



**Natural Health Trends Corp.**

**Fourth Quarter and Full Year 2016 Earnings Conference Call**

**February 8, 2017**

## CORPORATE PARTICIPANTS

**Chris Sharng**, *President, Chief Executive Officer*

**Scott Davidson**, *Senior Vice President, Chief Financial Officer*

**Kimberly Orlando**, *ADDO Investor Relations*

## CONFERENCE CALL PARTICIPANTS

**Stacy Adler**, *private investor*

**Per Anderson**, *Neologos*

**Will Hamilton**, *Manatuck Hill Partners*

**Jeff Lund**, *private investor*

## PRESENTATION

### Operator:

Greetings and welcome to the Natural Health Trends Corporation Fourth Quarter and Full Year 2016 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Kimberly Orlando of ADDO Investor Relations. Thank you, you may begin.

### Kimberly Orlando:

Thank you and welcome to Natural Health Trends Fourth Quarter and Full Year 2016 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 through 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 Investors 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 am 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.

**Chris Sharnq:**

Thank you, Kim, and thanks to everyone for joining us. With me today is Scott Davidson, our Senior Vice President and Chief Financial Officer.

2016 was a tremendous year for Natural Health Trends despite some external challenges throughout the year. We made solid progress executing against our strategic plan. I'd like to begin with some high level financials.

Total revenue for the fourth quarter was \$62.3 million, a decrease of 15% year-over-year. For the full year of 2016, total revenue increased 9% to \$287.7 million versus \$264.9 million in 2015. The fourth quarter reflected a continuation of some of the challenges we discussed in the prior quarter, including a slowdown in Hangzhou, one of our top three markets, after the G20 summit was held in that city last September. The softness in Q3 continued into October with local members unable to organize activities and events, which are key to their effectiveness. In addition, the Chinese currency depreciation of 7% against the Hong Kong dollar over the past 12 months impacted our top line by effectively increasing the price of our products to our members residing in Mainland China.

Despite these challenges, we were able to successfully manage our expenses to better align with our revenue. As such, we delivered record quarterly operating profit of \$20 million, a 44% increase year-over-year and a 32% increase over the prior quarter. This was achieved due to the flexibility we have built into many of our promotions and incentive programs.

Importantly, despite the sequential quarter-over-quarter revenue decline, we have retained all of our top leaders and morale continues to be strong. We are executing on our strategic plan, which includes leader training and motivation, expansion by both geography and product, and technological advancements to enhance member communication and productivity.

Beginning with leader training and motivation, our approach has been twofold. We have been placing greater emphasis on targeted training programs within the leader groups to improve their overall effectiveness in selling our products. In addition to training, we enhanced our Supreme Bonus program beginning in 2017 to help boost motivation. Our objective is to keep our leaders engaged throughout the entire year so as to not lose motivation in the course of a yearlong qualification period.

Furthermore, we ran a targeted promotion on our top selling product, Premium Noni Juice, during the quarter, which helped offset some of the top line weakness. We look forward to continuing to market this product on the road this month with our Premium Noni Juice brand ambassador, a descendant of the Samoan Islands where the product is derived. The brand ambassador will further educate leaders on this product, which is of high strategic importance to our wellness line.

In terms of new products, we will be introducing three additions in March, including a botanical hand lotion, new baby products, and an herbal supplement to boost cognitive function. The botanical hand protector is a daily hand moisturizer and the first product to be introduced as part of our new line of powerful anti-oxidant and toxin-shooting body care products to help combat the effects of environmental pollutants on the skin. Manufactured in the US, this product will be available in Hong Kong as well as in North America.

The introduction of the NHT Baby Bubble Cleanser and lotion marks our entry into the infant and mother care markets under our new NHT baby line. With the new two-child policy and growing consumer demand for high quality and safe products for children, we believe NHT Global is very well positioned to take advantage of this opportunity.

