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NHTC - Q1 2020 Natural Health Trends Corp Earnings Call

EVENT DATE/TIME: MAY 06, 2020 / 3:30PM GMT



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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

Kimberly Orlando *ADDO Investor Relations - SVP*

PRESENTATION

Operator

Greetings, and welcome to the Natural Health Trends Corp. First Quarter 2020 Earnings Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Kim Orlando, ADDO Investor Relations for Natural Health Trends. Thank you. You may begin.

Kimberly Orlando - ADDO Investor Relations - SVP

Thank you, and welcome to Natural Health Trends' First Quarter 2020 Earnings Conference Call. During today's call, there may be statements made relating to 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 as a 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 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, Kim, and thanks to everyone for joining us. With me today is Scott Davidson, our Senior Vice President and Chief Financial Officer.

It was a challenging first quarter for our business with total revenue of \$14.9 million, declining 23% compared to the prior year period. Before Scott walks you through the financials in greater detail, I'd like to begin by discussing the COVID-19 pandemic and its impact to our business as well as the actions we have been taking to address this unprecedented situation. First and foremost, our thoughts are with all of those around the world who have been impacted by the coronavirus. While these circumstances are beyond our control, I am pleased we have continued to run our operations efficiently with the health and safety of our employees, members and customers guiding our decisions as our top priority. The impact of the pandemic followed the already difficult operating conditions we experienced throughout 2019 related to China's 100-day campaign: negative sentiment associated with health products companies on social media in China, ongoing global trade tensions and civil unrest in Hong Kong.

As discussed on prior conference calls, we made the decision in early 2019 to voluntarily suspend our member activities as a result of all of the aforementioned factors. Despite the negative impact on our financial performance, that decision has served us well in the current environment. While we could have never foreseen the impact COVID-19 would have on the global economy, we focused our efforts in 2019 on preparing our business to adapt to new realities following China's 100-day campaign and have been applying key learnings from our experience to support our affected market.



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In January, COVID-19 spread throughout the Hubei province in which Wuhan is the capital and into Greater China, directly impacting our largest market and resulting in a government-mandated quarantine and extensive delays to parcel deliveries. Since we started implementing aggressive cost reduction measures beginning in the second half of 2019, we were able to effectively narrow the scope of our first quarter operating loss and corresponding decline in cash flow from operations despite the fact that our main markets were under severe lockdown for most of the first quarter of 2020.

Further, we continued to generate orders and took prudent measures to mitigate supply chain disruptions and ensure ample product availability to fulfill those orders. We were pleased that our members reacted positively to the incentives we put into place. Even though we did not hold a major event in March as originally planned, we came to this decision ahead of the government restrictions related to COVID-19 to ensure the health and safety of our employees, members and customers. I feel confident our members will work together through these unprecedented times with our support and that we will emerge from this downturn even stronger than before given the nature of our superior business model, high-quality product lineup, robust marketing plan, strong balance sheet and high level of financial flexibility and stable and resilient field leadership.

I will now walk through each of these in detail. First, we have a superior business model. We operate an e-commerce platform which does not require much physical contact. A wide array of technology enables us to keep sharing information about our high-quality products with anyone in the world. Many of our markets moved their training events to webinars and adapted their member services to various social media platforms to overcome restrictions on personal mobility. We want to be connected to our members as intensely and if not more than before the COVID-19 pandemic.

Second, we have a great lineup of products. We firmly believe in the efficacy and the quality of our products. This health crisis facilitated the sales of several of our immune-boosting products, in particular, including our Enhanced Essential Probiotics and Premium Noni Juice. In addition, we have plans to launch several new products in various markets beginning in the second quarter of this year.

Third, we have a robust marketing plan in place. We are deploying new and rewarding promotional programs made possible by our effective inventory management and are adapting our marketing programs as needed.

Fourth, we have a strong balance sheet and a conservative capital allocation philosophy to support our members and business. We have ample liquidity with \$95 million in cash and cash equivalents, 0 debt and no bank loans of any kind. Further, our highly variable cost structure allows us the flexibility to adapt in line with order volume.

As previously announced, we put a program in place in the second half of 2019 to position us for increased operating efficiencies in several areas, including reducing headcount and promotional spending. As a result, we now expect to realize annualized cost savings of approximately \$8 million in 2020.

Last but not least, we have the stability and resilience of our field leadership. I can't emphasize enough how important this is. We have retained all of our leaders throughout the downturn that has persisted over the past couple of years. Our leaders have proven themselves by navigating highly complex operating environments in many situations. I have confidence and rely on their ability to help support and lead our members by example.

