

NATURES SUNSHINE PRODUCTS INC  
Form 10-Q  
November 08, 2011  
[Table of Contents](#)

**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, 2011

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.)

**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)

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

Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

Non-accelerated filer   
(Do not check if a smaller reporting company)

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 .

The number of shares of Common Stock, no par value, outstanding on October 31, 2011 was 15,566,802 shares.

---

Table of Contents

NATURE'S SUNSHINE PRODUCTS, INC.

FORM 10-Q

For the Quarter Ended September 30, 2011

Table of Contents

**Part I. Financial Information**

Item 1. Financial Statements (Unaudited)

<u>Condensed Consolidated Balance Sheets</u>	3
<u>Condensed Consolidated Statements of Operations</u>	4
<u>Condensed Consolidated Statements of Cash Flows</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7

<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
----------------	--	----

<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	28
----------------	---	----

<u>Item 4.</u>	<u>Controls and Procedures</u>	31
----------------	--------------------------------	----

**Part II. Other Information**

<u>Item 1.</u>	<u>Legal Proceedings</u>	32
----------------	--------------------------	----

<u>Item 1A.</u>	<u>Risk Factors</u>	32
-----------------	---------------------	----

<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	32
----------------	--	----

<u>Item 3.</u>	<u>Default Upon Senior Securities</u>	32
----------------	---------------------------------------	----

<u>Item 4.</u>	<u>Removed and Reserved</u>	32
----------------	-----------------------------	----

<u>Item 5.</u>	<u>Other Information</u>	32
----------------	--------------------------	----

<u>Item 6.</u>	<u>Exhibits</u>	32
----------------	-----------------	----

Table of Contents**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, 2011	December 31, 2010
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 54,103	\$ 47,604
Accounts receivable, net of allowance for doubtful accounts of \$686 and \$918, respectively	11,765	5,947
Investments available for sale	4,551	6,470
Inventories	38,454	36,235
Deferred income tax assets	4,976	4,582
Prepaid expenses and other	5,052	5,700
Total current assets	118,901	106,538
Property, plant and equipment, net	25,208	27,391
Investment securities	1,423	1,778
Intangible assets, net	1,191	1,303
Deferred income tax assets	16,866	12,916
Other assets	11,594	9,489
	\$ 175,183	\$ 159,415
<b>Liabilities and Shareholders Equity</b>		
Current Liabilities:		
Accounts payable	\$ 5,130	\$ 4,855
Accrued volume incentives	19,789	18,619
Accrued liabilities	29,777	34,601
Deferred revenue	3,042	3,385
Current installments of long-term debt	3,283	
Income taxes payable	4,503	3,708
Total current liabilities	65,524	65,168
Liability related to unrecognized tax benefits	18,559	21,366
Long-term debt	6,717	
Deferred compensation payable	1,423	1,778
Other liabilities	2,574	2,721
Total long-term liabilities	29,273	25,865

Commitments and Contingencies (Note 12)

Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

Shareholders' Equity:

Common stock, no par value, 50,000 shares authorized, 15,567 and 15,533 shares issued and outstanding as of September 30, 2011 and December 31, 2010	70,043	67,752
Retained earnings	18,258	8,278
Accumulated other comprehensive loss	(7,915)	(7,648)
Total shareholders' equity	80,386	68,382
	\$ 175,183	\$ 159,415

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

(Amounts in thousands, except per share information)

(Unaudited)

	<b>Three Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
Net sales revenue (net of the rebate portion of volume incentives of \$10,877 and \$10,726, respectively)	\$ 91,102	\$ 86,096
Cost and expenses:		
Cost of goods sold	16,879	16,632
Volume incentives	32,733	32,065
Selling, general and administrative	31,845	33,523
Contract termination costs	14,750	
	96,207	82,220
Operating income (loss)	(5,105)	3,876
Other income, net	1,204	375
Income (loss) before provision for income taxes	(3,901)	4,251
(Benefit) provision for income taxes	(1,645)	1,573
Net income (loss) from continuing operations	(2,256)	2,678
Loss from discontinued operations		(8,418)
Net loss	\$ (2,256)	\$ (5,740)
<b>Basic and diluted net income (loss) per common share</b>		
<b>Basic:</b>		
Net income (loss) from continuing operations	\$ (0.14)	\$ 0.17
Loss from discontinued operations	\$	\$ (0.54)
Net loss	\$ (0.14)	\$ (0.37)
<b>Diluted:</b>		
Net income (loss) from continuing operations	\$ (0.14)	\$ 0.17
Loss from discontinued operations	\$	\$ (0.54)
Net loss	\$ (0.14)	\$ (0.37)
Weighted average basic common shares outstanding	15,562	15,514
Weighted average diluted common shares outstanding	15,562	15,612

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

(Amounts in thousands, except per share information)

(Unaudited)

	Nine Months Ended September 30,	
	2011	2010
Net sales revenue (net of the rebate portion of volume incentives of \$33,815 and \$32,942, respectively)	\$ 275,757	\$ 260,029
Cost and expenses:		
Cost of goods sold	52,560	51,308
Volume incentives	100,421	97,162
Selling, general and administrative	97,458	103,840
Contract termination costs	14,750	
	265,189	252,310
Operating income	10,568	7,719
Other income, net	1,049	2,374
Income before provision for income taxes	11,617	10,093
Provision for income taxes	1,637	1,238
Net income from continuing operations	9,980	8,855
Loss from discontinued operations		(9,388)
Net income (loss)	\$ 9,980	\$ (533)
<b>Basic and diluted net income per common share</b>		
<b>Basic:</b>		
Net income from continuing operations	\$ 0.64	\$ 0.57
Loss from discontinued operations	\$	\$ (0.60)
Net income (loss)	\$ 0.64	\$ (0.03)
<b>Diluted:</b>		
Net income from continuing operations	\$ 0.64	\$ 0.57
Loss from discontinued operations	\$	\$ (0.60)
Net income (loss)	\$ 0.64	\$ (0.03)
Weighted average basic common shares outstanding	15,544	15,512
Weighted average diluted common shares outstanding	15,674	15,606

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

(Amounts in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 9,980	\$ (533)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Write-off of cumulative translation adjustments		7,364
Provision for doubtful accounts	(101)	182
Depreciation and amortization	3,204	3,243
Share-based compensation expense	1,917	325
Loss on sale of property and equipment	14	50
Deferred income taxes	(4,419)	146
Loss on restricted cash		497
Amortization of bond discount	13	17
Purchase of trading investment securities	(59)	(141)
Proceeds from sale of trading investment securities	338	109
Realized and unrealized losses (gains) on investments	25	(93)
Amortization of prepaid taxes related to gain on intercompany sales		813
Foreign exchange losses (gains)	106	(3,231)
Changes in assets and liabilities:		
Accounts receivable	(5,691)	198
Inventories	(2,313)	3,224
Prepaid expenses and other current assets	607	(595)
Other assets	(2,155)	(420)
Accounts payable	428	425
Accrued volume incentives	1,224	1,216
Accrued liabilities	(4,554)	2,552
Deferred revenue	(343)	(1,286)
Income taxes payable	848	(6,704)
Liability related to unrecognized tax benefits	(2,834)	2,750
Deferred compensation payable	(355)	112
Net cash (used in) provided by operating activities	(4,120)	10,220
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property, plant and equipment	(1,117)	(2,118)
Proceeds from sale of investments available for sale	5,650	109
Purchase of investments available for sale	(3,867)	
Net cash provided by (used in) investing activities	666	(2,009)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from the issuance of long-term debt	10,000	
Proceeds from the exercise of stock options	372	31
Net cash provided by financing activities	10,372	31
Effect of exchange rates on cash and cash equivalents	(419)	1,877
Net increase in cash and cash equivalents	6,499	10,119
Cash and cash equivalents at the beginning of the period	47,604	35,538

Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

Cash and cash equivalents at end of the period	\$	54,103	\$	45,657
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>				
Cash paid for income taxes	\$	7,851	\$	4,797

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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. and its subsidiaries (hereinafter referred to collectively as the Company) are primarily engaged in the manufacturing and marketing of nutritional, herbal, weight management, energy and other complementary products. Nature's Sunshine Products, Inc. is a Utah corporation with its principal place of business in Provo, Utah. The Company sells its products to a sales force of independent Distributors and Managers who use the products themselves or resell them to other Distributors or consumers.

The Company markets its products in Australia, Austria, Belarus, Canada, the Czech Republic, Colombia, Costa Rica, Denmark, the Dominican Republic, Ecuador, El Salvador, Germany, Guatemala, Honduras, Hong Kong, Indonesia, Ireland, Japan, Kazakhstan, Latvia, Lithuania, Malaysia, Mexico, Mongolia, the Netherlands, Nicaragua, Norway, Panama, Peru, the Philippines, Poland, Russia, Singapore, South Korea, Sweden, Taiwan, Thailand, Ukraine, the United Kingdom, the United States, Venezuela and Vietnam. The Company also exports its products to several other countries, including 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 September 30, 2011, and for the three and nine-month periods ended September 30, 2011 and 2010. 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, 2011.

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, 2010.

**Discontinued Operations**

As more fully described in Note 2, Discontinued Operations, the Company ceased the operations of its Brazilian subsidiary in the third quarter of 2010, and the results of its operations are classified as discontinued operations in the Company's statements of operations and accompanying notes for all periods presented.

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

As of January 1, 2010, Venezuela was 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 January 8, 2010, the Venezuelan government announced the devaluation of the bolivar against the 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 2010, the government of Venezuela enacted additional currency restrictions, which effectively replaced the market rate with the System for Foreign Currency Denominated Securities (SITME), which is administered by the Venezuela Central Bank. Under SITME, entities domiciled in Venezuela can obtain U.S. dollar denominated securities in limited quantities each month through banking institutions approved by the government.

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 SITME rate. However, the Company has been successful repatriating funds from Venezuela for imported products using the SITME rate. The Company re-measures its results in Venezuela at the SITME rate, which was approximately 5.3 bolivars per U.S. dollar as of September 30, 2011.

As a result of the events described in the preceding paragraphs, the Company recorded a gain of \$3,668 in the first quarter of 2010 in connection with the re-measurement of its balance sheet to reflect the highly inflationary designation and the devaluation due to the negative position of the Company's Venezuelan subsidiary's net monetary assets, which is recorded in

Table of Contents

foreign exchange gains or losses, a part of other income. The success of future operations will be affected by several factors, including the Company's ability to take actions to mitigate the effect of devaluation, further actions of the Venezuelan government and economic conditions in Venezuela, such as inflation and consumer spending.

During the three months ended September 30, 2011 and 2010, the Company's Venezuelan subsidiary's net sales revenue represented approximately 1.4 percent and 2.0 percent of consolidated net sales revenue, respectively. During the nine months ended September 30, 2011 and 2010, its net sales revenue represented approximately 1.4 percent and 1.8 percent of consolidated net sales revenue, respectively. The Company's Venezuelan subsidiary held total assets of \$8,471 and \$8,024 (which includes an intercompany receivable denominated in U.S. dollars of \$2,076 and \$1,978) and net assets of \$5,444 and \$4,185 at September 30, 2011 and December 31, 2010, respectively.

**Recent Accounting Pronouncements**

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-04 Fair Value Measurement (Topic 820): *Amendments to Achieve Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. This update addresses how to measure fair value and requires new disclosures about fair value measurements. The amendments in this update are effective for interim and annual periods beginning after December 15, 2011.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05 for Comprehensive Income (Topic 220): *Presentation of Comprehensive Income*. This update improves the comparability, consistency and transparency of financial reporting and increases the prominence of items reported in other comprehensive income. This update is effective for interim and annual periods beginning after December 15, 2011.