Lastly, CogniMax - that is C-O-G-N-I-Max, is an addition to our herbal line, formulated to promote long-term brain health. In China, those 60 and older are projected to overtake in numbers those 14 and younger by the year 2020. We believe this product will be very appealing to our member base looking for

solutions to address signs of mild cognitive impairment such as memory loss. We've formulated this product in conjunction with the Chinese University of Hong Kong, with whom we have had a longstanding partnership.

The three new products will be introduced at our rebranded Ambassador Academy to be held in Macau in early March. For logistic reasons, we moved our first half event, which traditionally takes place in January to March. We expect that this change may make the first quarter year-over-year comparison with 2016 difficult, but we believe that the effect will work out better for the longer term.

In regards to geographical expansion, we are pleased to announce that we have recently begun shipping products in Mexico and will soon in Peru. We are also taking steps to establish a local presence in Malaysia and Vietnam and are confident that both will be up and running in 2017. Beyond that, China remains our top priority. We have made further progress in the long and ongoing direct selling license application process, though the timing of obtaining the license as well as whether or not we can obtain one is beyond our control. We will provide updates as material developments arise.

Our third key initiative involves technology enhancements to improve member communication and productivity. We are currently on track to launch a proprietary business interface for our members worldwide in March. This newly designed tool has added reporting features and functionality previously not available on our platform. After a few testing with our members, we believe the added features will help members conduct business far more efficiently. That will in turn provide better insight into their business and progress on the many programs we offer. We look forward to keeping you updated on this front.

In summary, we are very proud of all we have accomplished in 2016. I believe we were able to successfully navigate through many of the challenges we faced and look forward to a bright future for Natural Health Trends.

On that note, I'm pleased to announce that we will be once again be declaring a special dividend in the amount of \$0.35 per share. In addition, we are increasing our regular quarterly dividend to \$0.09 per share, reflecting an increase of 13% over the prior quarter's dividend. Our ability to return capital to our shareholders is due to our high profitability, effective management of working capital, and robust operating cash flow, which has kept our balance sheet strong. We have also repurchased nearly \$24 million worth of shares in 2016, underscoring the confidence our Board and Management have in the Company. We will continue to evaluate our capital allocation priorities and strive to build sustainable long-term growth for our stockholders, while simultaneously focusing on our strategic plan to revitalize top line growth.

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

**Scott Davidson:**

Thank you, Chris. Total revenue for the fourth quarter was \$62.3 million, a decrease of 15% compared to \$73.7 million in the fourth quarter of 2015. Sales in Hong Kong, which accounted for 90% of our fourth quarter revenue, decreased 17% year-over-year, and revenue outside of Hong Kong increased 5% year-over-year. Our active member base declined slightly to approximately 119,000 at December 31 from 123,000 at September 30; however, on a year-over-year basis, active members were up 9%. As Chris mentioned, we successfully retained all of our top leaders in 2016.

In regards to our cost and operating expenses, our gross profit margin for the fourth quarter expanded to 80.8% from 79.5% in the fourth quarter last year due to reduced shipping costs coupled with some event-driven revenue that was not present in the prior year period. Commissions expense as a percent of total revenue decreased to 34.5% from 45% in the fourth quarter last year. On a full-year basis, commissions expense was 43.5% of total revenue, a decrease from 47.8% in 2015.

Selling, general and administrative expenses for the quarter decreased 24% to \$8.7 million versus \$11.5 million a year ago. The decreases in both commissions and expense and SG&A versus the prior year periods were primarily due to cost reduction measures we took related to our ongoing cash and other incentive programs to better align with our level of revenue.

Operating income for the quarter totaled a record \$20 million, reflecting an increase of 44% compared to \$13.9 million in the fourth quarter last year. For the full year of 2016, operating income totaled \$64.1 million, an increase of 34% compared to \$47.9 million in 2015. As a percent of total revenue for the full year of 2016, our operating income margin expanded to 22.3% compared to 18.1% last year.

We recorded an income tax provision of \$867,000 for the fourth quarter of 2016. For the full year, we recognized a provision of \$9 million primarily due to the accrual for US taxes on the expected partial repatriation of overseas profits. As a result, our full-year effective tax rate was 14%.

