

NATURAL HEALTH TRENDS CORP
Form 10-Q
May 08, 2013

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 March 31, 2013

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: 0-26272

NATURAL HEALTH TRENDS CORP.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

59-2705336
(I.R.S. Employer
Identification No.)

4514 Cole Avenue
Suite 1400
Dallas, Texas 75205
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (972) 241-4080

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,

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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 <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

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

At April 30, 2013, the number of shares outstanding of the registrant’s common stock was 11,335,276 shares.

NATURAL HEALTH TRENDS CORP.
Quarterly Report on Form 10-Q
March 31, 2013

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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 include the following:

- 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;
- 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 majority of our overall business, and most 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 failure to maintain and expand our distributor relationships could adversely affect our business;
 - The high level of competition in our industry could adversely affect our business;
 - An increase in the amount of compensation paid to distributors would reduce profitability;
 - Failure of new products to gain distributor 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;
 - Challenges by third parties to the form of our business model could 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 distributors are independent contractors, improper distributor 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;

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- 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;
 - Transfer pricing, duties and other tax regulations affect our business;
 - Failure to properly pay business taxes or customs duties, including those in China, could have a material adverse effect;
 - We may be held responsible for certain taxes or assessments relating to the activities of our distributors, which could harm our financial condition and operating results;
 - We may face litigation that could harm our business;
 - We may be unable to protect or use our intellectual property rights;
 - We do not have product liability insurance 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 system, software and data reside on third-party servers, our access could be temporarily or permanently interrupted;
 - 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;
 - There is no assurance of an active public trading market;
- The exercise of our warrants may result in substantial dilution and may depress the market price of our common stock;
 - Future sales by us or our existing stockholders could depress the market price of our common stock; and
 - Penny stock regulations are applicable to investment in our shares of 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 heading “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)

	December 31, 2012	March 31, 2013 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$4,207	\$5,173
Accounts receivable	122	179
Inventories, net	867	888
Other current assets	641	406
Total current assets	5,837	6,646
Property and equipment, net	121	123
Goodwill	1,764	1,764
Restricted cash	239	231
Other assets	258	255
Total assets	\$8,219	\$9,019
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$1,385	\$1,811
Income taxes payable	10	22
Accrued distributor commissions	1,308	1,512
Other accrued expenses	1,688	1,403
Deferred revenue	836	1,136
Deferred tax liability	92	92
Other current liabilities	991	856
Total current liabilities	6,310	6,832
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized; 1,761,900 shares designated Series A convertible preferred stock, 138,400 shares issued and outstanding at December 31, 2012 and March 31, 2013, aggregate liquidation value of \$333	124	124
Common stock, \$0.001 par value; 50,000,000 shares authorized; 11,324,048 and 11,323,369 shares issued and outstanding at December 31, 2012 and March 31, 2013, respectively	11	11
Additional paid-in capital	80,584	80,603
Accumulated deficit	(78,708)	(78,421)
Accumulated other comprehensive loss:		
Foreign currency translation adjustments	(102)	(130)

Total stockholders' equity	1,909	2,187
Total liabilities and stockholders' equity	\$8,219	\$9,019

See accompanying notes to consolidated financial statements.

NATURAL HEALTH TRENDS CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(In Thousands, Except Per Share Data)

	Three Months Ended March 31,	
	2012	2013
Net sales	\$9,090	\$8,651
Cost of sales	2,399	2,228
Gross profit	6,691	6,423
Operating expenses:		
Distributor commissions	3,691	3,674
Selling, general and administrative expenses (including stock-based compensation expense of \$20 and \$30 during the three months ended March 31, 2012 and 2013, respectively)	2,437	2,445
Depreciation and amortization	12	12
Total operating expenses	6,140	6,131
Income from operations	551	292
Other income (expense), net	(63) 7
Income before income taxes	488	299
Income tax provision (benefit)	(19) 12
Net income	507	287
Preferred stock dividends	(4) (4
Net income available to common stockholders	\$503	\$283
Income per share:		
Basic	\$0.05	\$0.03
Diluted	\$0.04	\$0.03
Weighted-average number of shares outstanding:		
Basic	10,863	11,069
Diluted	11,181	11,248

See accompanying notes to consolidated financial statements.

