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Natural Health Trends Corporation

First Quarter 2017 Earnings Conference Call

April 27, 2017

CORPORATE PARTICIPANTS

Kimberly Orlando, *ADDO Investor Relations*

Chris Sharng, *President*

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

CONFERENCE CALL PARTICIPANTS

Perry Brice, *Private Investor*

Will Hamilton, *Manatuck Hill Partners*

PRESENTATION

Operator:

Greetings, and welcome to Natural Health Trends Corporation First Quarter 2017 Earnings Conference Call. At this time, all participants are in a listen-only mode. A 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.

I would now like to turn the conference over to your host, Kimberly Orlando of ADDO Investor Relations. Please go ahead.

Kimberly Orlando:

Thank you, and welcome to Natural Health Trends First 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 materially differ 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. 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.

Chris Sharng:

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

As I mentioned on our last conference call, we are still working to overcome the slowdown we experienced since the third quarter of 2016. In addition, we moved our first half major event from early January in prior years to March this year, making the year-over-year comparison challenging. Also, the stronger dollar made our products more expensive for our Chinese consumers. As a result, total revenue of $59.9 million declined by 19% compared to the $74.3 million in the first quarter of 2016 and was roughly flat with the $62.3 million in the fourth quarter.

That said, our gross profit margin reached an all-time high of 81.2%, and due to our proactive expense management, our operating income margin of 21.7%, expanded by nearly 290-basis points compared to the first quarter a year ago. Partially offsetting the factors affecting our top line was heightened productivity in March, following our successful Ambassador Academy in Macau, which attracted over 6,000 members and guests. We were very pleased with the record turnout after moving the event to after the Chinese New Year, which we believe will improve the member experience longer-term.

At the event, we introduced new products, including our new NHT Baby line, as well as CogniMax, a new herbal supplement to promote long-term brain health. CogniMax generated over $520,000 in product orders during the month of March, a very encouraging start.

In March we completed a three-week, 12-city road show in China for our top selling product, Premium Noni Juice. This promotion, which kicked off at our Macau event, was led by our Premium Noni Juice Brand Ambassador. As a descendent of the Samoan Islands where the noni fruit is sourced, he did a fantastic job, conducting product training for over 2,500 members, and educating them on the benefits of this product.

Our first domestic incentive trip of the year, what we call Fly High training, just took place in Southwest China last weekend and it was our biggest Chinese incentive trip ever with more than 1,600 in attendance. Our first 2017 international incentive trip to Dubai is also coming up in May. For those that cannot attend in person, we expect that our members on the trip will be sharing their experiences, excitement, and energy live through various social media platforms to connect with other members and help encourage incremental product orders.

In regard to our geographical expansion, we are making good progress toward our goal of establishing a local presence in Malaysia and Vietnam, and believe both markets should be up and running by year-end. Following our opening in Mexico earlier this year, we also anticipate we will begin shipping products in Peru in the second quarter.

I would like to highlight that, although still a small percentage of our overall sales, we have been experiencing strong growth in our European markets in the triple digit range. We hosted two successful events in March, one in Gothenburg, Sweden and one in Helsinki. We hosted a third meeting in Oslo, where our leaders in the Nordic regions continue to perform very well, as do leaders in both Ireland and the Czech Republic. North America has been another bright spot with the highest growth occurring on the East Coast, particularly in the tri-state area.

Despite the various expansion initiatives underway, China still remains our top priority. We are making progress 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 will provide updates as material developments arise.

With respect to technological advancements, we rolled out our updated proprietary business interface, now called the N-Office, in March in an effort to improve member communication and efficiency worldwide. Within a month of going live, over 30% of our total orders have been coming through N-Office and we have received positive feedback with regard to the ease of use and expanded functionality. This newly designed interface includes, a streamlined ordering process, educational product information, and added customization during enrollment, to help our members conduct business with greater ease

During the quarter, we generated $13.8 million in cash flow from operations, consistent with levels achieved in the prior-year quarter. In regard to capital allocation, I'm pleased to announce that we have declared another special dividend in the amount of $0.35 per share. In addition, we are increasing our regular quarterly dividend to $0.10 per share, which is up 11% over the prior quarter.

Our strong balance sheet and working capital management afford us the ability to return capital to our stockholders while simultaneously focusing on our growth initiatives. We will continuously evaluate our capital allocation priorities going forward in a concerted effort to build sustainable long-term growth for our stockholders.

While it will take time for the results of our strategic initiatives to bear fruit, we're confident in our ability to attract, motivate, and retain a strong member base, as well as to expand our product offering into new geographies and categories.

Before I turn it over to Scott, I would like to mention our charitable activities with a few programs underway. Our Healthy Walking event will take place in Eastern China in June. We participated as one of many corporate sponsors in a similar program in Guangzhou a year ago. This time we decided to be the sole sponsor and organize the activities ourselves. We will donate the proceeds to the China Youth Development Foundation and will unite our members with friends to support a great cause.

Our Million Forest Program, co-sponsored by the United Nations Environment Program, China Green Foundation, and The Climate Group, is funded from sales of our air purifier product in China. For each air purifier sold, we will donate three trees to be planted in China's western region, with the goal of planting at least 10,000 trees.

Further, in collaboration with the Chinese Post Office, we also released a collection of NHT Global stamps, the proceeds of which will be donated to other charitable causes in China.

These efforts help support our mission to enrich the lives of our customers, by staying committed to wellness and giving back to the community.

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

Scott Davidson:

Thank you, Chris. Total revenue for the first quarter was $59.9 million, a decrease of 19% compared to $74.3 million in the first quarter of 2016. Sales in Hong Kong, which accounted for 91% of our first quarter revenue, decreased 20% year-over-year. Outside of Hong Kong, China revenue decreased 47%, while North America and Europe increased 37% and 297% year-over-year, respectively. Sales were roughly in line with the fourth quarter of 2016 despite two fewer days in the calendar, as well as a major extended holiday to sell and ship.

