

NATURES SUNSHINE PRODUCTS INC  
Form 10-Q  
November 09, 2004

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 10-Q

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

For the Quarterly Period Ended  
September 30, 2004

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.)

**75 East 1700 South**  
**Provo, Utah 84606**  
(Address of principal executive offices and zip code)

**(801) 342-4300**  
(Registrant s telephone number including area code)

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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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares of Common Stock, no par value, outstanding on November 7, 2004 was 15,390,269 shares.

When we refer in this Form 10-Q to the Company, we, our, and us, we mean Nature s Sunshine Products, Inc., a Utah corporation, together with our subsidiaries.

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NATURE'S SUNSHINE PRODUCTS, INC.

FORM 10-Q

For the Quarter Ended September 30, 2004

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## PART I FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## NATURE S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in Thousands)

(Unaudited)

	September 30, 2004	December 31, 2003
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 39,521	\$ 30,665
Accounts receivable, net	6,920	5,567
Inventories, net	35,087	26,528
Deferred income tax assets	4,747	3,553
Prepaid expenses and other	13,261	9,723
Total current assets	99,536	76,036
PROPERTY, PLANT AND EQUIPMENT, net	33,874	32,318
LONG-TERM INVESTMENTS	7,554	6,416
DEFERRED TAX ASSETS LONG TERM	5,619	5,359
DEFINITE-LIVED INTANGIBLE ASSETS, net	1,832	2,094
OTHER ASSETS	2,053	3,335
	\$ 150,468	\$ 125,558
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Line of credit	\$	\$ 5,000
Accounts payable	6,519	4,003
Accrued volume incentives	14,323	12,093
Accrued liabilities	24,993	18,009
Income taxes payable	8,561	6,879
Total current liabilities	54,396	45,984
DEFERRED COMPENSATION	2,010	2,232
<b>SHAREHOLDERS EQUITY:</b>		
Common Stock, no par value; 20,000 shares authorized, 19,446 shares issued	19,904	25,437
Retained earnings	135,178	124,997
Treasury stock, at cost, 4,352 and 5,267 shares, respectively	(41,142)	(54,833)
Accumulated other comprehensive loss	(19,878)	(18,259)
Total shareholders equity	94,062	77,342
	\$ 150,468	\$ 125,558

See accompanying notes to condensed consolidated financial statements.



NATURE S SUNSHINE PRODUCTS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS)  
AND COMPREHENSIVE INCOME (LOSS)

(Amounts in Thousands, Except Per-Share Information)

(Unaudited)

	Three Months Ended September 30,	
	2004	2003 (As Restated, See Note 1)
NET SALES REVENUE (net of the rebate portion of volume incentives of \$8,823 and \$9,600, respectively)	\$ 83,617	\$ 63,470
<b>COST AND EXPENSES:</b>		
Cost of goods sold	15,312	13,228
Volume incentives	33,363	23,503
Selling, general and administrative	28,160	27,787
<b>OPERATING INCOME (LOSS)</b>	<b>6,782</b>	<b>(1,048)</b>
<b>OTHER INCOME (EXPENSE)</b>		
Interest income	94	110
Interest expense	(59)	(77)
Other income (expense), net	140	187
	175	220
<b>INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES</b>	<b>6,957</b>	<b>(828)</b>
<b>PROVISION (BENEFIT) FOR INCOME TAXES</b>	<b>2,350</b>	<b>(264)</b>
<b>NET INCOME (LOSS)</b>	<b>4,607</b>	<b>(564)</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS), net of tax:</b>		
Foreign currency translation adjustments	319	(57)
Net unrealized holding losses on marketable securities	(5)	(61)
Reclassification adjustment for net realized gains on marketable securities included in net income	32	5
	346	(113)
<b>COMPREHENSIVE INCOME (LOSS)</b>	<b>\$ 4,953</b>	<b>\$ (677)</b>
<b>BASIC NET INCOME (LOSS) PER COMMON SHARE</b>	<b>\$ 0.31</b>	<b>\$ (0.04)</b>
<b>WEIGHTED AVERAGE BASIC COMMON SHARES</b>	<b>15,076</b>	<b>13,930</b>
<b>DILUTED NET INCOME (LOSS) PER COMMON SHARE</b>	<b>\$ 0.29</b>	<b>\$ (0.04)</b>
<b>WEIGHTED AVERAGE DILUTED COMMON SHARES</b>	<b>15,654</b>	<b>13,930</b>

See accompanying notes to condensed consolidated financial statements.



