

NATURES SUNSHINE PRODUCTS INC
Form 10-Q
August 09, 2013
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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 June 30, 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: 0-8707

NATURE S SUNSHINE PRODUCTS, INC.

(Exact name of Registrant as specified in its charter)

Utah
(State or other jurisdiction of
incorporation or organization)

87-0327982
(IRS Employer
Identification No.)

2500 West Executive Parkway, Suite 100

Lehi, Utah 84043

(Address of principal executive offices and zip code)

(801) 341-7900

(Registrant's telephone number including area code)

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 (§ 232.405 of this chapter) during the preceding 12 months (or for such 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
(Do not check if a smaller reporting company)

Smaller reporting company

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

The number of shares of Common Stock, no par value, outstanding on July 26, 2013 was 15,980,249 shares.

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NATURE'S SUNSHINE PRODUCTS, INC.

FORM 10-Q

For the Quarter Ended June 30, 2013

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NATURE S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands)

(Unaudited)

| | June 30, 2013 | December 31, 2012 |
|--|------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 87,295 | \$ 79,241 |
| Accounts receivable, net of allowance for doubtful accounts of \$671 and \$631, respectively | 9,104 | 9,614 |
| Investments available for sale | 2,018 | 2,071 |
| Inventories | 41,674 | 43,280 |
| Deferred income tax assets | 5,233 | 5,307 |
| Prepaid expenses and other | 6,378 | 5,820 |
| Total current assets | 151,702 | 145,333 |
| Property, plant and equipment, net | 28,155 | 27,950 |
| Investment securities | 1,151 | 1,276 |
| Intangible assets, net | 928 | 1,002 |
| Deferred income tax assets | 11,385 | 11,516 |
| Other assets | 6,372 | 6,842 |
| | \$ 199,693 | \$ 193,919 |
| Liabilities and Shareholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 5,044 | \$ 6,226 |
| Accrued volume incentives | 19,541 | 18,130 |
| Accrued liabilities | 27,702 | 27,302 |
| Deferred revenue | 3,410 | 4,311 |
| Current installments of long-term debt | 3,371 | 3,350 |
| Income taxes payable | 2,349 | 2,071 |
| Total current liabilities | 61,417 | 61,390 |
| Liability related to unrecognized tax benefits | 10,797 | 10,571 |
| Long-term debt | 858 | 2,270 |
| Deferred compensation payable | 1,151 | 1,276 |
| Other liabilities | 2,698 | 2,776 |
| Total long-term liabilities | 15,504 | 16,893 |
| Commitments and Contingencies | | |

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Shareholders' equity:

| | | |
|---|------------|------------|
| Common stock, no par value, 50,000 shares authorized, 15,962 and 15,810 shares issued and outstanding as of June 30, 2013 and December 31, 2012, respectively | 80,578 | 77,292 |
| Retained earnings | 56,656 | 48,910 |
| Accumulated other comprehensive loss | (14,462) | (10,566) |
| Total shareholders' equity | 122,772 | 115,636 |
| | \$ 199,693 | \$ 193,919 |

See accompanying notes to the unaudited condensed consolidated financial statements.

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NATURE'S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share information)

(Unaudited)

| | Three Months Ended June 30, | |
|--|--------------------------------|-----------|
| | 2013 | 2012 |
| Net sales revenue | \$ 93,675 | \$ 92,991 |
| Cost of sales | (22,630) | (22,610) |
| Gross profit | 71,045 | 70,381 |
| Operating expenses: | | |
| Volume incentives | 34,525 | 33,540 |
| Selling, general and administrative | 28,709 | 26,530 |
| Operating income | 7,811 | 10,311 |
| Other income, net | 1,482 | 165 |
| Income before provision for income taxes | 9,293 | 10,476 |
| Provision for income taxes | 3,241 | 3,190 |
| Net income | \$ 6,052 | \$ 7,286 |
| Basic and diluted net income per common share | | |
| Basic: | | |
| Net income | \$ 0.38 | \$ 0.47 |
| Diluted: | | |
| Net income | \$ 0.38 | \$ 0.46 |
| Weighted average basic common shares outstanding | 15,896 | 15,605 |
| Weighted average diluted common shares outstanding | 16,112 | 15,864 |
| Dividends declared per common share | \$ 0.10 | \$ 0.05 |

See accompanying notes to the unaudited condensed consolidated financial statements.

NATURE'S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in thousands)

(Unaudited)

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| | Three Months Ended | |
|---|--------------------|----------|
| | June 30, | |
| | 2013 | 2012 |
| Net income | \$ 6,052 | \$ 7,286 |
| Foreign currency translation loss (net of tax) | (2,040) | (464) |
| Net unrealized gains (losses) on investment securities (net of tax) | 6 | (23) |
| Total comprehensive income | \$ 4,018 | \$ 6,799 |

See accompanying notes to the unaudited condensed consolidated financial statements.

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NATURE'S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share information)

(Unaudited)

| | Six Months Ended June 30, | |
|--|------------------------------|------------|
| | 2013 | 2012 |
| Net sales revenue | \$ 190,154 | \$ 185,859 |
| Cost of sales | (47,075) | (46,339) |
| Gross profit | 143,079 | 139,520 |
| Operating expenses: | | |
| Volume incentives | 69,500 | 67,121 |
| Selling, general and administrative | 58,826 | 52,914 |
| Operating income | 14,753 | 19,485 |
| Other income, net | 1,812 | 55 |
| Income before provision for income taxes | 16,565 | 19,540 |
| Provision for income taxes | 5,649 | 5,026 |
| Net income | 10,916 | 14,514 |
| Basic and diluted net income per common share | | |
| Basic: | | |
| Net income | \$ 0.69 | \$ 0.93 |
| Diluted: | | |
| Net income | \$ 0.68 | \$ 0.91 |
| Weighted average basic common shares outstanding | 15,860 | 15,591 |
| Weighted average diluted common shares outstanding | 16,079 | 15,953 |
| Dividends declared per common share | \$ 0.20 | \$ 0.05 |

See accompanying notes to the unaudited condensed consolidated financial statements.

NATURE'S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in thousands)

(Unaudited)

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| | Six Months Ended June 30, | | |
|--|------------------------------|---------|-----------|
| | 2013 | | 2012 |
| Net income | \$ | 10,916 | \$ 14,514 |
| Foreign currency translation loss (net of tax) | | (3,926) | (355) |
| Net unrealized gains on investment securities (net of tax) | | 30 | 21 |
| Total comprehensive income | \$ | 7,020 | \$ 14,180 |

See accompanying notes to the unaudited condensed consolidated financial statements.

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NATURE S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

| | Six Months Ended June 30, | |
|---|------------------------------|-----------|
| | 2013 | 2012 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 10,916 | \$ 14,514 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for doubtful accounts | 19 | 19 |
| Depreciation and amortization | 2,181 | 2,015 |
| Share-based compensation expense | 1,930 | 1,321 |
| Loss on sale of property and equipment | 25 | 18 |
| Deferred income taxes | 183 | (7) |
| Amortization of bond discount | 1 | 3 |
| Purchase of trading investment securities | (36) | (37) |
| Proceeds from sale of trading investment securities | 193 | 180 |
| Realized and unrealized gains on investments | (33) | (38) |
| Foreign exchange (gains) losses | (1,583) | 505 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 229 | (713) |
| Inventories | 1,163 | (1,158) |
| Prepaid expenses and other current assets | (642) | (733) |
| Other assets | 103 | 60 |
| Accounts payable | (1,296) | (581) |
| Accrued volume incentives | 1,643 | 220 |
| Accrued liabilities | 699 | (1,196) |
| Deferred revenue | (901) | 406 |
| Income taxes payable | 401 | (4,846) |
| Liability related to unrecognized tax benefits | 216 | (642) |
| Deferred compensation payable | (125) | (83) |
| Net cash provided by operating activities | 15,286 | 9,227 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property, plant and equipment | (2,332) | (2,562) |
| Proceeds from sale of property, plant and equipment | 46 | 22 |
| Proceeds from maturity and sale of investments available for sale | | 3,574 |
| Purchase of investments available for sale | (75) | (178) |
| Net cash provided by (used in) investing activities | (2,361) | 856 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Principal payments of long-term debt | (1,391) | (1,640) |
| Dividends paid | (3,170) | (780) |
| Proceeds from the exercise of stock options | 1,356 | 401 |
| Net cash used in financing activities | (3,205) | (2,019) |
| Effect of exchange rates on cash and cash equivalents | (1,666) | (680) |
| Net increase in cash and cash equivalents | 8,054 | 7,384 |
| Cash and cash equivalents at the beginning of the period | 79,241 | 58,969 |
| Cash and cash equivalents at the end of the period | \$ 87,295 | \$ 66,353 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |

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| | | | | |
|----------------------------|----|-------|----|--------|
| Cash paid for income taxes | \$ | 5,407 | \$ | 11,132 |
| Cash paid for interest | | 32 | | 68 |

See accompanying notes to the unaudited condensed consolidated financial statements.

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NATURE'S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per-share information)

(Unaudited)

(1) Basis of Presentation

Nature's Sunshine Products, Inc. together with its subsidiaries (hereinafter referred to collectively as the Company) is a natural health and wellness company primarily engaged in the manufacturing and direct selling of nutritional and personal care products. Nature's Sunshine Products, Inc. is a Utah corporation with its principal place of business in Lehi, Utah. The Company sells its products to a sales force of independent Managers and Distributors who use the products themselves or resell them to other Distributors or consumers. The formulation, manufacturing, packaging, labeling, advertising, distribution and sale of each of the Company's major product groups are subject to regulation by one or more governmental agencies.