Our active member base declined slightly to approximately 114,000 at March 31 from 119,000 at December 31 and from 120,000 at March 31 last year. In regards to our costs and operating expenses, our gross profit margin for the first quarter expanded to 81.2% from 80.8% in the first quarter last year due primarily to reduced shipping costs.

Commissions expense as a percent of total revenue decreased to 43.4% from 47.2% in the first quarter of last year and is in line with the full-year 2016 rate.

Selling, general and administrative expenses for the quarter decreased 13% to $9.5 million versus $10.9 million a year ago. The decrease in both commissions expense and SG&A versus the prior-year period reflects the cost reduction measures we successfully implemented last quarter.

Operating income for the quarter totaled $13.0 million, reflecting a decrease of 7% compared to $14.0 million in the first quarter of last year. However, as a percent of total revenue, our operating income margin expanded to 21.7% compared to 18.8% in the first quarter last year.

We continued to recognize the income tax provision for the expected partial repatriation of overseas profits, resulting in an effective tax rate of 21% for the first quarter compared to 19% in the prior-year period. Net income totaled $10.4 million, or $0.93 per diluted share, as compared to net income of $11.3 million, or $0.95 per diluted share, in the first quarter last year.

As Chris shared, our Board of Directors declared a quarterly cash dividend of $0.10 per share, representing an 11% 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. Both dividends will be payable on May 19, 2017 to stockholders of record as of May 9.

Finally, I would like to welcome Marcum as our new independent registered public accounting firm, beginning with our Q1 review. Given Marcum's strong presence in both the U.S. and China and its growing SEC Practice, we believe the firm is well-positioned to support our Company as we continue to grow.

That completes our prepared remarks. I would now like to turn the call back over to the Operator to begin the question-and-answer session. Operator?

Operator:

Thank you, Sir. At this time, we will be conducting a 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 keys. One moment please while we poll for questions.

Our first question today comes from Perry Brice, a Private Investor.

Perry Brice:

Hi, Chris. I see that revenue was down 19%, but the bottom line did not change much and the margin improved. How did you do that? Are you hurting your future growth with this cost reduction? Thanks.

Chris Sharng:

Thank you, Perry, for calling in. I think we always have a process of evaluating our opportunities and risks compared to the cost benefits of reacting to what's in front of us. Since we face the headwinds in the second half of 2016, which many of the factors were outside of our control, we still see lots of prospect for growth.

But we think that, especially on the outer ridge (phon) of this prospect for growth opportunities, for us to chase them, it may be very expensive; it might cost a lot of money. I think in the long-term our stockholders are better served and we are a stronger Company if we do a better job protecting our margin and protecting our profitability. So, you see that unfold in our financial statements and our financial results for the first quarter.

Perry Brice:

Thank you.

Operator:

The next question comes from Will Hamilton of Manatuck Hill. Please go ahead.

Will Hamilton:

Hey, good morning, guys. Just a question. Could you possible quantify the impact of moving the Ambassador event from January to March? Was there some push of orders that you would've normally gotten into Q2 from Q1?

Chris Sharng:

Will, I think that is a decision that we made based on customer services. I can't quite quantify the effect on making the changes. We see that in January, usually we were able to generate a lot more orders in January in prior years. But then a lot of the orders are hung up and backed up at customs because of the Chinese New Year holidays, and then many of the necessary parties in the logistics process were off, and we were not able to deliver. The logistics process within China is longer to begin with. It will usually take us weeks, if not months, to resolve that backlog, so this year we decided to forgo that earlier opportunity and, instead, improve our customer services. I think that over the long-term this is the better decision, but we won't be able to quantify an effect of this change.

Will Hamilton:

Okay. So, then if I just look at your bookings, just taking the revenues and deferred revenues, about $64 million, which is up slightly from Q4 and almost similar to Q3. I mean should I view that as a sign that, I mean, the business, while down year-over-year is actually starting to stabilize and sequentially may be up in Q2?

Chris Sharng:

Well, I think that is a remarkable observation. I do agree that I think right now at this point of our business development, a sequential comparison quarter-to-quarter is more meaningful for us and I'm also seeing that the seasonality of each and every particular quarter is diminished and that even though there are some holidays, in particular in the first quarter, but over the longer-term is not as important as it used to be.

I agree with you that I think the product orders being generated each and every quarter seems to be around this particular level and we're hoping that we can do better. But I agree with your observation.

Will Hamilton:

Okay. Great. Then, so in theory—I mean, you're probably not going answer this—but, I mean, second half we could see growth year-over-year as you lap to easier comparisons and the business continues to pick up momentum again?

Chris Sharng:

We won't be able to give guidance as a matter of policy. But we do have a lot of good programs lined up and, as you heard earlier, that we have an incentive trip. We have two incentive trips going on this rest of the year, and then we have also a revised and, in our opinion, enhanced supreme bonus that have proved effective in the prior years. So, we feel good about 2017.

Will Hamilton:

Okay. Last question, just Stem Renew (phon); can you provide any color on how much of revenues it was in the quarter?

Scott Davidson:

Yes, Will. It's Scott. Stem Renew was around 3% of our revenue for Q1.

Will Hamilton:

Okay. That's still growing or…?

Scott Davidson:

We introduced Stem Renew late last year and it had a good start. I expect it to grow. It's a good product, but we introduced other products in Q1 as well. So, maybe it was a little bit subdued in Q1.

Will Hamilton:

Okay. Thanks.

Scott Davidson:

Mm-hm.

Chris Sharng:

Thank you.

Operator:

There are no further questions, so this concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.