**(2) Discontinued Operations**

During 2010, the Company ceased its operations in Brazil as a result of declining sales and increased regulatory restrictions, which made it difficult for the Company to register and sell key products in that market. This market was part of the Company's NSP International segment.

The following table summarizes the operating results of the Company's discontinued operations for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net sales revenue	\$	\$ 211	\$	\$ 682
Loss before income tax provision	\$	\$ (8,418)	\$	\$ (9,388)
Income tax provision				
Loss from discontinued operations, net of tax	\$	\$ (8,418)	\$	\$ (9,388)

The cash flows from our discontinued operations are included in the Company's operating cash flows, but were insignificant.

**(3) Inventories**

Inventories consist of the following:

	September 30, 2011		December 31, 2010
Raw Materials	\$ 10,727	\$	9,177
Work in Progress	1,059		956
Finished Goods	26,668		26,102
	\$ 38,454	\$	36,235

**(4) Intangible Assets**

At September 30, 2011 and December 31, 2010, intangibles for product formulations had a gross carrying amount of \$1,763 and \$1,763, accumulated amortization of \$571 and \$460, and a net amount of \$1,191 and \$1,303, 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 September 30, 2011 and 2010 was \$37 and \$30, respectively. Amortization expense for intangible assets for the nine months ended September 30, 2011 and 2010 was \$111 and \$89, respectively. Estimated amortization expense for each of the five succeeding fiscal years thereafter is \$149.

Table of Contents**(5) Investments**

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

	Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
<b>As of September 30, 2011</b>							
Municipal obligations	\$ 1,365	\$	66	\$		\$	1,431
U.S. government securities funds	982				(1)		981
Short-term deposits	1,783						1,783
Equity securities	228		133		(5)		356
Total short-term investment securities	\$ 4,358	\$	199	\$	(6)	\$	4,551

	Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
<b>As of December 31, 2010</b>							
Municipal obligations	\$ 1,883	\$	77	\$		\$	1,960
U.S. government securities funds	989				(15)		974
Short-term deposits	3,148						3,148
Equity securities	228		160				388
Total short-term investment securities	\$ 6,248	\$	237	\$	(15)	\$	6,470

The municipal obligations held at a fair value of \$1,431 at September 30, 2011 all mature in less than five years.

During the nine-month periods ended September 30, 2011 and 2010, the proceeds from the sales of available-for-sale securities were \$5,650 and \$109, respectively. There were no gross realized gains (losses) on sales of available-for-sale securities (net of tax) for the nine-month periods ended September 30, 2011 and 2010, respectively.

The Company's trading securities portfolio totaled \$1,423 at September 30, 2011 and \$1,778 at December 31, 2010, and generated losses of \$121 and gains of \$102 for the three months ended September 30, 2011 and 2010, respectively and generated losses of \$46 and gains of \$76 for the nine months ended September 30, 2011 and 2010, respectively.

As of September 30, 2011 and December 31, 2010, the Company had unrealized losses of \$1 and \$15, respectively, in its U.S. government securities funds. These losses are due to the interest rate sensitivity of the U.S. government securities funds.

**(6) Long-Term Debt**

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

On August 9, 2011, the Company entered into a Revolving Credit agreement with Wells Fargo Bank, National Association that permits the Company to borrow up to \$15,000 through August 9, 2013, 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 September 30, 2011, the Company had \$15,000 available under this facility.

A term loan of \$10,000 was obtained in conjunction with the Revolving Credit agreement with Wells Fargo Bank, National Association 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 September 30, 2011). The term loan has been collateralized by the Company's manufacturing facility in Spanish Fork, Utah.

Long-term debt at September 30, 2011 and December 31, 2010 consists of the following:

	September 30, 2011	December 31, 2010
Term loan in monthly installments of approximately \$284, including interest, secured by real estate	\$ 10,000	\$
Total long-term debt	10,000	
Less current installments	(3,283)	
Long-term debt less current installments	\$ 6,717	\$

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 currently in compliance with these debt covenants.

The aggregate maturities of long-term debt for each of the next five years are: \$816 in 2011, \$3,296 in 2012, \$3,346 in 2013 and \$2,542 in 2014.

Table of Contents**(7) Net Income (Loss) Per Share**

Basic net income (loss) per common share ( Basic EPS ) is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) 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 (loss) per common 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, 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>Net income (loss) available to common stockholders</b>				
Net income (loss) from continuing operations	\$ (2,256)	\$ 2,678	\$ 9,980	\$ 8,855
Loss from discontinued operations		(8,418)		(9,388)
Net income (loss)	\$ (2,256)	\$ (5,740)	\$ 9,980	\$ (533)
<b>Basic weighted average shares outstanding</b>	15,562	15,514	15,544	15,512
<b>Basic net income (loss) per common share:</b>				
Net income (loss) from continuing operations	\$ (0.14)	\$ 0.17	\$ 0.64	\$ 0.57
Loss from discontinued operations	\$	(0.54)	\$	(0.60)
Net income (loss)	\$ (0.14)	\$ (0.37)	\$ 0.64	\$ (0.03)
<b>Diluted shares outstanding</b>				
Basic weighted-average shares outstanding	15,562	15,514	15,544	15,512
Stock options		98	130	94
Diluted weighted-average shares outstanding	15,562	15,612	15,674	15,606
<b>Diluted net income (loss) per common share:</b>				
Net income (loss) from continuing operations	\$ (0.14)	\$ 0.17	\$ 0.64	\$ 0.57
Loss from discontinued operations	\$	(0.54)	\$	(0.60)
Net income (loss)	\$ (0.14)	\$ (0.37)	\$ 0.64	\$ (0.03)
<b>Potentially dilutive shares excluded from diluted-per-share amounts:</b>				
Stock options		50	661	50
<b>Potentially anti-dilutive shares excluded from diluted per share amounts:</b>				
Stock options	1,379	418	202	415

Potentially dilutive shares excluded from diluted-per-share amounts include performance-based options to purchase shares of common stock which will not vest until certain earnings metrics have been achieved. Potentially anti-dilutive shares excluded from diluted-per-share amounts include both non-qualified stock options and unearned performance-based options to purchase shares of common stock with exercise prices greater than the weighted-average share price during the period and shares that would be anti-dilutive to the computation of dilutive net loss per share for the three months ended September 30, 2011.

**(8) Comprehensive Income**

The components of comprehensive income (loss), net of tax, for the three and nine months ended September 30, 2011 and 2010, respectively, are as follows:

	<b>Three Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
Net loss	\$ (2,256)	\$ (5,740)
Foreign currency translation (loss) gain	(1,735)	8,126
Net unrealized (losses) gains on investment securities	(40)	34
Total comprehensive income (loss)	\$ (4,031)	\$ 2,420

Table of Contents

	Nine Months Ended September 30,	
	2011	2010
Net income (loss)	\$ 9,980	\$ (533)
Foreign currency translation (loss) gain	(249)	9,699
Net unrealized (losses) gains on investment securities	(18)	1
Total comprehensive income	\$ 9,713	\$ 9,167

**(9) Share-Based Compensation**

Stock option activity for the nine months ended September 30, 2011 is as follows:

	Number of Shares	Weighted Average Exercise Price Per Share
Options outstanding at December 31, 2010	859	\$ 9.20
Granted	630	10.84
Expired	(76)	9.67
Exercised	(34)	10.99
Options outstanding at September 30, 2011	1,379	9.88

During the nine-month period ended September 30, 2011, the Company issued options to purchase 630 shares of common stock under the 2009 Incentive Plan to the Company's executive officers, other employees and to new members of its Board of Directors, of which 505 will not vest until certain earnings metrics have been achieved. These options were issued with a weighted-average exercise price of \$10.84 per share, and a weighted-average grant date fair value of \$5.13 per share. All of the options issued have an option termination date of ten years from the option grant date.

The fair value of each option grant was estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for the nine-month period ended September 30, 2011:

	2011
Expected life (in years)	3.0 to 4.0
Risk-free interest rate	0.7 to 1.2
Expected volatility	49.0 to 67.7
Dividend yield	0.0

Expected option lives and volatilities are based on historical data of the Company. The risk-free interest rate is calculated as the average U.S. Treasury obligation rate that corresponds with the option life.

The Company's outstanding stock options include both non-qualified stock options, which vest over differing periods ranging from the date of issuance up to 36 months from the option grant date, and performance-based stock options, which vest upon achieving operating income margins

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

of six, eight and ten percent as reported in four of five consecutive quarters over the term of the options.

Share-based compensation expense from non-qualified stock options for the three-month periods ended September 30, 2011 and 2010 was approximately \$166 and \$107, respectively; the related tax benefit was approximately \$66 and \$42, respectively. Share-based compensation expense from non-qualified stock options for the nine-month periods ended September 30, 2011 and 2010 was approximately \$390 and \$325, respectively; the related tax benefit was approximately \$156 and \$127, respectively. As of September 30, 2011 and December 31, 2010, the unrecognized share-based compensation expense related to the grants described above was \$879 and \$451, respectively.

The Company recorded shared-based compensation expense of \$607 and a related tax benefit of approximately \$240 for the three months ended September 30, 2011 for the six and eight percent operating margin performance-based stock options. The Company recorded shared-based compensation expense of \$1,527 and a related tax benefit of approximately \$603 for the nine months ended September 30, 2011 for the performance-based stock options that will vest upon achieving six and eight percent operating income margins as reported in four of five consecutive quarters. No share-based compensation costs for performance-based stock options were recorded for the same periods in 2010. As of September 30, 2011, the unrecognized share-based compensation expense related to these options was approximately \$862. In the event that the Company achieves a ten percent operating income margin as reported in four of five consecutive quarters, the Company will recognize up to \$1,200 of additional share-based compensation expense.

At September 30, 2011, the aggregate intrinsic value of outstanding non-qualified and performance-based stock options to purchase 1,379 shares of common stock, exercisable non-qualified and performance-based stock options to purchase 334 shares of common stock and non-qualified and performance-based stock options to purchase 772 shares of common stock that are expected

# Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

## Table of Contents

to vest was \$5,987, \$1,753 and \$3,545, respectively. At December 31, 2010, the aggregate intrinsic value of outstanding options to purchase 859 shares of common stock was \$855.

## (10) Segment Information

The Company has three business segments. These business segments are components of the Company for which separate information is available that is evaluated regularly by the chief executive officer in deciding how to allocate resources and in assessing relative performance.

The Company has two reportable business segments that operate under the Nature's Sunshine Products brand and are divided based on their geographic operations in the United States (NSP United States) and in countries outside the United States (NSP International). The Company's third reportable business segment operates under the Synergy Worldwide brand, which offers marketing plans, Distributor compensation plans and product formulations that are sufficiently different from those of NSP United States and NSP International to warrant accounting for these operations as a separate business segment. Net sales revenues for each segment have been reduced by intercompany sales as they are not included in the measure of segment profit or loss reviewed by the chief executive officer. The Company evaluates performance based on operating income (loss) by segment before consideration of certain inter-segment transfers and expenses.

Reportable business segment information is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net sales revenue:				
Nature's Sunshine Products:				
United States	\$ 33,519	\$ 34,521	\$ 105,061	\$ 107,402
International	33,059	33,316	102,661	103,814
	66,578	67,837	207,722	211,216
Synergy Worldwide	24,524	18,259	68,035	48,813
Total net sales revenue	91,102	86,096	275,757	260,029
Operating expenses:				
Nature's Sunshine Products:				
United States	31,176	32,128	95,257	102,350
International	43,151	32,658	108,852	101,279
	74,327	64,786	204,109	203,629
Synergy Worldwide	21,880	17,434	61,080	48,681
Total operating expenses	96,207	82,220	265,189	252,310
Operating income (loss):				
Nature's Sunshine Products:				
United States	2,343	2,393	9,804	5,052
International	(10,092)	658	(6,191)	2,535
	(7,749)	3,051	3,613	7,587
Synergy Worldwide	2,644	825	6,955	132
Total operating income (loss)	(5,105)	3,876	10,568	7,719

Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

Other income, net	1,204	375	1,049	2,374
Income (loss) before provision for income taxes	\$ (3,901)	\$ 4,251	\$ 11,617	\$ 10,093

NSP International's operating loss of \$10,092 and \$6,191 for the three and nine months ended September 30, 2011, includes \$14,750 of contract termination costs related to the Company's arbitration settlement with NutriPlus LLC (described further in Note 12, Commitments and Contingencies).

