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NATURAL HEALTH TRENDS CORP

Form 10-Q

October 25, 2016

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-36849

NATURAL HEALTH TRENDS CORP.

(Exact name of registrant as specified in its charter)

Delaware 59-2705336

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

609 Deep Valley Drive

Suite 395

Rolling Hills Estates, California 90274

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (310) 541-0888

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

At October 21, 2016, the number of shares outstanding of the registrant's common stock was 11,287,196 shares.

NATURAL HEALTH TRENDS CORP.
Quarterly Report on Form 10-Q
September 30, 2016

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, in particular “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operation,” includes “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). When used in this report, the words or phrases “will likely result,” “expect,” “intend,” “will continue,” “anticipate,” “estimate,” “project,” “believe” and similar expressions are intended to identify “forward-looking statements” within the meaning of the Exchange Act. These statements represent our expectations or beliefs concerning, among other things, future revenue, earnings, growth strategies, new products and initiatives, future operations and operating results, and future business and market opportunities.

Forward-looking statements in this report speak only as of the date hereof, and forward looking statements in documents incorporated by reference speak only as of the date of those documents. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by law. We caution and advise readers that these statements are based on certain assumptions that may not be realized and involve risks and uncertainties that could cause actual results to differ materially from the expectations and beliefs contained herein.

For a summary of certain risks related to our business, see “Item 1A. Risk Factors” in our most recent Annual Report on Form 10-K, which includes the following:

- We could be adversely affected by management changes or an inability to attract and retain key management, directors and consultants;
- Because our Hong Kong operations account for a substantial portion of our overall business, and substantially all of our Hong Kong business is derived from the sale of products to members in China, any material adverse change in our business relating to either Hong Kong or China would likely have a material adverse impact on our overall business; Our operations in China are subject to compliance with a myriad of applicable laws and regulations, and any actual or alleged violations of those laws or government actions otherwise directed at us could have a material adverse impact on our business and the value of our company;
- Our failure to maintain and expand our member relationships could adversely affect our business;
- The high level of competition in our industry could adversely affect our business;
- Challenges by third parties to the legality of our business operations could harm our business;
 - We are currently being sued in three lawsuits alleging, among other things, that we made materially false and misleading statements regarding the legality of our business operations in China;
- An increase in the amount of compensation paid to members would reduce profitability;
- Failure of new products to gain member and market acceptance could harm our business;
- Direct-selling laws and regulations may prohibit or severely restrict our direct sales efforts and cause our revenue and profitability to decline, and regulators could adopt new regulations that harm our business;
- Our products and related activities are subject to extensive government regulation, which could delay, limit or prevent the sale of some of our products in some markets;
- New regulations governing the marketing and sale of nutritional supplements could harm our business;
- Regulations governing the production and marketing of our personal care products could harm our business;
- If we are found not to be in compliance with good manufacturing practices our operations could be harmed;
- Failure to comply with domestic and foreign laws and regulations governing product claims and advertising could harm our business;
- Although our members are independent contractors, improper member actions that violate laws or regulations could harm our business;
 - Adverse publicity associated with our products, ingredients or network marketing program, or those of similar companies, could harm our financial condition and operating results;

❖We have a limited product line;

❖We rely on a limited number of independent third parties to manufacture and supply our products;

- Growth may be impeded by the political and economic risks of entering and operating foreign markets;
- Currency exchange rate fluctuations could lower our revenue and net income;
- Changes in tax or duty laws, and unanticipated tax or duty liabilities, could adversely affect our net income;
- Transfer pricing regulations affect our business and results of operations;
- We may be held responsible for certain taxes or assessments relating to the activities of our members, which could harm our financial condition and operating results;
- We are currently involved in, and may in the future face, litigation that could harm our business;
- We may be unable to protect or use our intellectual property rights;
- We do not have a comprehensive product liability insurance program and product liability claims could hurt our business;
- Our internal controls and accounting methods may require modification;
- If we fail to achieve and maintain an effective system of internal controls in the future, we may not be able to accurately report our financial results or prevent fraud. As a result, investors may lose confidence in our financial reporting;
- We rely on and are subject to risks associated with our reliance upon information technology systems;
- System failures and attacks could harm our business;
- Terrorist attacks, cyber-attacks, acts of war, epidemics or other communicable diseases or any other natural disasters may seriously harm our business;
- Because our systems, software and data reside on third-party servers, our access could be temporarily or permanently interrupted;
- We may experience substantial negative cash flows, which may have a significant adverse effect on our business and could threaten our solvency;
- If we experience negative cash flows, we may need to seek additional debt or equity financing, which may not be available on acceptable terms or at all. If available, it could have a highly dilutive effect on the holdings of existing stockholders;
- Disappointing quarterly revenue or operating results could cause the price of our common stock to fall;
- Our common stock is particularly subject to volatility because of the industry in which we operate;
- Our common stock continues to experience wide fluctuations in trading volumes and prices. This may make it more difficult for holders of our common stock to sell shares when they want and at prices they find attractive; and
- Future sales by us or our existing stockholders could depress the market price of our common stock.

Additional factors that could cause actual results to differ materially from our forward-looking statements are set forth in this report, including under the headings “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and in our financial statements and the related notes.

PART I - FINANCIAL INFORMATION**Item 1. FINANCIAL STATEMENTS****NATURAL HEALTH TRENDS CORP.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)**

	September 30, 2016	December 31, 2015
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 114,500	\$ 104,914
Accounts receivable	98	57
Inventories, net	14,842	10,455
Other current assets	3,540	2,286
Total current assets	132,980	117,712
Property and equipment, net	1,297	894
Goodwill	1,764	1,764
Restricted cash	3,090	3,166
Other assets	723	616
Total assets	\$ 139,854	\$ 124,152
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 3,114	\$ 2,862
Income taxes payable	655	379
Accrued commissions	18,620	19,634
Other accrued expenses	18,443	16,703
Deferred revenue	4,236	4,011
Deferred tax liability	60	60
Amounts held in eWallets	19,510	16,414
Other current liabilities	1,543	1,510
Total current liabilities	66,181	61,573
Long-term incentive	4,945	5,770
Total liabilities	71,126	67,343
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$0.001 par value; 50,000,000 shares authorized; 12,979,414 shares issued at September 30, 2016 and December 31, 2015	13	13
Additional paid-in capital	86,564	85,963
Retained earnings (accumulated deficit)	24,342	(9,647)
Accumulated other comprehensive loss	(302)	(101)
Treasury stock, at cost; 1,692,218 and 840,202 shares at September 30, 2016 and December 31, 2015, respectively	(41,889)	(19,419)
Total stockholders' equity	68,728	56,809
Total liabilities and stockholders' equity	\$ 139,854	\$ 124,152

See accompanying notes to consolidated financial statements.

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NATURAL HEALTH TRENDS CORP.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales	\$70,679	\$80,779	\$225,416	\$191,204
Cost of sales	13,627	16,001	42,966	39,025
Gross profit	57,052	64,778	182,450	152,179
Operating expenses:				
Commissions expense	30,578	40,036	103,547	93,443
Selling, general and administrative expenses (including stock-based compensation expense of \$10 and \$21 during the three months ended September 30, 2016 and 2015, respectively, and \$94 and \$56 during the nine months ended September 30, 2016 and 2015, respectively)	11,170	9,867	34,505	24,571
Depreciation and amortization	96	72	276	181
Total operating expenses	41,844	49,975	138,328	118,195
Income from operations	15,208	14,803	44,122	33,984
Other income (expense), net	48	(135)	40	(112)
Income before income taxes	15,256	14,668	44,162	33,872
Income tax provision	2,699	137	8,124	330
Net income	\$12,557	\$14,531	\$36,038	\$33,542
Income per common share:				
Basic	\$1.12	\$1.19	\$3.15	\$2.71
Diluted	\$1.12	\$1.18	\$3.14	\$2.70
Weighted-average number of common shares outstanding:				
Basic	11,209	12,239	11,437	12,364
Diluted	11,232	12,284	11,463	12,439
Cash dividends declared per common share	\$0.07	\$0.04	\$0.18	\$0.09

See accompanying notes to consolidated financial statements.

NATURAL HEALTH TRENDS CORP.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(In thousands)

	Three Months		Nine Months	
	Ended September		Ended September	
	30,	30,	30,	30,
	2016	2015	2016	2015
Net income	\$12,557	\$14,531	\$36,038	\$33,542
Other comprehensive loss, net of tax:				
Foreign currency translation adjustment	(54) (118) (329) 35
Release of cumulative translation adjustment	—	—	132	