Net income totaled \$19 million for the quarter or \$1.70 per diluted share, as compared to net income of \$13.7 million or \$1.13 per diluted share in the fourth quarter last year. We generated \$16.9 million in cash provided by operations during the quarter and \$53.2 million for the full year. As of December 31, 2016, cash and cash equivalents totaled \$125.9 million, an increase of \$21 million compared to the prior year-end. The year-over-year increase was due to our strong cash provided by operations and was partially offset by our share repurchases of \$23.7 million as well as approximately \$7 million used to pay quarterly dividends.

As Chris shared, our Board of Directors declared a quarterly cash dividend of \$0.09 per share, representing a 13% increase over the prior quarter. In addition, we also announced a special dividend in the amount of \$0.35 per share on our outstanding common stock. Those dividends will be payable on March 3, 2017 to stockholders of record as of February 21, 2017.

That concludes our prepared remarks. I will now turn the call back over to the Operator to begin the question and answer session. Operator?

**Operator:**

Thank you. We will now begin the question and answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key. Once again, if you would like to ask a question, press star, one on your telephone keypad. One moment please while we poll for questions.

Thank you. Our first question comes from the line of Stacy Adler, a private investor. Please proceed with your question.

**Stacy Adler:**

Hi. I noticed that there are big differences in your gross margin, expense ratios, and profit margins between the first nine months and the fourth quarter. I suppose that was due to the adjustments you were talking about earlier, but can you tell me what are the numbers going forward and what are your targets for profit margin?

**Scott Davidson:**

Hi Stacy, this is Scott. In regards to gross margin, I would hope that we can maintain around 80% gross margin going forward, and as far as operating profit, of course we're very happy with the 22% achieved in

2016. However, it's more likely that we will be in the high teens for 2017 as we invest in member activities and programs and continued member development. Thank you.

**Stacy Adler:**

Okay, thank you.

**Operator:**

Our next question comes from the line of Per Anderson with Neologos. Please proceed with your question.

**Per Anderson:**

Hi. The G20 was back in September, but you're still mentioning that it had an impact on the fourth quarter. Is this impact now over? Thanks.

**Chris Sharn:**

Thank you for calling in, Per. As you know, we sell our products through a network of independent contractors, so it's always a challenge to keep them engaged and motivated, and they are not employees and they cannot be switched on and off. So in addition to our regular commission plan, we also designed other incentives, and I think the lingering effect has more to do with some of our designs. For instance, we have a program called the Supreme Bonus, and the idea; the concept is to make resources, more resources available to the up-and-coming members. The Supreme Bonus program is designed to reward steady and consistent performance on a monthly and quarterly basis, so if the members complete monthly and quarterly qualifications on a steady and consistent basis, they are proportionally rewarded with more benefits, and this program has worked very well in the last three years, each of the last three years.

But the interruption, the disruption of the G20 effect with the days leading up to the event starting from late July and August and September has put a halt to many of the members, especially in Hangzhou, for their Supreme Bonus qualification. We found that also because of many of their outlying members are elsewhere, outside of Hangzhou, so some of the members, they found that they cannot continue to meet this consistent qualification on a monthly and quarterly basis, they may have given up for the year 2016.

So we have made some changes in the 2017 Supreme Bonus program to address this issue so that some of the members, if they have fallen behind, would have the chance to make up for it. We think that we will have a good chance, a better chance to continue to grow with our regular commissions as well as the special incentive program.

**Per Anderson:**

Thank you.

**Operator:**

Our next question comes from the line of Will Hamilton with Manatuck Hill Partners. Please proceed with your question.

**Will Hamilton:**

Hey, good morning Chris and Scott.

**Chris Sharng:**

Good morning, Will. Thanks for calling in.

**Will Hamilton:**

Just to follow up on that question a little bit further, while you've got the difficult comparisons year-over-year, as you mentioned, would you expect Q1 to be up sequentially from Q4 of last year, either in China or as a whole?