The Company moved the reporting of its Dominican Republic market from NSP United States to NSP International during the quarter ended March 31, 2011, and has made conforming changes to the results presented above for the prior year periods. The net sales revenue and operating loss of this market for the three months ended September 30, 2010 were \$690 and (\$121), respectively. The net sales revenue and operating loss of this market for the nine months ended September 30, 2010 were \$3,105 and (\$358), respectively.

From an individual country perspective, only the United States comprises 10 percent or more of consolidated net sales revenue for either of the three and nine-month periods ended September 30, 2011 and 2010 as follows:

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net sales revenue:				
United States	\$ 38,885	\$ 38,674	\$ 120,868	\$ 117,997
Other	52,217	47,422	154,889	142,032
	\$ 91,102	\$ 86,096	\$ 275,757	\$ 260,029

Net sales revenue by product group has not been reported as management has determined that it is impracticable to accumulate such information.

From an individual country perspective, only the United States and Venezuela comprise 10 percent or more of consolidated property, plant and equipment as follows:

	September 30, 2011	December 31, 2010
Property, plant and equipment:		
United States	\$ 18,815	\$ 20,350
Venezuela	4,042	4,353
Other	2,351	2,688
Total property, plant and equipment	\$ 25,208	\$ 27,391

**(11) Income Taxes**

Interim income taxes are based on an estimated annualized effective tax rate applied to the respective quarterly periods, pro forma for discrete tax items in the period in which they occur. For the three months ended September 30, 2011 and 2010, the Company's (benefit) provision for income taxes, as a percentage of income (loss) before income taxes was (42.2) percent and 37.0 percent, respectively, compared with a U.S. federal statutory rate of 35.0 percent. For the nine months ended September 30, 2011 and 2010, the Company's provision for income taxes, as a percentage of income before income taxes was 14.1 percent and 12.3 percent, respectively, compared with a U.S. federal statutory rate of 35.0 percent.

The differences between the effective tax rates and the U.S. federal statutory tax rate for the three months and nine months ended September 30, 2011 was primarily attributed to foreign deductible items, including a favorable inflation adjustment, and lower rates in foreign jurisdictions than the rates in the U.S., in addition to a decrease in recognition of previous expense related to unremitted earnings.

The differences between the effective rate and the U.S. federal statutory rate for the three and nine months ended September 30, 2010 were primarily attributed to net increases in tax liabilities associated with uncertain tax positions offset by deductions of certain worthless foreign stock, and also offset by utilization of foreign tax credits.

The Company's U.S. federal income tax returns for 2003 through 2010 are open to examination for federal tax purposes. The Company has several foreign tax jurisdictions which have open tax years from 2000 through 2010. The Internal Revenue Service ( IRS ) is currently conducting

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

an audit of the Company's U.S. federal income tax returns for 2006 through 2010.

As of September 30, 2011, the Company had accrued \$12,872 (net of \$5,687 of other assets related to competent authority and royalty benefits) related to unrecognized tax positions compared with \$15,679 (net of \$5,687 of other assets related to competent authority and royalty benefits) as of December 31, 2010. This net decrease was primarily attributed to the expiration of the statute of limitations on certain liabilities in various foreign jurisdictions and payments made during the quarter of \$2,593 related to the IRS's audits of the Company's U.S. federal income tax returns for 2003 through 2005, which were expensed in prior periods.

In October 2009, the IRS issued an examination report formally proposing adjustments with respect to the 2003 through 2005 taxable years, which primarily relate to the prices that were charged in intra-group transfers of property and the disallowance of related deductions. The Company has commenced administrative proceedings with the Office of Appeals of the Internal Revenue Service challenging the proposed adjustments. Management believes that the Company has appropriately reserved for these matters, relating to all open periods, at an amount which it believes will ultimately be due upon resolution of the administrative proceedings, and such amounts reflect management's estimates based upon available evidence resulting from discussions with the IRS Office of Appeals. These estimates are based upon a more-likely-than-not recognition threshold. The Company is currently unable to determine the outcome of these discussions and their related impact, if any, on the Company's financial condition, results of operations, or cash flows.

Although the Company believes its estimates are reasonable, the Company can make no assurance that the final tax outcome of these matters will not be different from that which it has reflected in its historical income tax provisions and accruals.

Table of Contents

Such difference could have a material impact on the Company's income tax provision and operating results in the period in which the Company makes such determination.

**(12) Commitments and Contingencies**

**Legal Proceedings**

The Company is party to various legal proceedings, including those noted below. Management cannot predict the ultimate outcome of these proceedings, individually or in the aggregate, or their resulting effect on the Company's business, financial position, results of operations or cash flows as litigation and related matters are subject to inherent uncertainties, and unfavorable rulings could occur. Were an unfavorable outcome to occur, there exists the possibility of a material adverse impact on the business, financial position, results of operations, or cash flows for the period in which the ruling occurs and/or future periods. The Company maintains directors' and officers' liability, product liability, general liability and excess liability insurance coverage. However, no assurances can be given that such insurance will continue to be available at an acceptable cost to the Company, that such coverage will be sufficient to cover one or more large claims, or that the insurers will not successfully disclaim coverage as to a pending or future claim.

**NutriPlus Settlement**

In 1999 and 2000, the Company and NutriPlus LLC ( "NutriPlus" ) entered into an Asset Purchase Agreement and subsequent Settlement Agreement (together the "Purchase Agreement" ) under which the Company acquired certain assets in order to establish its Russian business, and NutriPlus acquired rights to receive certain royalty payments from the Company expressed as a percentage of the Company's net sales in its Russian business.

On July 12, 2010, the Company submitted a demand for arbitration to the American Arbitration Association (the "AAA" ) naming NutriPlus as respondent. The Company sought a declaration of its rights and obligations, including with respect to royalty payments, and the calculation thereof, arising out of the Purchase Agreement.

On July 20, 2010, NutriPlus submitted its own demand for arbitration to the AAA naming the Company as respondent. NutriPlus alleged that the Company underpaid NutriPlus for royalties arising out of the Purchase Agreement. In arbitration, NutriPlus sought damages related to the alleged underpayment and a declaratory judgment with respect to the method the Company must use in determining the amount of royalties to pay NutriPlus in the future.

The arbitration demands were consolidated into a single proceeding, and the hearing was scheduled for July 2011.

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

On July 8, 2011, the Company and NutriPlus entered into a settlement agreement, wherein both parties settled all claims in the arbitration and bore their own costs associated with the arbitration. As a result of the settlement, the Company agreed to pay NutriPlus \$21,700 for the release of all past and future royalty obligations. Of the \$21,700, the Company applied \$6,950 toward previously accrued and expensed but unpaid royalties, and \$14,750 in exchange for the contract termination and extinguishment of future royalty obligations.

For the year ended December 31, 2010, the Company recorded and expensed royalty payments to NutriPlus of approximately \$5,553 (included in selling, general and administrative expenses), which was approximately 4.0 percent of NSP International's revenue and 1.6 percent of the Company's consolidated revenue. For the six months ended June 30, 2011, the Company recorded and expensed royalty payments to NutriPlus of approximately \$2,894, which was approximately 4.2 percent of NSP International's revenue and 1.6 percent of the Company's consolidated revenue. As a result of the settlement, the Company's royalty costs related to NutriPlus will be eliminated in all future periods.

### **Other Litigation**

The Company is party to various other legal proceedings in several foreign jurisdictions related to value-added tax assessments and other civil litigation. Although there is a reasonable possibility that a material loss may be incurred, the Company cannot at this time estimate the loss, if any. Therefore, no provision for losses has been provided. The Company believes future payments related to these matters could range from \$0 to approximately \$1,500.

### **Non-Income Tax Contingencies**

The Company has reserved for certain state sales and use tax and foreign non-income tax contingencies based on the likelihood of an obligation in accordance with accounting guidance for probable loss contingencies. Loss contingency provisions are recorded for probable losses at management's best estimate of a loss, or when a best estimate cannot be made, a minimum loss contingency amount is recorded. The Company provides provisions for potential payments of tax to various tax authorities for contingencies related to non-income tax matters, including value-added taxes and sales tax. The Company provides provisions for U.S. state sales taxes in each of the states where the Company has a nexus. As of September 30, 2011 and December 31, 2010,

Table of Contents

accrued liabilities include \$7,460 and \$10,235, respectively, related to non-income tax contingencies. While management believes that the assumptions and estimates used to determine this liability are reasonable, the ultimate outcome of those matters cannot presently be determined. The Company is not able at this time to predict the ultimate outcomes of those matters or to estimate the effect that the ultimate outcomes, if greater than the amounts accrued, would have on the financial condition, results of operations or cash flows of the Company.

**Government Regulations**

The Company is subject to governmental regulations pertaining to product formulation, labeling and packaging, product claims and advertising, and to the Company's direct selling system. The Company is also subject to the jurisdiction of numerous foreign tax and customs authorities. Any assertions or determinations that either the Company or the Company's independent Distributors are not in compliance with existing statutes, laws, rules or regulations could potentially have a material adverse effect on the Company's operations. In addition, in any country or jurisdiction, the adoption of new statutes, laws, rules or regulations, or changes in the interpretation of existing statutes, laws, rules or regulations could have a material adverse effect on the Company and its operations. Although management believes that the Company is in compliance, in all material respects, with the statutes, laws, rules and regulations of every jurisdiction in which it operates, no assurance can be given that the Company's compliance with applicable statutes, laws, rules and regulations will not be challenged by foreign authorities or that such challenges will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

**(13) Fair Value Measurements**

The fair value of a financial instrument is the amount that could be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. A fair value hierarchy is used to prioritize the quality and reliability of the information used to determine fair values of each financial instrument. Categorization within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is defined into the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

The following table presents the Company's hierarchy for its assets measured at fair value on a recurring basis as of September 30, 2011:

	Level 1 Quoted Prices in Active Markets for Identical Assets	Level 2 Significant Other Observable Inputs	Level 3 Significant Unobservable Inputs	Total
Investments available-for-sale				

Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

Municipal obligations	\$		\$	1,431	\$		\$	1,431
U.S. government security funds		981						981
Short-term deposits				1,783				1,783
Equity securities		356						356
Investment securities		1,423						1,423
Total assets measured at fair value on a recurring basis	\$	2,760	\$	3,214	\$		\$	5,974

The following table presents the Company's hierarchy for its assets measured at fair value on a recurring basis as of December 31, 2010:

	Level 1 Quoted Prices in Active Markets for Identical Assets	Level 2 Significant Other Observable Inputs	Level 3 Significant Unobservable Inputs	Total
Investments available-for-sale				
Municipal obligations	\$		\$	1,960
U.S. government security funds		974		974
Short-term deposits			3,148	3,148
Equity securities		388		388
Investment securities		1,778		1,778
Total assets measured at fair value on a recurring basis	\$	3,140	\$	5,108
			\$	8,248

*Investments available-for-sale* The majority of the Company's investment portfolio consists of various fixed income securities such as U.S. government security funds, state and municipal bonds, mutual funds, short-term deposits and equity securities. The Level 1 securities are valued using quoted prices for identical assets in active markets including equity securities,

Table of Contents

U.S. government securities, and various mutual funds. The Level 2 securities include investments in state and municipal bonds whereby all significant inputs are observable or can be derived from or corroborated by observable market data for substantially the full term of the asset.