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

(Amounts in Thousands, Except Per-Share Information)

(Unaudited)

	2004	Nine Months Ended September 30,	2003 (As Restated, See Note 1)
NET SALES REVENUE (net of the rebate portion of volume incentives of \$27,930 and \$28,697, respectively)	\$	240,100	\$ 189,725
COST AND EXPENSES:			
Cost of goods sold		44,813	39,154
Volume incentives		92,986	68,928
Selling, general and administrative		87,142	77,744
OPERATING INCOME		15,159	3,899
OTHER INCOME (EXPENSE)			
Impairment of investment			(1,768)
Interest income		280	384
Interest expense		(73)	(207)
Other income, net		696	876
		903	(715)
INCOME BEFORE PROVISION FOR INCOME TAXES		16,062	3,184
PROVISION FOR INCOME TAXES		3,645	1,019
NET INCOME		12,417	2,165
OTHER COMPREHENSIVE INCOME (LOSS), net of tax:			
Foreign currency translation adjustments		(1,573)	(1,175)
Net unrealized holding losses on marketable securities		(68)	(136)
Reclassification adjustment for net realized gains on marketable securities included in net income		22	338
		(1,619)	(973)
COMPREHENSIVE INCOME	\$	10,798	\$ 1,192
BASIC NET INCOME PER COMMON SHARE	\$	0.84	\$ 0.15
WEIGHTED AVERAGE BASIC COMMON SHARES		14,846	14,237
DILUTED NET INCOME PER COMMON SHARE	\$	0.81	\$ 0.15
WEIGHTED AVERAGE DILUTED COMMON SHARES		15,395	14,411



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See accompanying notes to condensed consolidated financial statements.

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

(Amounts in Thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2004	2003
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 12,417	\$ 2,165
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,229	5,025
Tax benefit from stock option exercises	966	120
Gain on sale of property, plant and equipment	313	100
Deferred income taxes	(1,448)	(2,298)
Deferred compensation	(222)	561
Loss on impaired investments		1,768
Changes in assets and liabilities:		
Accounts receivable, net	(1,403)	251
Inventories, net	(8,523)	224
Prepaid expenses and other assets	(2,891)	(4,793)
Accounts payable	2,532	782
Accrued volume incentives	2,170	1,952
Accrued liabilities	6,963	3,769
Income taxes payable	1,681	67
Net cash provided by operating activities	16,784	9,693
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(6,061)	(2,833)
Proceeds from sale (purchase) of investments	(1,176)	2,020
Payments received on long-term receivables	478	840
Proceeds from sale of property, plant and equipment	79	138
Net cash provided by (used) in investing activities	(6,680)	165
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net (payments) proceeds from line of credit	(5,000)	4,500
Payment of cash dividends	(2,235)	(1,426)
Purchase of treasury stock	(17)	(11,796)
Proceeds from exercise of stock options	7,205	982
Net cash used in financing activities	(47)	(7,740)
<b>EFFECT OF EXCHANGE RATES ON CASH</b>	<b>(1,201)</b>	<b>(1,174)</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>8,856</b>	<b>944</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD</b>	<b>30,665</b>	<b>26,175</b>
<b>CASH AND CASH EQUIVALENTS AT END OF THE PERIOD</b>	<b>\$ 39,521</b>	<b>\$ 27,119</b>

See accompanying notes to condensed consolidated financial statements.

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 AND ACCOUNTING POLICIES**

The unaudited, condensed consolidated financial statements of Nature s Sunshine Products, Inc. and subsidiaries (together, the Company ) included herein have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission. Certain information and footnote disclosures normally required in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes the following disclosures are adequate to make the information presented not misleading.

These unaudited, condensed consolidated financial statements reflect all adjustments, which in the opinion of management are necessary to present fairly the Company s financial position as of September 30, 2004, and the results of their operations and their cash flows for the periods presented. All of the adjustments which have been made in these condensed consolidated financial statements are of a normal recurring nature. Operating results for the three and nine months ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

We re-evaluated our financial statement presentation of volume incentive payments made to our independent Distributors and Managers during the year ended December 31, 2003. These payments consist of (1) commissions paid for purchases made by the Distributors and Managers down-line organizations, and (2) rebates paid to Distributors and Managers for purchases of products for their own use or for resale. In accordance with Emerging Issue Task Force Issue 01-9 ( EITF 01-9 ), we determined it was appropriate to present the portion of volume incentive payments representing rebates as reductions to sales revenue rather than as operating expenses. As a result, we have reclassified the appropriate amounts for all periods presented in this Form 10-Q, including all quarterly and segment data, by reducing sales revenue and volume incentives (operating expense) by equal amounts. These reclassifications had no effect on operating income, net income, or earnings per basic or diluted common share.

These condensed consolidated financial statements should 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, 2003.

**(2) RECENT ACCOUNTING PRONOUNCEMENTS**

In January 2003, the Financial Accounting Standards Board, or FASB, issued FASB Interpretation ( FIN ) No. 46, Consolidation of Variable Interest Entities An Interpretation of ARB No. 51 ( FIN



No. 46 ). FIN No. 46 addresses consolidation and reporting by business enterprises of variable interest entities. All enterprises with variable interests in variable interest entities created after January 31, 2003 apply the provisions of FIN No. 46 to those entities immediately. A public entity with a variable interest in a variable interest entity created before February 1, 2003 applies the provisions of FIN No. 46 to that entity no later than the beginning of the first interim or annual reporting period beginning after June 15, 2003. In addition, FIN No. 46R delayed the effective date for application of FIN No. 46 by public companies, until periods ending after March 15, 2004 for all types of variable interest entities other than special-purpose entities. The adoption of FIN No. 46 did not have an effect on our results of operations, liquidity, or financial position.