NATURAL HEALTH TRENDS CORP.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(In Thousands)

	Three Months Ended March 31,	
	2012	2013
Net income	\$507	\$287
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustment	51	(28)
Comprehensive income	\$558	\$259

See accompanying notes to consolidated financial statements.

NATURAL HEALTH TRENDS CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In Thousands)

	Three Months Ended March 31,	
	2012	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$507	\$287
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12	12
Stock-based compensation	20	30
Changes in assets and liabilities:		
Accounts receivable	(240)	(59)
Inventories, net	95	(28)
Other current assets	(102)	232
Other assets	3	(2)
Accounts payable	(213)	428
Income taxes payable	11	12
Accrued distributor commissions	78	215
Other accrued expenses	306	(279)
Deferred revenue	359	304
Other current liabilities	24	(134)
Net cash provided by operating activities	860	1,018
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment, net	(18)	(14)
Decrease in restricted cash	247	-
Net cash provided by (used in) investing activities	229	(14)
CASH FLOWS FROM FINANCING ACTIVITIES		
Repurchase of common stock	-	(12)
Net cash used in financing activities	-	(12)
Effect of exchange rates on cash and cash equivalents	52	(26)
Net increase in cash and cash equivalents	1,141	966
CASH AND CASH EQUIVALENTS, beginning of period	1,617	4,207
CASH AND CASH EQUIVALENTS, end of period	\$2,758	\$5,173

See accompanying notes to consolidated financial statements.

NATURAL HEALTH TRENDS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of Operations

Natural Health Trends Corp. (the “Company”), a Delaware corporation, is an international direct-selling and e-commerce company headquartered in Dallas, Texas. Subsidiaries controlled by the Company sell personal care, wellness, and “quality of life” products under the “NHT Global” brand. In most markets, we sell our products to an independent member network that either uses the products themselves or resells them to consumers.

Our majority-owned subsidiaries have an active physical presence in the following markets: North America; Greater China, which consists of Hong Kong, Taiwan and China; Russia; South Korea; Japan; and Europe, which consists of Italy and Slovenia.

Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. As a result, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, considered necessary for a fair statement of the Company’s financial information for the interim periods presented. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the fiscal year. These consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our 2012 Annual Report on Form 10-K filed with the United States Securities and Exchange Commission (SEC) on March 12, 2013.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all of its majority-owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported period.

The most significant accounting estimates inherent in the preparation of the Company’s financial statements include estimates associated with obsolete inventory and the fair value of acquired intangible assets, including goodwill, as well as those used in the determination of liabilities related to sales returns and income taxes. Various assumptions and other factors prompt the determination of these significant estimates. The process of determining significant

estimates is fact specific and takes into account historical experience and current and expected economic conditions. The actual results may differ materially and adversely from the Company's estimates. To the extent that there are material differences between the estimates and actual results, future results of operations will be affected.

Income Taxes

The Company recognizes income taxes under the liability method of accounting for income taxes. Deferred income taxes are recognized for differences between the financial reporting and tax bases of assets and liabilities at enacted statutory tax rates in effect for the years in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be ultimately realized. The Company recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. Deferred taxes are not provided on the portion of undistributed earnings of subsidiaries outside of the United States when these earnings are considered permanently reinvested.

The Company and its subsidiaries file income tax returns in the United States, various states, and foreign jurisdictions. The Company is no longer subject to U.S. federal income tax examinations for years prior to 2009, and is no longer subject to state income tax examinations for years prior to 2008. No jurisdictions are currently examining any income tax returns of the Company or its subsidiaries.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, approximate fair value because of their short maturities. The carrying amount of the noncurrent restricted cash approximates fair value since, absent the restrictions, the underlying assets would be included in cash and cash equivalents.

Accounting standards permit companies, at their option, to choose to measure many financial instruments and certain other items at fair value. The Company has elected to not fair value existing eligible items.

Revenue Recognition

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