*Investment securities* The majority of the Company's trading portfolio consists of various marketable securities that are using quoted prices in active markets.

For the nine months ended September 30, 2011 and for the year ended December 31, 2010, there were no fair value measurements using the significant unobservable inputs (Level 3).

The carrying amounts reflected on the consolidated balance sheet for cash and cash equivalents, accounts and notes receivable, and accounts payable approximate fair value due to their short-term nature. The carrying amount reflected in the consolidated balance sheet for long-term debt approximates fair value due to the interest rate on the debt being variable based on current market rates. During the nine months ended September 30, 2011 and 2010, the Company did not have any write-offs related to the re-measurement of non-financial assets at fair value on a nonrecurring basis subsequent to their initial recognition.

Table of Contents

**Item 2.                    *MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS***

The following Management's Discussion and Analysis should be read in conjunction with the unaudited consolidated financial statements and notes thereto included in this report, as well as the consolidated financial statements, the notes thereto, and management's discussion and analysis included in our Annual Report on Form 10-K for the year ended December 31, 2010, and our Reports on Form 8-K, that have been filed with the SEC since then through the date of this report.

Throughout this report, we refer to Nature's Sunshine Products, Inc., together with its subsidiaries, as we, us, our, Company or the Company.

**OVERVIEW**

Nature's Sunshine Products, Inc. and its subsidiaries are primarily engaged in the manufacturing and marketing of nutritional, herbal, weight management, energy and other complementary products. Nature's Sunshine Products, Inc. is a Utah corporation with its principal place of business in Provo, Utah. We sell our products to a sales force of independent Distributors and Managers 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 our major product groups are subject to regulation by one or more governmental agencies. The Company has two reportable business segments that operate under the Nature's Sunshine Products brand and are divided based on their geographic operations in the United States (NSP United States) and in countries outside the United States (NSP International). We also sell our products through a separate division and operating business segment, Synergy Worldwide. Synergy Worldwide offers marketing plans, Distributor compensation plans and product formulations that are sufficiently different from those of NSP United States and NSP International to warrant its treatment as a separately reportable business segment.

We market our products in Australia, Austria, Belarus, Canada, the Czech Republic, Colombia, Costa Rica, Denmark, the Dominican Republic, Ecuador, El Salvador, Germany, Guatemala, Honduras, Hong Kong, Indonesia, Ireland, Japan, Kazakhstan, Latvia, Lithuania, Malaysia, Mexico, Mongolia, the Netherlands, Nicaragua, Norway, Panama, Peru, the Philippines, Poland, Russia, Singapore, South Korea, Sweden, Taiwan, Thailand, Ukraine, the United Kingdom, the United States, Venezuela and Vietnam. We export our products to several other countries, including Argentina, Australia, Chile, Israel, New Zealand and Norway.

During the third quarter of 2011, we experienced an increase in our consolidated net sales of 5.8 percent. Synergy Worldwide experienced an increase in net sales revenue of approximately 34.3 percent (or 26.9 percent in local currencies excluding the positive impact of foreign currency fluctuations). NSP International experienced a decrease in net sales of approximately 0.8 percent compared to the same period in 2010, and a decrease in local currency net sales of 2.4 percent (excluding the positive impact of foreign currency fluctuations), while NSP United States net sales decreased approximately 2.9 percent. The significant sales revenue growth was from our Synergy European, Korean, United States markets and our NSP Russian market during the third quarter of 2011. Gains in these markets were partially offset by decreases in our NSP Dominican Republic, NSP and Synergy Japan and NSP Mexico markets.

On July 8, 2011, we entered into a settlement agreement with NutriPlus LLC (NutriPlus), from which we acquired certain assets in 1999 in order to establish our Russian business and to which we agreed to make royalty payments as a percentage of sales from our Russian business. As a

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

result of the settlement, wherein both parties settled all claims in the arbitration and bore their own costs associated with the arbitration, the Company agreed to pay NutriPlus \$21.7 million for the release of all past and future royalty obligations. Of the \$21.7 million, the Company applied \$7.0 million toward previously accrued and expensed but unpaid royalties, and \$14.7 million in exchange for the contract termination and extinguishment of future royalty obligations.

For the year ended December 31, 2010, the Company recorded and expensed royalty payments to NutriPlus of approximately \$5.6 million (included in selling, general and administrative expenses), which was approximately 4.0 percent of NSP International's revenue and 1.6 percent of the Company's consolidated revenue. For the six months ended June 30, 2011, the Company recorded and expensed royalty payments to NutriPlus of approximately \$2.9 million, which was approximately 4.2 percent of NSP International's revenue and 1.6 percent of the Company's consolidated revenue.

As a result of the settlement, our operating costs for the quarter ended September 30, 2011, were reduced by \$1.3 million, which resulted in a corresponding increase to operating income of \$1.3 million. Similarly, based on current sales from our Russian business, we expect the settlement will result in an annual reduction of \$5.6 to \$6.0 million in operating costs and a corresponding increase in operating income above the level the Company would otherwise achieve if the NutriPlus royalty obligation remained in effect. This impact on operating costs and operating income will fluctuate with sales volumes in our Russian business.

Over the same period, selling, general and administrative costs as a percentage of net sales revenue for the quarter decreased from 39.0 percent in the prior year to 35.0 percent in the current year as a result of revenue growth (primarily in Synergy Worldwide), the reduction of our royalty costs related to our Russian business as noted above, and our successful efforts to reduce operating costs in all of our operating segments.

Table of Contents

As a result of our overall growth in net sales revenue and reductions in operating expenses, our consolidated pro forma operating income for the quarter increased from 4.5 percent of net sales revenue in the prior year to 10.6 percent of net sales revenue in the current year, after excluding contract termination costs of \$14.7 million due to the NutriPlus settlement.

We distribute our products to consumers through an independent sales force comprised of Managers and Distributors. A person who joins our independent sales force begins as a Distributor. A Distributor interested in earning additional income by committing more time and effort to selling our products may earn Manager status. Manager status is contingent upon attaining certain purchase volume levels, recruiting additional Distributors, and demonstrating leadership abilities. Active Managers worldwide totaled approximately 28,200 and 30,000 at September 30, 2011 and 2010, respectively. Active Distributors and customers worldwide totaled approximately 682,300 and 681,000 at September 30, 2011 and 2010, respectively.

**RESULTS OF OPERATIONS**

The following table summarizes our unaudited consolidated operating results in U.S. dollars and as a percentage of net sales revenue for the three months ended September 30, 2011 and 2010 (dollar amounts in thousands).

	2011		2010		Change from 2011 to 2010	
	Total dollars	Percent of net sales	Total dollars	Percent of net sales	Dollar	Percentage
Net sales revenue	\$ 91,102	100.0%	\$ 86,096	100.0%	\$ 5,006	5.8%
<b>Costs and expenses:</b>						
Cost of goods sold	16,879	18.5	16,632	19.3	247	1.5
Volume incentives	32,733	35.9	32,065	37.2	668	2.1
SG&A expenses	31,845	35.0	33,523	39.0	(1,678)	(5.0)
Contract termination costs	14,750	16.2		0.0	14,750	100.0
Total operating expenses	96,207	105.6	82,220	95.5	13,987	17.0
Operating income (loss)	(5,105)	(5.6)	3,876	4.5	(8,981)	(231.7)
Other income, net	1,204	1.3	375	0.4	829	222.1
Income (loss) before provision for income taxes	(3,901)	(4.3)	4,251	4.9	(8,152)	(191.8)
(Benefit) provision for income taxes	(1,645)	(1.8)	1,573	1.8	(3,218)	(204.6)
Net income (loss) from continuing operations	(2,256)	(2.5)	2,678	3.1	(4,934)	(184.2)
Loss from discontinued operations			(8,418)	(9.8)	8,418	100.0
Net loss	\$ (2,256)	(2.5)%	\$ (5,740)	(6.7)%	\$ 3,484	60.7%

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

### Table of Contents

The following table summarizes our unaudited consolidated operating results in U.S. dollars and as a percentage of net sales revenue for the nine months ended September 30, 2011 and 2010 (dollar amounts in thousands).

	2011		2010		Change from 2011 to 2010	
	Total dollars	Percent of net sales	Total dollars	Percent of net sales	Dollar	Percentage
Net sales revenue	\$ 275,757	100.0%	\$ 260,029	100.0%	\$ 15,728	6.0%
Costs and expenses:						
Cost of goods sold	52,560	19.1	51,308	19.7	1,252	2.4
Volume incentives	100,421	36.4	97,162	37.4	3,259	3.4
SG&A expenses	97,458	35.3	103,840	39.9	(6,382)	(6.1)
Contract termination costs	14,750	5.4	0.0	0.0	14,750	100.0
Total operating expenses	265,189	96.2	252,310	97.0	12,879	5.1
Operating income	10,568	3.8	7,719	3.0	2,849	36.9
Other income, net	1,049	0.4	2,374	0.9	(1,325)	(55.8)
Income before provision for income taxes	11,617	4.2	10,093	3.9	1,524	15.1
Provision for income taxes	1,637	0.6	1,238	0.5	399	32.2
Net income from continuing operations	9,980	3.6	8,855	3.4	1,125	12.7
Loss from discontinued operations			(9,388)	(3.6)	9,388	100.0
Net income (loss)	\$ 9,980	3.6%	\$ (533)	(0.2)%	\$ 10,513	1,972.4%

### *Net Sales Revenue*

Consolidated net sales revenue for the three and nine months ended September 30, 2011 was \$91.1 million and \$275.8 million compared to \$86.1 million and \$260.0 million for the same periods in 2010, increases of approximately 5.8 percent and 6.0 percent, respectively. The increases in net sales revenue for the three and nine months ended September 30, 2011 compared to the same periods in 2010, are due to growth in Synergy Worldwide, partially offset by declines in NSP United States and NSP International.

### NSP United States

Net sales revenue for NSP United States for the three and nine months ended September 30, 2011 was \$33.5 million and \$105.1 million compared to \$34.5 million and \$107.4 million for the same periods in 2010, or decreases of 2.9 percent and 2.2 percent, respectively, compared to the same periods in 2010. NSP United States Managers and Distributors are predominantly practitioners of nutritional supplement therapies and retailers and consumers of our products, a segment that continues to be adversely affected by the economic downturn. Net sales revenue also decreased compared to the same period in the prior year due to changes to some of our less profitable promotional programs.

NSP United States includes both English and Spanish language sales divisions, of which the English language division is approximately 80 percent of segment net sales revenue. The English language division net sales revenue decreased \$0.9 million and \$1.6 million for the three and nine months ended September 30, 2011, or decreases of 3.2 percent and 1.8 percent, respectively, compared to the same periods in 2010. The Spanish language division net sales revenue decreased \$0.1 million and \$0.8 million, or decreases of 1.9 percent and 3.5 percent, respectively,

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

for the three and nine months ended September 30, 2011, compared to the same periods in 2010. While both the English and Spanish Divisions have been adversely affected by the poor economic environment, the cancellation of some less profitable promotional programs had a more significant impact on our Spanish Division.

Active Managers within NSP United States totaled approximately 5,600 and 6,200 at September 30, 2011 and 2010, respectively. A significant contributor to the decrease in the number of active Managers was the discontinuance of a program that allowed Distributors to attain Manager status by meeting lower performance criteria. Active Distributors and customers within NSP United States totaled approximately 210,300 and 241,900 at September 30, 2011 and 2010, respectively. The number of active Distributors and customers decreased due to a poor economic environment. In addition, the number of active Distributors also decreased due to changes to some of our less profitable recruiting and retention programs.

### NSP International

NSP International reported net sales revenue for the three and nine months ended September 30, 2011 of \$33.1 million and \$102.7, compared to \$33.3 million and \$103.8 million for the same periods in 2010, or decreases of approximately 0.8 percent and

Table of Contents

1.1 percent, respectively, compared to the same periods in 2010. In local currencies, net sales decreased 2.4 percent and 2.4 percent, respectively, compared to the same periods in 2010. Fluctuation in foreign exchange rates had a \$0.5 million and \$1.4 million favorable impact on net sales for the three and nine months ended September 30, 2011, respectively. The decrease in sales is due to lower local currency sales in our Dominican Republic, Japan and Mexico markets, offset by higher sales in our Russian markets and positive currency fluctuations.

Notable activity in the following markets contributed to the results of NSP International:

In NSP International's Russian markets (Russia, Ukraine, Belarus and several other Eastern European nations), net sales revenues increased approximately \$0.7 million and \$2.0 million, or 5.6 percent and 5.0 percent, for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. The Russian markets continue to build on the momentum gained in the prior year as a result of improved Manager and Distributor recruiting efforts and strengthening economies in the region. However, this growth has been slowed by a growing debt crisis in Belarus, which has adversely affected NSP International's local Distributors' ability to obtain foreign currency to purchase our products and may continue to adversely affect sales going forward. NSP International's sales in Belarus were \$0.9 million and \$1.2 million lower for the three and nine months ended September 30, 2011, compared to the same periods in 2010.

In Japan, net sales revenues decreased approximately \$0.2 million and \$0.5 million, or 10.0 percent and 8.5 percent, for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. In local currency, net sales decreased 20.0 percent and 16.9 percent, respectively, compared to the same periods in 2010. Fluctuations in foreign exchange rates had a \$0.2 million and \$0.5 million favorable impact on net sales for the three and nine months ended September 30, 2011. The decrease in local currency sales is partially due to the recent earthquake, tsunami and subsequent nuclear disasters, which suppressed consumer confidence and spending and made it difficult to ship ordered products, as well as to retain active Distributors. NSP International's future sales in Japan may be adversely affected while the country rebuilds and recovers from these recent disasters.

In Mexico, net sales revenues decreased approximately \$0.7 million and \$1.8 million, or 19.4 percent and 16.2 percent, for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. In local currency, net sales decreased 25.0 percent and 20.7 percent, respectively, compared to the same periods in 2010. Fluctuations in foreign exchange rates had a \$0.2 million and \$0.5 million favorable impact on net sales for the three and nine months ended September 30, 2011. We believe the decrease in local currency net sales is principally due to the continuing effects of a tax law interpretation by the Mexican taxing authority requiring the collection of value-added tax on all of our products sold in Mexico and our compliance with this interpretation.

In the Dominican Republic, net sales revenues decreased approximately \$0.1 million and \$1.1 million, or 14.3 percent and 35.5 percent, for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. The decrease in sales is due to the elimination of promotional programs and events which historically had promoted sales growth, but did not produce profitable results.

Active Managers within NSP International totaled approximately 20,000 and 21,800 at September 30, 2011 and 2010, respectively. Active Distributors and customers within NSP International totaled approximately 387,000 and 354,800 at September 30, 2011 and 2010 respectively.

Synergy Worldwide

Synergy Worldwide reported net sales revenue for the three and nine months ended September 30, 2011 of \$24.5 million and \$68.0 million, compared to \$18.3 million and \$48.8 million in 2010, increases of approximately 34.3 percent and 39.4 percent, respectively. In local currencies, net sales increased 26.9 percent and 35.1 percent for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. Fluctuations in foreign exchange rates had a \$1.4 million and \$2.1 million favorable impact on net sales for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. The increase in net sales was primarily due to growth in Synergy Worldwide's United States, Korean and European markets, offset by sales declines in its Japan market.

Notable activity in the following markets contributed to the results of Synergy Worldwide:

In the United States, net sales revenues increased approximately \$1.2 million and \$5.2 million, or 28.6 percent and 49.1 percent, for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. Synergy Worldwide's growth within the United States is due to effective Company and Manager sales and marketing efforts of a well-accepted product offering, which has resulted in the growth of its U.S. Distributor base through recruiting and retention.

In Europe, net sales revenues increased approximately \$3.0 million and \$7.7 million, or 100.0 percent and 91.7 percent, for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. In local currency, net sales increased 83.3 percent and 79.8 percent, respectively, compared to the same periods in 2010. Fluctuations in foreign exchange rates had a \$0.5 million and \$1.0 million favorable impact on net sales for the three and nine months ended September

Table of Contents

30, 2011 compared to the same periods in 2010. Strong Distributor marketing and development continues to drive increased market penetration primarily within the relatively new markets of Austria, Norway and Sweden.

In Korea, net sales revenues increased approximately \$2.5 million and \$6.4 million, or 80.6 percent and 85.3 percent, for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. In local currency, net sales increased 64.5 percent and 74.7 percent, compared to the same periods in 2010. Fluctuations in foreign exchange rates had a \$0.5 million and \$0.8 million favorable impact on net sales for the three and nine months ended September 30, 2011, compared to the same periods in 2010. Synergy Worldwide's growth in Korea is due to productive joint Company and Manager efforts to develop sales groups as well as a broader product line that is well accepted in the market.

In Japan, net sales revenues decreased approximately \$0.4 million and \$0.9 million, or 9.3 percent and 7.5 percent, for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. In local currency, net sales decreased 18.6 percent and 16.7 percent compared to the same periods in 2010. Fluctuations in foreign exchange rates had a \$0.4 million and \$1.1 million favorable impact on net sales for the three and nine months ended September 30, 2011, compared to the same periods in 2010. The decrease in local currency sales is partially due to the recent earthquake, tsunami and subsequent nuclear disasters, which suppressed consumer confidence and spending and made it difficult to ship ordered products, as well as to recruit and retain active Distributors. Synergy Worldwide's future sales in Japan may be adversely affected while the country rebuilds and recovers from these recent disasters.

Active Managers within Synergy Worldwide totaled approximately 2,600 and 2,000 at September 30, 2011 and 2010, respectively. Active Distributors and customers within Synergy Worldwide totaled approximately 85,000 and 84,300 at September 30, 2011 and 2010, respectively.

Further information related to NSP United States, NSP International and Synergy Worldwide business segments is set forth in Note 10 to the Unaudited Condensed Consolidated Financial Statements in Part 1, Item 1 of this report.

*Cost of Goods Sold*

Cost of goods sold as a percent of net sales revenue decreased to 18.5 percent and 19.1 percent for the three and nine months ended September 30, 2011, compared to 19.3 percent and 19.7 percent for the same periods in 2010. These decreases are primarily due to reductions in product and material write-offs, changes in product mix between markets and lower raw material costs, partially offset by increased importation fees related to higher transfer prices within some of our foreign markets. While the Company intends to seek continued cost reductions where possible, pricing pressure on raw materials, fuel costs and other factors could affect our ability to reduce cost of goods sold further in the future.

*Volume Incentives*

Volume incentives are a significant part of our direct sales marketing program and represent commission payments made to our independent Distributors and Managers. These payments are designed to provide incentives for reaching higher sales levels and for recruiting additional Distributors. Volume incentives vary slightly, on a percentage basis, by product due to our pricing policies and commission plans in place in our

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

various operations. Volume incentives as a percent of net sales revenue decreased to 35.9 percent and 36.4 percent for the three and nine months in 2011, compared to 37.2 percent and 37.4 percent for the same periods in 2010. The decreases are primarily due to reductions in volume incentive rates due to our lower Manager and Distributor base within NSP United States and an increase in product purchases that pay a lower sales commission rate in Synergy Worldwide.

### *Selling, General and Administrative*

Selling, general and administrative expenses decreased to 35.0 percent and 35.3 percent of net sales revenue for the three and nine months ended September 30, 2011, compared to 39.0 percent and 39.9 percent in 2010, or by approximately \$1.7 million and \$6.4 million to \$31.9 million and \$97.5 million for the three and nine months ended September 30, 2011, respectively.

Significant increases to selling, general and administrative expenses during the three and nine months ended September 30, 2011, compared to the same period in 2010 included:

- increased variable costs of approximately \$1.4 million and \$3.3 million, respectively, related to the sales growth of Synergy Worldwide in Europe, Korea and the United States as well as NSP International in the Russian markets;
- approximately \$0.5 million and \$1.6 million, respectively, of unfavorable currency fluctuations;
- approximately \$0.6 million and \$1.5 million, respectively, due to the recognition of performance-based stock compensation costs based upon the Company's determination that it is probable the related performance metrics will be achieved;
- approximately \$0.1 million and \$1.5 million, respectively, in professional fees related to litigation costs; and
- approximately \$0.8 million and \$0.5 million, respectively, net decrease in the reduction of U.S. sales tax related reserves.

Table of Contents

Significant decreases to selling, general and administrative expenses during the three and nine months ended September 30, 2011, compared to the same period in 2010 included:

- cost reductions in many of our foreign markets totaling approximately \$1.9 million and \$5.1 million, respectively, related to changes in leases and compensation costs;
- decreased royalty costs related to our Russian business as a result of the NutriPlus settlement of \$1.2 million and \$1.2 million, respectively;
- decreased U.S. compensation and other benefit related costs of \$1.0 million and \$2.6 million, respectively;
- a decrease of \$1.1 million and \$1.9 million, respectively, related to our U.S. healthcare costs;
- decreased administrative costs of \$0.2 million and \$2.6 million, respectively, in U.S. convention and promotion related costs due to the differences in event qualification periods between years; and
- a \$0.3 million and \$1.4 million decrease in foreign value-added tax reserves between periods during 2011.

We continue to implement cost reduction measures within all of our operating segments wherever possible.

*Contract Termination Costs*

On July 8, 2011, we entered into a settlement agreement with NutriPlus, from which we acquired certain assets in 1999 in order to establish our Russian business and to which we agreed to make royalty payments as a percentage of sales from our Russian business. As a result of the settlement, wherein both parties settled all claims in the arbitration and bore their own costs associated with the arbitration, the Company agreed to pay NutriPlus \$21.7 million for the release of all past and future royalty obligations. Of the \$21.7 million, the Company applied \$7.0 million toward previously accrued and expensed but unpaid royalties, and \$14.7 million in exchange for the contract termination and extinguishment of future royalty obligations.

For the year ended December 31, 2010, the Company recorded and expensed royalty payments to NutriPlus of approximately \$5.6 million (included in selling, general and administrative expenses), which was approximately 4.0 percent of NSP International's revenue and 1.6 percent of the Company's consolidated revenue. For the six months ended June 30, 2011, the Company recorded and expensed royalty payments to NutriPlus of approximately \$2.9 million, which was approximately 4.2 percent of NSP International's revenue and 1.6 percent of the Company's consolidated revenue.

As a result of the settlement, our operating costs for the quarter ended September 30, 2011, were reduced by \$1.3 million, which resulted in a corresponding increase to operating income of \$1.3 million. Similarly, based on current sales from our Russian business, we expect the settlement will result in an annual reduction of \$5.6 to \$6.0 million in operating costs and a corresponding increase in operating income above the level the Company would otherwise achieve if the NutriPlus royalty obligation remained in effect. This impact on operating costs and

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

operating income will fluctuate with sales volumes in our Russian business.

See Note 12, Commitments and Contingencies in the Condensed Notes to the Consolidated Financial Statements for further discussion.