**(3) INVENTORIES**

Inventories consist of the following:

	September 30, 2004	December 31, 2003
Raw materials	\$ 9,286	\$ 6,940
Work in process	743	914
Finished goods	25,058	18,674
	\$ 35,087	\$ 26,528

**(4) DEFINITE-LIVED INTANGIBLE ASSETS**

The composition of the Company's definite-lived intangible assets is as follows:

	As of September 30, 2004			As of December 31, 2003		
	Carrying Amount	Accumulated Amortization	Net	Carrying Amount	Accumulated Amortization	Net
Acquired Distributor Networks	\$ 3,213	\$ 1,381	\$ 1,832	\$ 3,213	\$ 1,119	\$ 2,094

As of September 30, 2004, the Company determined that none of its intangible assets are impaired. Amortization expense for intangible assets for the nine months ended September 30, 2004 was \$262. Estimated amortization expense for the remainder of 2004 and the five succeeding fiscal years is as follows:

	Estimated Amortization Expense
2004 (remainder)	\$ 75
2005	299
2006	299
2007	299
2008	299
Thereafter	561

\$ 1,832

**(5) NET INCOME PER COMMON 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 common stock equivalents that would have an anti-dilutive effect on net income per common share. For periods in which the Company incurs losses, Diluted EPS does not assume the exercise or conversion of common stock equivalents.

As of September 30, 2004, the Company had a total of 2,228 common stock options outstanding. These options were granted at fair market value and have a weighted-average exercise price of \$8.53 per share.

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 nine months ended September 30, 2004 and 2003.

	Net Income (Numerator)	Shares (Denominator)	Per Share Amount
<b><u>Three Months Ended September 30, 2004</u></b>			
Basic EPS	\$ 4,607	15,076	\$ 0.31
Effect of stock options		578	(0.02)
Diluted EPS	\$ 4,607	15,654	\$ 0.29
<b><u>Three Months Ended September 30, 2003</u></b>			
Basic EPS	\$ (564)	13,930	\$ (0.04)
Effect of stock options			
Diluted EPS	\$ (564)	13,930	\$ (0.04)
<b><u>Nine Months Ended September 30, 2004</u></b>			
Basic EPS	\$ 12,417	14,846	\$ 0.84
Effect of stock options		549	(0.03)
Diluted EPS	\$ 12,417	15,395	\$ 0.81
<b><u>Nine Months Ended September 30, 2003</u></b>			
Basic EPS	\$ 2,165	14,237	\$ 0.15
Effect of stock options		174	
Diluted EPS	\$ 2,165	14,411	\$ 0.15

For the three months ended September 30, 2004 and 2003, there were outstanding options to purchase 47 and 3,430 shares of common stock, respectively, that were not included in the computation of Diluted EPS, as their effect would have been anti-dilutive. For the nine months ended September 30, 2004 and 2003, there were options to purchase 36 and 497 shares of common stock, respectively, that were not included in the computation of diluted EPS, as their effect would have been anti-dilutive.





**(6) EQUITY TRANSACTIONS**

The Company has declared consecutive quarterly cash dividends since 1988. During the third quarter, the Company paid a dividend of 5 cents per common share on August 19, 2004 to shareholders of record on August 9, 2004.

Common shares held as treasury stock totaled 4,352 at September 30, 2004 compared to 5,267 at December 31, 2003. Common shares held as treasury stock decreased as a result of common shares issued from treasury stock for the exercise of stock options.

**(7) OPERATING LINE OF CREDIT**

The Company has an operating line of credit with an interest rate equal to LIBOR plus 1.5 percent, which provides for borrowings of up to \$15,000. Borrowings under this line of credit may be used to repurchase shares of the Company's outstanding common stock under Board-authorized repurchase programs as well as to fund working capital, capital expenditures, and related costs. The Company amended the terms of the line of credit during the second quarter to extend the maturity date to July 1, 2006. The line of credit had an original maturity of July 1, 2004. There were no outstanding borrowings under this line of credit at September 30, 2004. The line of credit contains various terms and conditions, including affirmative and negative financial covenants. As of September 30, 2004, the Company was in compliance with these covenants.

**(8) ACCUMULATED OTHER COMPREHENSIVE LOSS**

The composition of accumulated other comprehensive loss, net of tax, is as follows:

	Foreign Currency Translation Adjustments	Unrealized Gains On Available-For- Sale Securities	Total Accumulated Other Comprehensive Loss
Balance as of December 31, 2003	\$ (18,428)	\$ 169	\$ (18,259)
Period Change	(1,573)	(46)	(1,619)
Balance as of September 30, 2004	\$ (20,001)	\$ 123	\$ (19,878)

**(9) STOCK-BASED COMPENSATION**

The Company accounts for stock-based compensation plans for employees and directors under Accounting Principles Board Opinion No. 25, under which no compensation cost has been recognized in the accompanying condensed consolidated statements of income for the three and nine months ended September 30, 2004 and 2003. Had compensation cost been determined consistent with SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, the Company's net income (loss) and net income (loss) per share would have been reduced to the following pro forma amounts: