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NHTC - Q4 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 *ADDQ Investor Relations - Senior Associate*

PRESENTATION

Operator

Greetings, and welcome to the Natural Health Trends Corp. Fourth Quarter and Full Year 2019 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

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

Ariel Papermaster - *ADDQ Investor Relations - Senior Associate*

Thank you, and welcome to Natural Health Trends Fourth Quarter and Full Year 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 results 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 and today's financial results press release, which was issued at approximately 9:00 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.

2019 was a challenging year for our business amid a host of macroeconomic and industry-specific factors that created a highly difficult operating environment. As a result, total revenue declined to \$77.6 million from \$191.9 million in 2018. In addition to China's 100-day campaign announced last January in which we voluntarily suspended member activities and negative sentiment stemming from social media as it relates to health products companies in China, additional developments such as ongoing global trade tensions, China's slowing economy and civil unrest in Hong Kong further contributed to the decline in total revenue. While these factors were beyond our control, I am 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.

As our business has been under pressure, we have been applying what we learned from our experience in this uncertain and evolving environment to help support our affected market.

I'd like to also highlight the strength of our balance sheet that has enabled us to weather the adverse market conditions and ensure our inventory levels are sufficient to fulfill orders in a timely fashion.



Because of the persistent slowdown, we have implemented a strategy to more effectively manage elements within our control, including: number one, making sure our incentives remain attractive to retain our leaders and member base; number two, continuing to expand our operations into new geographies; and number three, further reducing our cost structure.

I'll now walk through each of these in detail. Our members maintained solid order volume throughout 2019 and continued to react positively to the incentives we put into place. In the fourth quarter, specifically, total orders increased over 12% from the third quarter of 2019. This led to a 5% sequential quarter increase in revenue, partly due to our second half major event in October where over 3,000 attendees, including all of our top leaders, came together for a few productive high-energy days in Macau. There, we unveiled 2 exciting new products, a color-changing lip balm and electric toothbrush, both of which were very well received and quickly sold out.

I am thrilled with the outcome in Macau, which proved our leaders continue to be highly engaged. Several Fly High training events throughout the year helped further contribute to order volume improvement, along with specialized training events, such as our NHT university. Additionally, we held various successful product promotions made possible by our effective inventory management. We are working to carry this momentum into 2020.

In terms of our geographical expansion priorities, I'm happy to report that a number of our new emerging markets have been performing well. We also made solid traction in Europe through our preferred customer base. More on that in a moment.

In Peru, total orders grew 43% in 2019 compared to last year led by the strength of our solid leadership in the region. We had some exciting new incentive trips, product road shows and corporate events planned in Peru for 2020 with qualification period already underway.

With the help of our Peruvian leadership team, we are moving forward with building a presence in both Bolivia and Colombia. In Bolivia, we have incorporated our legal entity and are currently engaging local service providers to support operations and obtain product registrations. We expect to start accepting orders and hold our first in-market event during the third quarter of 2020.

In Russia and Kazakhstan, total orders grew by 13% in 2019 compared to 2018. We believe there is a long runway for growth and expansion in Russia.

We officially entered the market in India in mid-2019, and since then, have been making good progress, especially the order volume trend to date. We believe that India represents a significant opportunity.

Our preferred customer feature in Europe continues to deliver impressive progress and a solid recurring revenue stream following the initiation of the program in December 2017. As a reminder, preferred customers are consumers of our products who do not wish to engage in selling. The number of preferred customer accounts in 2019 grew 70% over 2018 on a 55% year-over-year improvement in preferred customer sales. We are evaluating how to roll out this feature into other markets given its promising performance.

The third piece of our strategy involves further reducing our cost structure. As I mentioned on our last conference call, we put a program in place in the first quarter of 2020 to position us for increased operating efficiencies. To that end, we identified several areas, including head count redundancy as well as decreasing event spending. We expect to realize annualized cost savings of approximately \$6.5 million in 2020.

Lastly, I wanted to comment on the ongoing evolving situation in China about the coronavirus. While our first quarter results are typically affected by the Chinese New Year, the coronavirus outbreak and the unprecedented government measures to control it are posing further challenges. Following the extended Chinese New Year holidays, we are deploying product promotions and webcast training to overcome physical restrictions. We are monitoring the situation closely and plan to adapt our marketing programs accordingly.

Therefore, we made the decision to move our first half major event last year held in March into the second half of 2020 as the health and safety of our employees, members and customers remains a top priority.



Also our understanding is that the Chinese government has advised all remaining direct-selling license applicants to withdraw applications. We agree with the government's advice and withdrew our application. It is our expectation that we will reapply as still had regulatory and legal circumstances are again ready for doing so.