### *Operating Income (Loss)*

Operating income decreased \$9.0 million during the three months ended September 30, 2011, compared to the same period in 2010, from \$3.9 million to an operating loss of \$5.1 million. For the nine months ended September 30, 2011, operating income increased \$2.9 million, compared to the same period in 2010, from \$7.7 million to \$10.6 million. Excluding the NutriPlus related contract termination costs of \$14.7 million, consolidated pro forma operating income increased approximately \$5.7 million during the three months ended September 30, 2011, compared to the same period in 2010, from \$3.9 million to \$9.6 million. For the nine months ended September 30, 2011, pro forma operating income increased approximately \$17.6 million, compared to the same period in 2010, from \$7.7 million to \$25.3 million. Pro forma operating income increased to 10.6 percent and 9.2 percent of net sales for the three and nine months ended September 30, 2011, compared to 4.5 percent and 3.0 percent for the same periods in 2010, respectively.

Operating income for NSP United States decreased \$0.1 million for the three months ended September 30, 2011, compared to the same period in 2010, from \$2.4 million to \$2.3 million. For the nine months ended September 30, 2011, operating income increased approximately \$4.7 million, compared to the same period in 2010, from \$5.1 million to \$9.8 million. The increase in operating income is primarily the result of significant cost reductions in our selling, general and administrative expenses described above for the nine months ended September 30, 2011.

Operating income for NSP International decreased \$10.8 million during the three months ended September 30, 2011, compared to the same period in 2010, from \$0.7 million to an operating loss of \$10.1 million. For the nine months ended September 30, 2011, operating income decreased \$8.7 million, compared to the same period in 2010, from \$2.5 million to an operating loss of \$6.2 million. Excluding the NutriPlus related contract termination costs of \$14.7 million, pro forma operating income for NSP International increased approximately \$3.9 million and \$6.0 million for the three and nine months ended September 30, 2011, compared to the same periods in 2010, from \$0.7 million and \$2.5 million to \$4.6 million and \$8.5 million,

Table of Contents

respectively. The increase in pro forma operating income has primarily been the result of revenue growth in our Russian markets, and cost reductions within our foreign markets and positive changes in foreign value-added tax reserves.

Operating income for Synergy Worldwide increased \$1.8 million and \$6.9 million for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010, from \$0.8 million and \$0.1 million to \$2.6 million and \$7.0 million, respectively. This was primarily due to growth in sales within its European, U.S and Korean subsidiaries.

*Other Income (Expense), Net*

Other income (expense), net for the three and nine months ended September 30, 2011 increased \$0.8 million and decreased \$1.3 million, respectively, compared to the same periods in 2010. The year-to-date decrease is primarily due to prior year foreign exchange gains of \$3.7 million in Venezuela as a result of the devaluation of the bolivar and the change to a highly inflationary economy that were non-recurring and recognized in 2010, offset by net foreign exchange gains and losses in certain of our other markets based on changes in exchange rates.

*Income Taxes*

Interim income taxes are based on an estimated annualized effective tax rate applied to the respective quarterly periods, pro forma for discrete tax items in the period in which they occur. For the three months ended September 30, 2011 and 2010, the Company's (benefit) provision for income taxes, as a percentage of income (loss) before income taxes was (42.2) percent and 37.0 percent, respectively, compared with a U.S. federal statutory rate of 35.0 percent. For the nine months ended September 30, 2011 and 2010, the Company's provision for income taxes, as a percentage of income before income taxes was 14.1 percent and 12.3 percent, respectively, compared with a U.S. federal statutory rate of 35.0 percent.

The differences between the effective tax rates and the U.S. federal statutory tax rate for the three months and nine months ended September 30, 2011 was primarily attributed to foreign deductible items, including a favorable inflation adjustment, and lower rates in foreign jurisdictions than the rates in the U.S., in addition to a decrease in recognition of previous expense related to unremitted earnings.

The differences between the effective rate and the U.S. federal statutory rate for the three and nine months ended September 30, 2010 were primarily attributed to net increases in tax liabilities associated with uncertain tax positions offset by deductions of certain worthless foreign stock, and also offset by utilization of foreign tax credits.

The Company's U.S. federal income tax returns for 2003 through 2010 are open to examination for federal tax purposes. The Company has several foreign tax jurisdictions which have open tax years from 2000 through 2010. The Internal Revenue Service ( IRS ) is currently conducting an audit of the Company's U.S. federal income tax returns for 2006 through 2010.

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

In October 2009, the IRS issued an examination report formally proposing adjustments with respect to the 2003 through 2005 taxable years, which primarily relate to the prices that were charged in intra-group transfers of property and the disallowance of related deductions. The Company has commenced administrative proceedings with the Office of Appeals of the Internal Revenue Service challenging the proposed adjustments. Management believes that the Company has appropriately reserved for these matters, relating to all open periods, at an amount which it believes will ultimately be due upon resolution of the administrative proceedings, and such amounts reflect management's estimates based upon available evidence resulting from discussions with the IRS Office of Appeals. These estimates are based upon a more-likely-than-not recognition threshold. The Company is currently unable to determine the outcome of these discussions and their related impact, if any, on the Company's financial condition, results of operations, or cash flows.

Although the Company believes its estimates are reasonable, the Company can make no assurance that the final tax outcome of these matters will not be different from that which it has reflected in its historical income tax provisions and accruals. Such difference could have a material impact on the Company's income tax provision and operating results in the period in which the Company makes such determination.

### *Discontinued Operations*

During 2010, we ceased our operations in Brazil as a result of increased import regulations and declining sales. As a result, we reclassified the Brazil subsidiary's operations to discontinued operations. During 2011, there were no significant costs related to this market. This market represented less than 0.3 percent of our consolidated net sales for 2010.

### **LIQUIDITY AND CAPITAL RESOURCES**

Our principal use of cash is to pay for operating expenses, including volume incentives, inventory and raw material purchases, capital assets and funding of international expansion. As of September 30, 2011, working capital was \$53.4 million, compared to \$41.4 million as of December 31, 2010. At September 30, 2011, we had \$54.1 million in cash and cash equivalents, of which \$41.3 million was held in our foreign markets and may be subject to various withholding taxes and other restrictions

Table of Contents

related to repatriation, and \$4.6 million in unrestricted short-term investments, which were available to be used along with our normal cash flows from operations.

Our net consolidated cash (outflows) inflows are as follows (in thousands):

	<b>Nine Months Ended September 30,</b>			
	<b>2011</b>		<b>2010</b>	
Operating activities	\$	(4,120)	\$	10,220
Investing activities		666		(2,009)
Financing activities		10,372		31

For the nine months ended September 30, 2011, operating activities used cash in the amount of \$4.1 million compared to providing cash in the amount of \$10.2 million for the same period in 2010. Operating cash flows decreased due to the NutriPlus settlement payment of \$21.7 million as well as the timing of payments and receipts for accounts receivable and inventory, and was partially offset by the growth in our operating income. Excluding the payment of \$21.7 million to NutriPlus, our pro forma cash flow from operations was \$17.6 million.

Capital expenditures related to the purchase of equipment, computer systems and software for the nine months ended September 30, 2011 and 2010 were \$1.1 million and \$2.1 million, respectively.

During the nine months ended September 30, 2011, we had cash proceeds of \$5.7 million from the sale of available-for-sale investments. During the same period we used cash of \$3.9 million to purchase available-for-sale investments.

During the nine months ended September 30, 2011, we borrowed \$10.0 million on a term credit facility repayable over three years, which is secured by the Company's manufacturing facility in Spanish Fork, Utah.

The Company has an additional long-term revolving credit facility that allows us to borrow up to \$15.0 million. As of September 30, 2011, no amounts were drawn under the credit facility. We believe that, with this credit facility in place, our working capital requirements can be met for the foreseeable future with cash generated from operating activities, available cash and cash equivalents and draws on the credit facility. However, among other things, a prolonged economic downturn, a decrease in demand for our products, an unfavorable settlement of our unrecognized tax positions or non-income tax contingencies could adversely affect our long-term liquidity.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our unaudited consolidated financial statements have been prepared in accordance with U.S. GAAP and form the basis for the following discussion and analysis on critical accounting policies and estimates. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and

liabilities. On a regular basis we evaluate our estimates and assumptions. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates and those differences could have a material effect on our financial position and results of operations. Management has discussed the development, selection and disclosure of these estimates with the Board of Directors and its Audit Committee.

A summary of our significant accounting policies is provided in Note 1 of the Notes to Consolidated Financial Statements in Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2010. We believe the critical accounting policies and estimates described below reflect our more significant estimates and assumptions used in the preparation of our consolidated financial statements. The impact and any associated risks on our business that are related to these policies are also discussed throughout this Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect reported and expected financial results.

#### *Revenue Recognition*

Net sales revenue and related volume incentive expenses are recorded when persuasive evidence of an arrangement exists, collectability is reasonably assured, the amount is fixed and determinable, and title and risk of loss have passed, generally when the merchandise has been delivered. The amount of the volume incentive is determined based upon the amount of qualifying purchases in a given month. It is necessary for us to make estimates about the timing of when merchandise has been delivered. These estimates are based upon our historical experience related to time in transit, and timing of when shipments occurred and shipping volumes. Amounts received for undelivered merchandise are recorded as deferred revenue. From time to time, our U.S. operations extend short-term credit associated with product promotions. In addition for certain of our international operations, we offer credit terms consistent with industry standards within the country of operation. Payments to Distributors and Managers for sales incentives or rebates are recorded as a reduction of revenue. Payments for sales incentives and rebates are calculated

Table of Contents

monthly based upon qualifying sales. Membership fees are deferred and amortized as revenue over the life of the membership, primarily one year. Prepaid event registration fees are deferred and recognized as revenues when the related event is held.

A reserve for product returns is recorded based upon historical experience. We allow Distributors or Managers to return the unused portion of products within ninety days of purchase if they are not satisfied with the product. In some of our markets, the requirements to return product are more restrictive.

*Investments*

Our available-for-sale investment portfolio is recorded at fair value and consists of various fixed income securities such as U.S. government and state and municipal bonds, mutual funds, depository certificates and equity securities. These investments are valued using (a) quoted prices for identical assets in active markets or (b) from significant inputs that are observable or can be derived from or corroborated by observable market data for substantially the full term of the asset. Our trading portfolio is recorded at fair value and consists of various marketable securities that are valued using quoted prices in active markets.

For available-for-sale debt securities with unrealized losses, we perform an analysis to assess whether it intends to sell or whether it would be more likely than not required to sell the security before the expected recovery of the amortized cost basis. Where we intend to sell a security, or may be required to do so, the security's decline in fair value is deemed to be other-than-temporary and the full amount of the unrealized loss is recorded within earnings as an impairment loss.

For all other debt securities that experience a decline in fair value that is determined to be other-than-temporary and not related to credit loss, we record a loss, net of any tax, in accumulated other comprehensive income (loss). The credit loss is recorded within earnings as an impairment loss when sold. Management judgment is involved in evaluating whether a decline in an investment's fair value is other-than-temporary.

Regardless of our intent to sell a security, we perform additional analysis on all securities with unrealized losses to evaluate losses associated with the creditworthiness of the security. Credit losses are identified where we do not expect to receive cash flows sufficient to recover the amortized cost basis of a security.

For equity securities, when assessing whether a decline in fair value below our cost basis is other-than-temporary, we consider the fair market value of the security, the length of time and extent to which market value has been less than cost, the financial condition and near-term prospects of the issuer as well as specific events or circumstances that may influence the operations of the issuer, and our intent and ability to hold the investment for a sufficient time in order to enable recovery of our cost. New information and the passage of time can change these judgments. Where we have determined that we lack the intent and ability to hold an equity security to its expected recovery, the security's decline in fair value is deemed to be other-than-temporary and is recorded within earnings as an impairment loss.