The Company markets its products in Australia, Austria, Belarus, Canada, Colombia, Costa Rica, the Czech Republic, Denmark, the Dominican Republic, Ecuador, El Salvador, Finland, Germany, Guatemala, Honduras, Hong Kong, Indonesia, Ireland, Japan, Kazakhstan, Latvia, Lithuania, Malaysia, Mexico, Moldova, Mongolia, the Netherlands, Nicaragua, Norway, Panama, Peru, the Philippines, Poland, Russia, Singapore, South Korea, Spain, Sweden, Taiwan, Thailand, the Ukraine, the United Kingdom, the United States, Venezuela and Vietnam. The Company also exports its products to Argentina, Australia, Chile, Israel, New Zealand and Norway.

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The unaudited condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the Company's financial information as of June 30, 2013, and for the three and six-month periods ended June 30, 2013 and 2012. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the fiscal year ending December 31, 2013.

It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

Classification of Venezuela as a Highly Inflationary Economy and Devaluation of Its Currency

Since January 1, 2010, Venezuela has been designated as a highly inflationary economy. Accordingly, the U.S. dollar became the functional currency for the Company's subsidiary in Venezuela. All gains and losses resulting from the re-measurement of its financial statements are determined using official rates. On February 11, 2013, the Venezuelan government announced the further devaluation of the bolivar to 6.3 bolivars per U.S. dollar.

Currency restrictions enacted by the government of Venezuela require approval from the government's currency control agency organization in order for the Company's subsidiary in Venezuela to obtain U.S. dollars at the official exchange rate to pay for imported products or to repatriate dividends back to the Company. Prior to January 1, 2010, the market rate, which is substantially lower than the official rate, was available to obtain U.S. dollars or other currencies without approval of the government's currency control organization. In 2013, the government of Venezuela enacted a new currency transaction system, the Complementary System for Foreign Currency Administration (SICAD), to replace the System for Foreign Currency Denominated Securities (SITME) which was enacted in 2010 to end the trading of currency at the market rate. Under SICAD, which is administered by the Venezuela Central Bank, entities domiciled in Venezuela submit bids to obtain U.S. dollar denominated securities in limited quantities each month through banking institutions approved by the government. Based on the bids received, the Venezuela Central Bank will determine how many U.S. dollars will be sold and which companies are authorized to buy. Subsequently, the Venezuela Central Bank will pay the foreign entities directly to limit the amount of U.S. dollars available within Venezuela.

The Company re-measures its results in Venezuela at the SICAD rate, which was approximately 6.3 bolivars per U.S. dollar as of June 30, 2013.

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During the three months ended June 30, 2013 and 2012, the Company's Venezuelan subsidiary's net sales revenue represented approximately 2.0 percent and 1.8 percent of consolidated net sales revenue, respectively. During the six months ended June 30, 2013 and 2012, the Company's Venezuelan subsidiary's net sales revenue represented approximately 2.1 percent and 1.7 percent of consolidated net sales revenue, respectively. As of June 30, 2013 and December 31, 2012, the Company's Venezuelan subsidiary held cash and cash equivalents of \$2,611 and \$1,748, respectively. At this time, the Company is not able to reasonably estimate the future state of exchange controls in Venezuela and its availability of U.S. dollars at the official exchange rate or at the SICAD rate.

Classification of Belarus as a Highly Inflationary Economy and Devaluation of Its Currency

As of June 30, 2012, Belarus was designated as a highly inflationary economy. Historically, the U.S. dollar has been our functional currency for this market. As a result, there were no resulting gains or losses from a re-measurement of the financial statements using official rates of the Company's Belarusian subsidiary. However, as a result of the weakening of the Belarusian ruble, the purchasing power of our Distributors in this market has diminished. During the three months ended June 30, 2013 and 2012, the Company's Belarusian subsidiary's net sales revenue represented approximately 1.9 percent and 1.6 percent of consolidated net sales revenue, respectively. During the six months ended June 30, 2013 and 2012, the Company's Belarusian subsidiary's net sales revenue represented approximately 2.1 percent and 1.7 percent of consolidated net sales revenue, respectively.

(2) Inventories

Inventories consist of the following:

| | June 30, 2013 | December 31, 2012 |
|------------------|--------------------------|------------------------------|
| Raw Materials | \$ 11,820 | \$ 13,287 |
| Work in Progress | 954 | 742 |
| Finished Goods | 28,900 | 29,251 |
| | \$ 41,674 | \$ 43,280 |

(3) Intangible Assets

At June 30, 2013 and December 31, 2012, intangibles for product formulations had a gross carrying amount of \$1,763 and \$1,763, accumulated amortization of \$835 and \$761, and a net amount of \$928 and \$1,002, respectively. The estimated useful lives of the product formulations range from 9 to 15 years.