In summary, 2019 was a difficult year for our business. Though we are optimistic we are well positioned to execute our strategy, 2020 would not be without challenges. As we experienced in 2019, China's 100-day campaign did not officially conclude in April as the effects are still felt today. As I highlighted at the beginning of the call, negative sentiment stemming from social media associated with this program has created misperception about health products companies, like ours, that operate in good faith. That said, while the 100-day campaign adversely impacted our financial results in the short run, we continue to support the actions taken by the Chinese government to remove companies that operate illegally, manufacture and sell counterfeit and substandard products and use false advertising and misleading claims. The government's efforts have already drastically benefited Chinese consumers.

Our leaders did an excellent job navigating a highly complex and complicated operating environment in 2019 as evidenced by the positive order volume trends we experienced in Q4. While we remain cautious on both macroeconomic factors and the spread of the coronavirus in 2020, I have confidence in our ability to help stem the decline to our top line and improve our profitability through the strategic initiatives I discussed.

As we embark on the new year ahead, I'd like to thank all of our leaders, members, employees and investors for their ongoing support of NHT Global.

Now I'd like to turn the call over to Scott Davidson, our CFO, to discuss our fourth quarter and full year 2019 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 fourth quarter was \$17.8 million, a decline of 57% compared to \$41.6 million in the fourth quarter of 2018 and an increase of 5% compared to \$17 million in the third quarter of 2019. The decrease year-over-year was primarily due to the macroeconomic challenges Chris discussed, which have continued to adversely impact our business.

For the full year of 2019, total revenue was \$77.6 million compared to \$191.9 million in 2018.

Our Active Member base decreased 16% to approximately 57,400 at December 31 from 68,000 at September 30, was down 41% from 97,800 at December 31 last year.

Turning to our cost and operating expenses. Gross profit margin of 71.4% declined from 78.8% in the fourth quarter last year primarily as a result of special product promotions designed for the quarter and higher logistics costs. For the full year, our gross profit margin was 74.1% compared to 79.5% in 2018.

Commissions expense as a percent of total revenue for the fourth quarter declined to 40.9% from 48.6% in the prior year quarter due to lower incentive costs. On a full year basis, commissions expense was 45.8% of total revenue, roughly in line with 45.6% for 2018.

Selling, general and administrative expenses for the quarter increased 1% to \$6.9 million from \$6.8 million a year ago. For the full year, SG&A was \$27.2 million, a decrease of 13% from \$31.3 million for 2018. The decrease in full year SG&A versus 2018 was primarily due to a decrease in both employee-related costs and credit card fees, which were partially offset by higher professional fees.

Our total operating expenses for the quarter also included a goodwill impairment charge of \$1.8 million due to the early adoption of a new accounting standard pertaining to goodwill that arose from a merger transaction in March 2004.

As a result, operating loss for the quarter was \$3.2 million compared to operating income of \$5.7 million in the fourth quarter last year. For the full year of 2019, operating loss was \$7 million compared to operating income of \$33.7 million in 2018.

We recorded an income tax benefit of \$106,000 for the quarter compared to an income tax provision of \$498,000 recognized in the fourth quarter of last year. For the full year, we recognized an income tax provision of \$14,000 compared to \$3.5 million for 2018.

Net loss for the fourth quarter totaled \$2.8 million or a loss of \$0.27 per diluted share compared to net income of \$5.6 million or \$0.49 per diluted share in the fourth quarter of 2018. For the full year, net loss totaled \$5.6 million or \$0.52 per diluted share compared to net income of \$31 million or \$2.74 per diluted share in 2018.

Now I'll turn to our balance sheet and cash flow. Total cash and cash equivalents were \$96 million at December 31, down from \$101.1 million at September 30. The decrease was due to our payment of \$4.6 million in dividends and repurchase of \$552,000 worth of our common stock. Net cash provided by operating activities was \$110,000 for the quarter and net cash used in operating activities was \$18.6 million for the full year.

We repurchased just over 97,000 shares of our common stock during the quarter at an average price of \$5.64 for a total of \$552,000. As of December 31, \$21.9 million of the previously approved stock repurchase program remained available for future purchases. For the full year of 2019, we paid out \$7.3 million in dividends. Earlier this week, on February 10, our Board of Directors declared a quarterly cash dividend of \$0.20 per share, which will be payable on March 6, 2020 to stockholders of record as of February 25, 2020. We expect to pay a comparable quarterly cash dividend in 2020 and 2021 at the sole discretion of our Board.

As Chris highlighted, as a result of our effective working capital management, our balance sheet remained strong with no debt and sufficient liquidity to run our operations and continue our stockholder return priorities.

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

Operator

Thank you. Ladies and gentlemen, this does conclude 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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