*Inventories*

Inventories are stated at the lower-of-cost-or-market, using the first-in, first-out method. The components of inventory cost include raw materials, labor and overhead. To estimate any necessary lower-of-cost-or-market adjustments, various assumptions are made in regard to excess or slow-moving inventories, non-conforming inventories, expiration dates, current and future product demand, production planning and market conditions.

*Self-Insurance Liabilities*

Similar to other manufacturers and distributors of products that are ingested, we face an inherent risk of exposure to product liability claims in the event that, among other things, the use of our products results in injury to consumers due to tampering by unauthorized third parties or product contamination. We have historically had a very limited number of product claims or reports from individuals who have asserted that they have suffered adverse consequences as a result of using our products. These matters have historically been settled to our satisfaction and have not resulted in material payments. We have established a wholly owned captive insurance company to provide us with product liability insurance coverage and have accrued a reserve that we believe is sufficient to cover probable and reasonable estimable liabilities related to product liability claims based upon our history. However, there can be no assurance that these estimates will prove to be sufficient, nor can there be any assurance that the ultimate outcome of any litigation for product liability will not have a material negative impact on our business prospects, financial position, results of operations or cash flows.

We self-insure for certain employee medical benefits. The recorded liabilities for self-insured risks are calculated using actuarial methods and are not discounted. The liabilities include amounts for actual claims and claims incurred but not reported. Actual experience, including claim frequency and severity as well as health care inflation, could result in actual liabilities being more or less than the amounts currently recorded.

Table of Contents

*Incentive Trip Accrual*

We accrue expenses for incentive trips associated with our direct sales marketing program, which rewards independent Distributors and Managers with paid attendance at our conventions and meetings. Expenses associated with incentive trips are accrued over qualification periods as they are earned. We specifically analyze incentive trip accruals based on historical and current sales trends as well as contractual obligations when evaluating the adequacy of the incentive trip accrual. Actual results could generate liabilities more or less than the amounts recorded.

*Impairment of Long-Lived Assets*

We review our long-lived assets, such as property, plant and equipment and intangible assets for impairment when events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We use an estimate of future undiscounted net cash flows of the related assets or groups of assets over their remaining lives in measuring whether the assets are recoverable. An impairment loss is calculated by determining the difference between the carrying values and the fair values of these assets. As of September 30, 2011 and December 31, 2010, we did not consider any of our long-lived assets to be impaired.

*Contingencies*

We are involved in certain legal proceedings. When a loss is considered probable in connection with litigation or non-income tax contingencies and when such loss can be reasonably estimated with a range, we record our best estimate within the range related to the contingency. If there is no best estimate, we record the minimum of the range. As additional information becomes available, we assess the potential liability related to the contingency and revise the estimates. Revision in estimates of the potential liabilities could materially affect our results of operations in the period of adjustment. Our contingencies are discussed in further detail in Note 11, *Commitments and Contingencies*, to the Notes of our Condensed Consolidated Financial Statements, of Item 1, Part 1 of this report.

*Income Taxes*

Interim income taxes are based on an estimated annualized effective tax rate applied to the respective quarterly periods, pro forma for discrete tax items in the period in which they occur. For the three months ended September 30, 2011 and 2010, the Company's (benefit) provision for income taxes, as a percentage of income (loss) before income taxes was (42.2) percent and 37.0 percent, respectively, compared with a U.S. federal statutory rate of 35.0 percent. For the nine months ended September 30, 2011 and 2010, the Company's provision for income taxes, as a percentage of income before income taxes was 14.1 percent and 12.3 percent, respectively, compared with a U.S. federal statutory rate of 35.0 percent.

The differences between the effective tax rates and the U.S. federal statutory tax rate for the three months and nine months ended September 30, 2011 was primarily attributed to foreign deductible items, including a favorable inflation adjustment, and lower rates in foreign jurisdictions than the rates in the U.S., in addition to a decrease in recognition of previous expense related to unremitted earnings.

The differences between the effective rate and the U.S. federal statutory rate for the three and nine months ended September 30, 2010 were primarily attributed to net increases in tax liabilities associated with uncertain tax positions offset by deductions of certain worthless foreign stock, and also offset by utilization of foreign tax credits.

The Company's U.S. federal income tax returns for 2003 through 2010 are open to examination for federal tax purposes. The Company has several foreign tax jurisdictions which have open tax years from 2000 through 2010. The Internal Revenue Service ( IRS ) is currently conducting an audit of the Company's U.S. federal income tax returns for the 2006 through 2010 tax years.

Our income tax expense, deferred tax assets and liabilities and contingent reserves reflect management's best assessment of estimated future taxes to be paid. We are subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgments and estimates are required in determining the Company's consolidated income tax expense.

Deferred income taxes arise from temporary differences between the tax and financial statement recognition of revenue and expense. In evaluating our ability to recover our deferred tax assets, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations. In projecting future taxable income, we develop assumptions including the amount of future state, federal and foreign pretax operating income, the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates that we are using to manage the underlying businesses. Valuation allowances are recorded as reserves against net deferred tax assets by the Company when it is determined that net deferred tax assets are not likely to be realized in the foreseeable future.

Table of Contents

Changes in tax laws and rates could also affect recorded deferred tax assets and liabilities in the future. Management is not aware of any such changes that would have a material effect on the Company's results of operations, cash flows or financial position.

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in a multitude of jurisdictions across our global operations. Income tax positions must meet a more-likely-than-not recognition threshold to be recognized.

*Share-Based Compensation*

Our outstanding stock options include both non-qualified stock options, which vest over differing periods ranging from the date of issuance up to 36 months from the option grant date and performance based stock options that vest upon achieving operating income margins of six, eight and ten percent as reported in four of five consecutive quarters over the term of the options.

We recognize all share-based payments to employees, including grants of employee stock options, in the statement of operations based on their grant-date fair values. We record compensation expense, net of an estimated forfeiture rate, over the vesting period of the stock options based on the fair value of the stock options on the date of grant. We estimate the forfeiture rate based upon historical experience.

For performance-based stock options, we perform a review of each reporting period to determine if the associated earnings metrics for each option have been achieved and consider other pertinent information available to the Company.

**RECENT ACCOUNTING PRONOUNCEMENTS**

Please refer to Note 1 to the Unaudited Condensed Consolidated Financial Statements in Part 1, Item 1 of this report for information regarding recently issued accounting pronouncements.

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

The Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this report may contain forward-looking statements. Such forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities and Exchange Act. All statements other than statements of historical fact are forward-looking statements. Forward-looking statements may include, but are not limited to, statements relating to our objectives, plans and strategies. All statements (other than statements of historical fact) that address activities, events or developments that we intend, expect, project, believe or anticipate will or may occur in the future are forward-looking statements. These statements are often characterized by terminology such as believe, hope, may, anticipate, should, intend, plan, will, expect, estimate, project, positioned, strategy and similar terms based on assumptions and assessments made by management in light of their experience and their perception of historical trends, current

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

conditions, expected future developments and other factors they believe to be appropriate. Forward-looking statements are not guarantees of future performance and are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by, or underlying the forward-looking statements.

Important factors that could cause our actual results, performance and achievements, or industry results to differ materially from estimates or projections contained in our forward-looking statements includes, among others, the following:

- our relationship with and our ability to influence the actions of our independent Distributors and Managers;
- our ability to recruit and retain a sufficient number of independent Distributors and Managers;
- changes in laws and regulations regarding network marketing that may prohibit or restrict our ability to sell our products in new or existing markets;
- determinations regarding tax liabilities and required tax obligations in U.S. and foreign jurisdictions;
- our products and manufacturing activities are subject to extensive government regulations and restrictions;
- general economic conditions;

Table of Contents

- an economic slowdown in the markets in which we do business could reduce consumer demand for our products;
- currency and exchange rate fluctuations could lower our revenue and net income;
- some of the markets in which we operate may become highly inflationary;
- some of the markets in which we operate have currency controls in place which restrict our ability to repatriate funds to the United States;
- the availability and integrity of raw materials could be compromised;
- significant legal disputes and adverse settlements;
- geopolitical issues and conflicts could adversely affect our business;
- our business is subject to the effects of adverse publicity and negative public perception;
- changes in taxation and transfer pricing could affect our operations;
- our business is subject to intellectual property risks;
- product and liability claims;
- changing consumer preferences and demands;

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

- inventory obsolescence due to finite shelf lives and changing product demand;
- product concentration;
- system failures;
- changes in key management personnel; and
- the competitive nature of our business.

Additional factors that could cause actual results to differ materially from our forward-looking statements are set forth in this report and our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 under the heading Risk Factors.

Forward-looking statements in this report speak only as of the date hereof, and forward-looking statements in documents attached that are incorporated by reference speak only as of the date of those documents. We do not undertake any obligation to update or release any revisions to any forward-looking statement or to report any events or circumstances after the date hereof or to reflect the occurrence of unanticipated events, except as required by law.

### **Item 3. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

We conduct business in several countries and intend to continue to grow our international operations. Net sales revenue, operating income and net income are affected by fluctuations in currency exchange rates, interest rates and other uncertainties inherent in doing business and selling product in more than one currency. In addition, our operations are exposed to risks associated with changes in social, political and economic conditions inherent in international operations, including changes in the laws and policies that govern international investment in countries where we have operations, as well as, to a lesser extent, changes in U.S. laws and regulations relating to international trade and investment.

#### **Foreign Currency Risk**

During the nine months ended September 30, 2011, approximately 56.2 percent of our net sales revenue and approximately 56.9 percent of our operating expenses were realized outside of the United States. Inventory purchases are transacted primarily in U.S. dollars from vendors located in the United States. The local currency of each international subsidiary is generally the functional currency, while certain regions, including Russia and the Ukraine, are served by a U.S. subsidiary through third party entities, for which all business is conducted in U.S. dollars. We conduct business in twenty-three different currencies with exchange rates that are not on a one-to-one relationship with the U.S. dollar. All revenues and expenses are translated at average exchange rates for the periods reported. Therefore, our operating results will be positively or negatively affected by a weakening or strengthening of the U.S. dollar in relation to another fluctuating currency. Given the uncertainty and diversity of exchange rate fluctuations, we cannot estimate the effect of these fluctuations on our future business, product pricing, results of

operations or

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

### Table of Contents

financial condition, but we have provided consolidated sensitivity analyses below of functional currency/reporting currency exchange rate risks. Changes in various currency exchange rates affect the relative prices at which we sell our products. We regularly monitor our foreign currency risks and periodically take measures to reduce the risk of foreign exchange rate fluctuations on our operating results. We do not use derivative instruments for hedging, trading or speculating on foreign exchange rate fluctuations. Additional discussion of the impact on the effect of currency fluctuations has been included in our management's discussion and analysis included in Part I, Item 2 of this report.

The following table sets forth a composite sensitivity analysis of our net sales revenue, costs and expenses and operating income in connection with strengthening of the U.S. dollar (our reporting currency) by 10%, 15% and 25% against every other fluctuating functional currency in which we conduct business. We note that our individual net sales revenue, cost and expense components and our operating income were equally sensitive to increases in the strength of the U.S. dollar against every other fluctuating currency in which we conduct business. We have excluded the contract termination costs of \$14.7 million in connection with the NutriPlus arbitration settlement as it is not subject to fluctuations of foreign currency exchange rates.