**Chris Sharng:**

Will, we don't give out guidance, you know, so the first quarter is still early so we can't quite say. But we think that it's a good idea to let our investors know that we consider that the first quarter of last year and the first quarter of this year would not be really comparable because of a major change in our business practice.

**Will Hamilton:**

Okay, and then just to further on the subject with the license, have you received any communication recently from the Chinese government as it relates to that, or has it just been silent and just waiting? Any extra color you can provide?

**Chris Sharng:**

Well, this is a very long process, and we turned in our paperwork in the middle of 2015. Since the middle of 2015 all the way up to now, we've maintained ongoing communication with various levels of the Chinese government. We started out in the City of Hangzhou, we went through the Province of Guangdong, and then we are in contact with multiple bureaus in Beijing in the central government. We are getting feedback, but we're not there yet, and I don't know how long this will take. But we are always talking to the government officials.

**Will Hamilton:**

Are you aware whether they've given a license to any other foreign direct sellers recently?

**Chris Sharng:**

Well, I am not aware that any foreign company has received a license in the last several years, so we're hoping to be the trailblazer.

**Will Hamilton:**

All right, same here. Just a question then on use of capital. Special dividends are nice, stock obviously even if earnings are, say, down a little bit, remains pretty cheap clearly given all the cash you have. So could you speak to just sort of the dividend thoughts on—since you are on the Board, re-accelerating or re-initiating the buyback program?

**Chris Sharng:**

Well, I think the buyback program continues to be available, and we also would like to reward our existing shareholders with special dividends. We think that the impact is immediate and it remains to be a valuable tool. We would like to make all the possible tools available to reward our stockholders.

**Will Hamilton:**

Right, but with \$11 in cash, you have more than you need, so I understand that there's a tax implication in terms of repatriating it, but we could certainly do both dividends and buybacks.

**Chris Sharng:**

I agree, and we continue to evaluate all the options.

**Will Hamilton:**

Okay, thanks guys.

**Chris Sharng:**

Thank you, Will.

**Operator:**

Our next question comes from the line of Jeff Lund, a private investor. Please proceed with your question.

**Jeff Lund:**

Yes, thank you. You mentioned the logistical reasons for moving the event from January to March. Are there any other reasons for making the schedule change, and do you expect this change to benefit the business in the long term?

**Chris Sharng:**

Thank you, Jeff, for calling in. Yes, I'd like to explain that when we say logistic reasons, it's because traditionally we've put the first half major event in January or early part of the year, and so for instance last year our major event was on the 6 and 7 of January. When we had the event early in the year before the Chinese New Year, it created some logistic challenges. For instance, usually we are able to generate a large volume of orders, and that happened ahead of the Chinese New Year, but the Chinese customs is usually shut down for the duration of the Chinese New Year holiday, which could be as long as two weeks. So we have always ended up with a bunch of orders that were backlogged and that we could not ship, and it takes some time to clear Chinese customs. We found that to be challenging for customer services, so we'd like to change that maybe to a major event to be held after the Chinese New Year.

The other consideration is that when we had the event early in the year before the Chinese New Year, we were able to successfully motivate our members. They left the event feeling very pumped and also educated about new products and promotions, but then they went to the Chinese New Year holiday and they could be off 10 days, 14 days, so I think ideally we would like the momentum to continue.

I will say that in hindsight, we would like to have the major event probably in the middle of February and that would be the end of the official holiday period. We're not over yet. You know, there is still another lantern holiday coming up, but the availability of venues for the size of 8,000 to 10,000 people between Hong Kong and Macau is challenging, so we are able—the best that we can do is to have the event in early March. That's what we found this year, and I think that that will provide us a better chance. You know, we'd like to try something different this year and we'll do what we can to manage to continue to keep our member base motivated.

Thank you for calling in.

**Jeff Lund:**

Thank you.

**Operator:**

Thank you. Ladies and gentlemen, we have reached the end of the question and answer session, and with that the conclusion of today's conference call. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.