over-year impact of the yuan devaluation of 6% against the Hong Kong dollar, which effectively made our products more expensive for our Chinese consumers, revenue for the first quarter of 2019 would have been \$20.2 million. Aside from what has been taking place in China, there is positive developments transpired during the quarter, including in Hong Kong, India, Peru and Mexico.

In Hong Kong, we ended the quarter on a positive note with our successful major event, which was attended by 3,000 people. Importantly, all of our top leaders who have remained with NHT Global through our voluntary suspension and the government's 100-day campaign, were present and enthusiastic at the event. This gives us great confidence in their ability to navigate the business through challenging times and to ultimately contribute to renew growth, once the macro climate improves.

The event generated \$2.3 million in orders and was followed by an incentive trip to Thailand for close to 300 qualifying members. We also introduced a new addition to our beauty line called Adonis, a brightening skincare system. Sales from Adonis topped \$225,000. I should note that most of our first quarter product orders were received in the beginning of the quarter, prior to our suspension of member activities and at the end of the quarter, when we staged this major event in Hong Kong.

Our progress in India was another highlight of the quarter. We now have a team of talented professional staff on the ground, supporting a growing member base and top leaders. We engage a local logistics partner and were able to start taking orders at the end of February, but those products already register and began shipping products in March. Further, with the financial infrastructure in place, we are now able to accept payments via local credit cards and make commission payments. We also just completed an incentive, so that many of our new members can attend our office grand opening celebration in Mumbai early June. We believe India represents a significant opportunity.

Our momentum in Peru continue, with a 2019 recognition event in Lima, drawing over a 300 attendees for an inspiring afternoon, complete with guest speakers to showcase of strength of our leader base and product lines, including the introduction of our BioCell SC anti-aging facial mask. With the help of our Peruvian leadership team, we are moving forward with establishing a presence in both Bolivia and Colombia.

In Mexico, we are continuing our marketing efforts and had a productive product roadshow in February, highlighting our Omega-3 and Botanical Hand Protector.

In summary, while we anticipated that our first quarter performance will be significantly impacted due to our proactive response to China's 100-day campaign. We had great confidence in our ability to operate the business through challenging times and to renew growth once the national climates improves.

While we are cautious, as it relates to our overall performance for the remainder of 2019, given the uncertain trade and regulatory environment. We were pleased with the outcome of our successful major event in Hong Kong at the end of March and ongoing support of our market leaders. We're also thrilled to have launched NHT Global in India and remained encouraged by the continuing growth in Latin America, led by Peru.

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 \$19.3 million, a 63% decrease compared to \$52.4 million in the first quarter of 2018. The sales decline was primarily due to a decrease in Greater China revenue.

Our active member base decreased 11% to 87,300 at March 31, down from 97,800 at December 31, and down 8% from 95,000 at March 31 last year.

Turning to our cost and operating expenses. Our gross profit margin for the first quarter was 73% compared to 80.5% in the first quarter of last year. The decline in gross profit margin reflects special product promotions design for the quarter and higher logistics cost.



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Commissions expense as a percent of total revenue increased to 49.1% from 43.9% in the first quarter last year. The increase as a percent of net sales was largely due to a onetime special incentive in March to help these qualifications status for our members during an extraordinary quarter, which resulted in incremental incentive cost of 5.9% of revenue for the quarter.

Selling, general and administrative expenses for the quarter decreased 20% to \$7.3 million from \$9.1 million a year ago, primarily due to a decrease in both employee-related cost and credit card fees, partially offset by distributor and other event cost.

As a result, operating loss for the quarter was \$2.7 million compared to operating income of \$10 million in the first quarter of last year. Our first quarter operating loss included approximately \$2.4 million of marketing, product discounts and legal cost incurred during the quarter that we did not anticipate to be recurring at this elevated level going forward.

We recorded income tax benefit of \$354,000 for the quarter, due to the current period loss. This compares to an income tax provision of \$1.4 million, recognized in the first quarter of last year, which resulted in an effective tax rate of 14%.

Our net loss for the first quarter totaled \$1.9 million or \$0.17 per diluted share compared to net income of \$8.8 million or \$0.78 per diluted share in the first quarter of 2018.

Net cash used in operating activities was \$11.4 million during the quarter compared to net cash provided by operating activities of \$11.1 million in the first quarter of 2018.

Total cash and cash equivalents were \$118.7 million at March 31, down from \$132.7 million at December 31.

As of March 31, \$32 million of the previously approved stock repurchase program remained available for future purchases.

As always, we will continue to evaluate our capital allocation strategy going forward to deliver increased value to our shareholders. As noted in our financial results press release issued earlier this morning, we are pleased to announce that we have regained compliance with NASDAQ from listing requirements.

We received a letter from the Listing Qualifications Department of NASDAQ on April 29, confirming we regained compliance following the April 26 filing of our 2018 Form 10-K. With this matter now resolved, we remain focused on revitalizing growth and driving value for our shareholders.

In conclusion, while the first quarter was highly challenging from a macroeconomic perspective, we remain cautious -- cautiously optimistic that we can deliver improved financial performance in 2019 and beyond. That completes our prepared remarks. I will now turn the call back over to the operator to begin the question-and-answer period. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of [Jeff Lund], a private investor.

Unidentified Analyst

Chris, so if I heard correctly for the first quarter, if you exclude the special items of spending that you don't believe will be recurring, you guys almost broke even. Is that correct?

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

Thanks for calling in, [Jeff]. And mathematically, that's correct. But we do believe that those items -- and you're referring to the product discounts, the special incentives and legal and marketing expenses were necessary to manage the extraordinary circumstances of the quarter. We do have a very low fixed overhead base and our spending is tightly managed to be co-measured with the top line. Thank you for the question.

Operator

Our next question comes from the line of [Gorian Clonake], a private investor.

Unidentified Participant

Chris, so the 100-day campaign was over in April, are you back to normal trading conditions now?

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

Thank you for calling in, [Gorian]. We mentioned in our disclosure that we didn't see an official conclusion to end the 100-day campaign. And we also learned rather early on in this campaign that according to directors from the central government, the interpretation and the enforcement of the campaign were left to the local government. Therefore, I expect that we will have to work our way through the process, province by province and city by city for some time. And we do regularly communicate with our contacts at various levels of the government, and we will follow due guidance. Thank you for your question.

Operator

Thank you. Ladies and gentlemen, that is all the time we have for questions today, and this does conclude our teleconference. You may now disconnect your line at this time. Thank you for your participation, and have a wonderful day.

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