Exchange rate sensitivity for the three months ended September 30, 2011 (dollar amounts in thousands)

	With Strengthening of U.S. Dollar by:							
	10%		15%		25%			
	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)
Net sales revenue	\$ 91,102	\$ (3,174)	(3.5)%	\$ (4,553)	(5.0)%	\$ (6,982)	(7.7)%	
<b>Cost and expenses</b>								
Cost of goods sold	16,879	(571)	(3.4)%	(820)	(4.9)%	(1,258)	(7.5)%	
Volume incentives	32,733	(1,202)	(3.7)%	(1,724)	(5.3)%	(2,643)	(8.1)%	
Selling, general and administrative	31,845	(984)	(3.1)%	(1,412)	(4.4)%	\$ (2,165)	(6.8)%	
Operating income	\$ 9,645	\$ (417)	(4.3)%	\$ (597)	(6.2)%	\$ (916)	(9.5)%	

Exchange rate sensitivity for the nine months ended September 30, 2011 (dollar amounts in thousands)

	With Strengthening of U.S. Dollar by:							
	10%		15%		25%			
	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)
Net sales revenue	\$ 275,757	\$ (9,190)	(3.3)%	\$ (13,185)	(4.8)%	\$ (20,217)	(7.3)%	
<b>Cost and expenses</b>								
Cost of goods sold	52,560	(1,650)	(3.1)%	(2,368)	(4.5)%	(3,631)	(6.9)%	
Volume incentives	100,421	(3,473)	(3.5)%	(4,983)	(5.0)%	(7,640)	(7.6)%	
Selling, general and administrative	97,458	(3,036)	(3.1)%	(4,356)	(4.5)%	\$ (6,679)	(6.9)%	
Operating income	\$ 25,318	\$ (1,031)	(4.1)%	\$ (1,478)	(5.8)%	\$ (2,267)	(9.0)%	

As noted above, certain of our operations, including Russia and the Ukraine, are served by a U.S. subsidiary through third-party entities, for which all business is conducted in U.S. dollars. Although changes in exchange rates between the U.S. dollar and the Russian ruble or the

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

Ukrainian hryvnia do not result in currency fluctuations within our financial statements, a weakening or strengthening of the U.S. dollar in relation to these other currencies can significantly affect the prices of our products and the purchasing power of our independent Managers and Distributors within these markets.

The following table sets forth a composite sensitivity analysis of our financial instruments by those balance sheet line items that are subject to exchange rate risk, together with the total gain or loss from the strengthening of the U.S. dollar in relation to our various fluctuating functional currencies. The sensitivity of our assets and liabilities, taken by balance sheet line items, is somewhat less than the sensitivity of our operating income to increases in the strength of the U.S. dollar in relation to other fluctuating currencies in which we conduct business.

Exchange rate sensitivity of Balance Sheet as of September 30, 2011 (dollar amounts in thousands)

Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

Table of Contents

	With Strengthening of U.S. Dollar by:						
	10%		15%		25%		
	(\$)	(%)	(\$)	(%)	(\$)	(%)	
<b>Financial Instruments Included in Current Assets Subject to Exchange Rate Risk</b>							
Cash and cash equivalents	\$ 54,103	\$ (3,589)	(6.6)%	\$ (5,149)	(9.5)%	\$ (7,895)	(14.6)%
Accounts receivable, net	11,765	(376)	(3.2)%	(539)	(4.6)%	(827)	(7.0)%
Available-for-sale investments	4,551	(327)	(7.2)%	(470)	(10.3)%	(720)	(15.8)%
<b>Financial Instruments Included in Current Liabilities Subject to Exchange Rate Risk</b>							
Accounts payable	5,130	(74)	(1.4)%	(106)	(2.1)%	(162)	(3.2)%
<b>Net Financial Instruments Subject to Exchange Rate Risk</b>	<b>65,289</b>	<b>(4,218)</b>		<b>(6,052)</b>		<b>(9,280)</b>	

The following table sets forth the local currencies other than the U.S. dollar in which our assets that are subject to exchange rate risk were denominated as of September 30, 2011, and exceeded \$1 million upon translation into U.S. dollars. None of our liabilities that are denominated in a local currency other than the U.S. dollar and that are subject to exchange rate risk exceeded \$1 million upon translation into U.S. dollars. We use the spot exchange rate for translating balance sheet items from local currencies into our reporting currency. The respective spot exchange rate for each such local currency meeting the foregoing thresholds is provided in the table as well.

Translation of Balance Sheet Amounts Denominated in Local Currency as of September 30, 2011 (dollar amounts in thousands)

	Translated into U.S. Dollars	At Spot Exchange Rate per One U.S. Dollar as of September 30, 2011
<b>Cash and Cash Equivalents</b>		
Japan (Yen)	\$ 8,810	76.6
Korea (Won)	3,958	1,177.7
European Markets (Euro)	3,818	0.7
Canada (Dollar)	3,688	1.0
Mexico (Peso)	2,753	13.5
Colombia (Peso)	1,641	1,938.5
Honduras (Lempira)	1,193	19.3
Venezuela (Bolivar)	1,219	5.3
Indonesia (Rupiah)	1,065	8,936.6
Other	6,691	Varies
Total foreign denominated cash and cash equivalents	34,836	
U.S. dollars held by foreign subsidiaries	6,421	
Total cash and cash equivalents held by foreign subsidiaries	\$ 41,257	
<b>Accounts Receivable</b>		
Japan (Yen)	\$ 1,217	76.6
Other	2,916	Varies
Total	\$ 4,133	

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

Finally, the following table sets forth the annual weighted average of fluctuating currency exchange rates of each of the local currencies per one U.S. dollar for each of the local currencies in which sales revenue exceeded \$10.0 million during any of the two periods presented. We use the annual average exchange rate for translating items from the statement of operations from local currencies into our reporting currency.

<b>Nine months ended September 30,</b>	<b>2011</b>	<b>2010</b>
Canada (Dollar)	<b>1.0</b>	1.0
Japan (Yen)	<b>80.5</b>	89.5
Korea (Won)	<b>1,096.2</b>	1,161.0
Mexico (Peso)	<b>12.0</b>	12.7
Venezuela (Bolivar)	<b>5.3</b>	4.3

The local currency of the foreign subsidiaries is used as the functional currency, except for subsidiaries operating in highly inflationary economies or where the Company's operations are served by a U.S. based subsidiary (for example Russia and Ukraine). The financial statements of foreign subsidiaries, where the local currency is the functional currency, are translated into U.S. dollars using exchange rates in effect at year-end for assets and liabilities and average exchange rates during each year for the results of operations. Adjustments resulting from translation of financial statements are reflected in accumulated other comprehensive loss, net of income taxes. Foreign currency transaction gains and losses are included in other income (expense) in the consolidated statements of operations.

The functional currency in highly inflationary economies is the U.S. dollar and transactions denominated in the local currency are re-measured as if the functional currency were the U.S. dollar. The re-measurement of local currencies into U.S.

Table of Contents

dollars creates translation adjustments, which are included in the consolidated statements of operations. A country is considered to have a highly inflationary economy if it has a cumulative inflation rate of approximately 100 percent or more over a three-year period as well as other qualitative factors including historical inflation rate trends (increasing and decreasing), the capital intensiveness of the operation and other pertinent economic factors. During the nine months ended September 30, 2011 and 2010, Venezuela was considered to be highly inflationary. With the exception of Venezuela, there were no other countries considered to have a highly inflationary economy during the nine months ended September 30, 2011 and 2010.

As of January 1, 2010, Venezuela was 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 January 8, 2010, the Venezuelan government announced the devaluation of the bolivar against the 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 2010, the government of Venezuela enacted additional currency restrictions, which effectively replaced the market rate with the System for Foreign Currency Denominated Securities (SITME), which is administered by the Venezuela Central Bank. Under SITME, entities domiciled in Venezuela can obtain U.S. dollar denominated securities in limited quantities each month through banking institutions approved by the government.

At this time, the Company is not able to estimate reasonably the future state of exchange controls in Venezuela and its availability of U.S. dollars at the official exchange rate or at the SITME rate. However, the Company has been successful repatriating funds from Venezuela for imported products using the SITME rate. The Company re-measures its results in Venezuela at the SITME rate, which was approximately 5.30 bolivars per U.S. dollar as of September 30, 2011.

As a result of the events described in the preceding paragraphs, the Company recorded a gain of \$3.7 million in the first quarter of 2010 in connection with the re-measurement of its balance sheet to reflect the highly inflationary designation and the devaluation due to the negative position of the Company's Venezuelan subsidiary's net monetary assets, which is recorded in foreign exchange gains or losses, a part of other income. The success of future operations will be affected by several factors, including the Company's ability to take actions to mitigate the effect of devaluation, further actions of the Venezuelan government and economic conditions in Venezuela, such as inflation and consumer spending.

During the three months ended September 30, 2011 and 2010, the Company's Venezuelan subsidiary's net sales revenue represented approximately 1.4 percent and 2.0 percent of consolidated net sales revenue, respectively. During the nine months ended September 30, 2011 and 2010, the Company's Venezuelan subsidiary's net sales revenue represented approximately 1.4 percent and 1.8 percent of consolidated net sales revenue, respectively. The Company's Venezuelan subsidiary held total assets of \$8.5 million and \$8.0 million (which includes an intercompany receivables denominated in U.S. dollars of \$2.1 million and \$2.0 million) and net assets of \$5.4 million and \$4.2 million at September 30, 2011 and December 31, 2010, respectively.

**Interest Rate Risk**

## Edgar Filing: NATURES SUNSHINE PRODUCTS INC - Form 10-Q

The primary objectives of our investment activities are to preserve principal while maximizing yields without significantly increasing risk. These objectives are accomplished by purchasing investment grade securities. On September 30, 2011, we had investments of \$4.6 million of which \$1.4 million were municipal obligations, which carry an average fixed interest rate of 5.1 percent and mature within a 5-year period. A hypothetical 1.0 percent change in interest rates would not have had a material effect on our liquidity, financial position or results of operations.

### **Item 4. CONTROLS AND PROCEDURES**

#### **Disclosure Controls and Procedures**

Our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) are designed to provide reasonable assurance that the information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in rules and forms adopted by the SEC, and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosures. Our management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2011. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of September 30, 2011, at the reasonable assurance level.

Table of Contents

**Changes in Internal Control over Financial Reporting**

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the fiscal quarter ended September 30, 2011, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

Please refer to Note 12 to the Unaudited Condensed Consolidated Financial Statements in Part 1, Item 1 of this report, as well as our recent SEC filings, including our Annual Report on Form 10-K for the year ended December 31, 2010, for information regarding the status of certain legal proceedings that have been previously reported.

**Item 1A. RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the risks discussed under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2010, which could materially affect our business or our consolidated financial statements, results of operations, and cash flows. Additional risks not currently known to us, or risks that we currently believe are not material, may also impair our business operations. There have been no material changes to our risk factors since the filing of our Annual Report on Form 10-K for the year ended December 31, 2010.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**Item 4. REMOVED AND RESERVED**

**Item 5. OTHER INFORMATION**

None.

**Item 6. EXHIBITS**

a) Index to Exhibits

<b>Item No.</b>	<b>Exhibit</b>
31.1(1)	Certification of Chief Executive Officer under SEC Rule 13a-14(a)/15d-14(a) promulgated under the Securities Exchange Act of 1934
31.2(1)	Certificate of Chief Financial Officer under SEC Rule 13a-14(a)/15d-14(a) promulgated under the Securities Exchange Act of 1934
32.1(1)	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350
32.2(1)	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350
101*	The following financial information from the quarterly report on Form 10-Q of Nature's Sunshine Products, Inc. for the quarter ended September 30, 2011, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations, (iii) Condensed Consolidated Statements of Cash Flows, and (v) Notes to the Condensed Consolidated Financial Statements, tagged as blocks of text.

---

(1) Filed currently herewith.

Table of Contents

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NATURE S SUNSHINE PRODUCTS, INC.

Date: November 7, 2011

/s/ Michael D. Dean  
Michael D. Dean, President and Chief Executive Officer

Date: November 7, 2011

/s/ Stephen M. Bunker  
Stephen M. Bunker, Executive Vice President, Chief Financial Officer  
and Treasurer