Amortization expense for intangible assets for the three months ended June 30, 2013 and 2012 was \$37 and \$37, respectively. Amortization expense for intangible assets for the six months ended June 30, 2013 and 2012 was \$74 and \$74, respectively. Estimated amortization expense for each of the three succeeding fiscal years thereafter is \$149 followed by two fiscal years with estimated amortization expense of \$91.

(4) Investments

The amortized cost and estimated fair values of available-for-sale securities by balance sheet classification are as follows:

| As of June 30, 2013 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|---------------------------|---------------------------------------|--|-----------------------|
| Municipal obligations | \$ 505 | \$ 19 | \$ | \$ 524 |
| U.S. government securities funds | 995 | | (14) | 981 |
| Equity securities | 227 | 288 | (2) | 513 |
| Total short-term investment securities | \$ 1,727 | \$ 307 | \$ (16) | \$ 2,018 |

| As of December 31, 2012 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|---------------------------|---------------------------------------|--|-----------------------|
| Municipal obligations | \$ 608 | \$ 30 | \$ | \$ 638 |
| U.S. government securities funds | 995 | | (9) | 986 |
| Equity securities | 227 | 228 | (8) | 447 |
| Total short-term investment securities | \$ 1,830 | \$ 258 | \$ (17) | \$ 2,071 |

The municipal obligations held at a fair value of \$524 at June 30, 2013 all mature in less than two years.

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During the six month periods ended June 30, 2013 and 2012, the proceeds from the maturities and sales of available-for-sale securities were \$0 and \$3,574, respectively. There were no gross realized gains (losses) on sales of available-for-sale securities (net of tax) for the six month periods ended June 30, 2013 and 2012, respectively.

The Company's trading securities portfolio totaled \$1,151 at June 30, 2013 and \$1,276 at December 31, 2012, and generated losses of \$12 and \$26 for the three months ended June 30, 2013 and 2012, respectively, and generated gains of \$33 and \$60 for the six months ended June 30, 2013 and 2012, respectively.

As of June 30, 2013 and December 31, 2012, the Company had unrealized losses of \$14 and \$9, respectively, in its U.S. government securities funds. These losses are due to the interest rate sensitivity of the municipal obligations and the performance of the overall stock market for the equity securities.

(5) Long-Term Debt

On August 9, 2011, the Company entered into a Revolving Credit agreement with Wells Fargo Bank, N.A. that permits the Company to borrow up to \$15,000 through August 9, 2014, bearing interest at LIBOR plus 1.25 percent. The Company must pay an annual commitment fee of 0.25 percent on the unused portion of the commitment. At June 30, 2013, the Company had \$15,000 available under this facility.

On August 8, 2013, the Company renegotiated the Revolving Credit agreement with Wells Fargo Bank, N.A. to increase to borrowing limit to \$25,000 and extend the maturity to August 8, 2015. The Company will pay an annual commitment fee of 0.25 percent on the unused portion of the commitment and LIBOR plus 1.25 percent on any drawings on the agreement.

A term loan of \$10,000 was obtained in conjunction with the Revolving Credit agreement with Wells Fargo Bank, N.A. and has a maturity date of August 9, 2014 and a variable interest rate of LIBOR plus 1.25 percent (1.50 percent as of June 30, 2013 and December 31, 2012). The term loan is collateralized by the Company's manufacturing facility in Spanish Fork, Utah.

Long-term debt consists of the following:

| | June 30, 2013 | December 31, 2012 |
|--|--------------------------|------------------------------|
| Term loan in monthly installments of approximately \$284, including interest, secured by real estate | \$ 4,229 | \$ 5,620 |
| Less current installments | (3,371) | (3,350) |
| Long-term debt less current installments | \$ 858 | \$ 2,270 |

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The various debt agreements contain restrictions on liquidity, leveraging, minimum net income and consecutive quarterly net losses. In addition, the agreements restrict capital expenditures, lease expenditures, other indebtedness, liens on assets, guaranties, loans and advances, and the merger, consolidation and the transfer of assets except in the ordinary course of business. The Company is in compliance with these debt covenants as of June 30, 2013.

(6) Net Income Per Share

Basic net income per common share (Basic EPS) is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share (Diluted EPS) reflects the potential dilution that could occur if stock options or other contracts to issue common stock were exercised or converted into common stock. The computation of Diluted EPS does not assume exercise or conversion of securities that would have an anti-dilutive effect on net income per common share.

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The following is a reconciliation of the numerator and denominator of Basic EPS to the numerator and denominator of Diluted EPS for the three and six months ended June 30, 2013 and 2012:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------|-----------------------------|------|---------------------------|------|
| | 2013 | 2012 | 2013 | 2012 |
| Net income | | | | |