In terms of our geographical expansion priorities, I'm happy to report that a number of our new and emerging markets performed well during the first quarter of 2020, including South Korea, Taiwan and Japan. On the other hand, Peru, which had been a very strong market for us, was significantly impacted by COVID-19. A nationwide lockdown has disrupted our members' abilities to hold meetings and events and also affected the delivery of products to certain parts of the country. Since the onset of the crisis, we have fortunately been able to resume shipping into the largest cities in Peru. We are working diligently to support our leadership in the region through additional online training and technological capabilities as the situation stabilizes.

In summary, in light of the high level of uncertainty that still exists in the marketplace, 2020 will be another challenging year for our business given the significant adverse impact COVID-19 has had on the global economy. That said, I'm pleased that we have continued to execute our strategy and run our operations efficiently to ensure the retention of our top leaders who are key to our success. Our leaders did an excellent job navigating this highly fluid, complex situation, and I applaud them for their efforts.



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While we remain cautious on both macroeconomic factors and the spread of the coronavirus in 2020, I have confidence we will emerge from the other side of this pandemic as a much stronger company than before. I'd like to thank all of our leaders, members, employees and investors for their ongoing support of NHT Global and wish you all good health.

With that, I'd like to turn the call over to Scott Davidson, our CFO, to discuss our first quarter 2020 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 of 2020 was \$14.9 million, a decrease of 23% compared to \$19.3 million in the first quarter of 2019. The year-over-year decline was due to the increasingly difficult operating environment and suspension of events and member activities associated with the COVID-19 pandemic, which significantly impacted our results. As Chris mentioned, we did not hold a major event in the first quarter this year, which positively benefited our first quarter of 2019 revenue. To a lesser extent, our revenue was further adversely impacted by the extension of the Chinese New Year holiday and the aftermath of the Chinese government's 100-day campaign.

Our active member base decreased 2% to 56,500 at March 31 from 57,400 at December 31 and was down 35% from 87,300 at March 31 last year.

Turning to our first quarter cost and operating expenses. Gross profit margin of 69.8% declined from 73% in the first quarter last year due primarily to additional logistics costs and product promotions put into place to help address the challenges posed by the coronavirus and the government restrictions put into place to control its spread. Commissions expense as a percent of total revenue declined to 44.2% from 49.1% in the prior year quarter as a result of our proactive efforts to reduce incentive costs. Selling, general and administrative expenses decreased 28% to \$5.3 million from \$7.3 million a year ago, reflecting our cost reduction measures, including reduced headcount and event spending.

When looking at our total operating expenses, the aggressive cost reduction measures we started implementing in the second half of 2019 were partially offset by additional spending during the first quarter in direct response to COVID-19 and the government's measures to control it. As a result of the net effect of these actions, we were able to narrow our first quarter operating loss despite the fact that our main markets were under severe lockdown for most of the first quarter. As a result, operating loss was \$1.4 million compared to a loss of \$2.7 million in the first quarter last year.

We recorded an income tax benefit of \$782,000 for the quarter compared to a benefit of \$354,000 in the first quarter last year. The increased tax benefit for the first quarter is a result of the enactment of the CARES Act in March 2020 as we now expect our 2019 loss to be carried back to offset taxable income in years with higher tax rates.

Net loss totaled \$573,000 or \$0.05 per diluted share compared to a net loss of \$1.9 million or \$0.17 per diluted share in the first quarter of 2019.

Now I'll turn to our balance sheet and cash flow. Total cash and cash equivalents were \$95.4 million at March 31, down slightly from \$96 million at December 31. Net cash used in operating activities was \$990,000 in the first quarter of 2020 compared to \$11.3 million in the first quarter of 2019.

I am pleased to announce that on May 4, our Board of Directors declared another quarterly cash dividend of \$0.20 per share, which will be payable on May 29 to stockholders of record as of May 19, 2020. Our Board of Directors will continue to monitor the economic conditions and evaluate our capital allocation strategy going forward to determine the most efficient use of capital to deliver value to our shareholders.

While no one can predict the duration of the COVID-19 pandemic and its resulted impact on our business longer term, we have maintained a very strong balance sheet and a business model that enables financial flexibility to quickly react to changing market conditions and align our cost structure with current sales levels.

As Chris highlighted, we have ample liquidity with 0 debt, and we remain disciplined in our cost reduction and cash preservation efforts. As we continue to navigate the evolving and uncertain situation, we remain focused on the task at hand: supporting the health and safety of our members, our employees and customers while operating our business as efficiently as possible.



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That completes our prepared remarks. I will now turn the call back over to the operator.

Operator

Thank you. Ladies and gentlemen, this concludes today's call. Thank you for your interest and participation. You may now disconnect your lines.

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